STATEMENT OF THE

FINANCIAL ACCOUNTING STANDARDS BOARD

TO THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

COMMITTEE ON ENERGY AND COMMERCE

HOUSE OF REPRESENTATIVES

FEBRUARY 20, 1985

The Financial Accounting Standards Board appreciates this opportunity to submit this statement to the Subcommittee. The Board has not previously testified before this Subcommittee but has twice testified before Senate subcommittees on similar issues.

We understand that the focus of the Subcommittee's hearings will be the oversight exercised by the Securities and Exchange Commission (SEC) over the public accounting profession. Since 1973, the Financial Accounting Standards Board (FASB) has been the designated organization in the private sector for establishing standards of financial accounting and reporting, subject to oversight by the SEC. Those standards, in effect, govern the preparation of financial reports by business enterprises and nonprofit entities.

This statement is intended to help the Subcommittee in its task by discussing the role of the FASB in financial reporting. This document describes the FASB's operating structure, its mission, its due process procedures for issuing standards, the evolution of these procedures in response to several self-initiated reviews, and its continued attempts to assure its independence, objectivity, and openness to a diversity of views in setting standards. The document also describes the Board's relationships with its many constituencies, as well as with federal agencies such as the SEC, and its recent activities in attempting to enhance comparability in financial reporting, consider the needs of small businesses, and provide timely guidance on emerging issues of financial accounting and reporting. An examination of these different areas of the Board's activities reveals that, despite the controversy that frequently accompanies standard-setting activity, the Board has set standards in an independent, deliberate, and open manner.

STRUCTURE OF THE FASB

In issuing standards, the FASB operates within a structure and with procedures that promote independence, objectivity, and openness and ensure that no interest is put before the public interest in credible, concise, and understandable financial information.

The FASB is the operating part of a structure that is independent of all other business and professional organizations. Before the present structure was created, financial accounting and reporting standards were established first (1936-1959) by the Committee on Accounting Procedure of the American Institute of Cerified Public Accountants (AICPA) and then (1959-1973) by the Accounting Principles Board, also an arm of the AICPA. In 1972, a study group of eminent persons chaired by a former commissioner of the SEC concluded that the need for complete independence and objectivity in setting accounting standards required that the standard-setting body be independent of any particular professional organization. Pronouncements of those predecessor bodies remain in force unless amended or superseded by the FASB.

The seven members of the FASB serve full time and are required to sever all connections with the firms or institutions they served prior to joining the Board. They have diverse backgrounds, but they must possess "knowledge of accounting, finance, and business, and a concern for the public interest in matters of financial accounting and reporting." Board members are appointed for five-year terms and are eligible for reappointment to one additional five-year term. Appendix A provides a brief background on each of the Board members.

The Board is assisted by a technical staff of 45 professionals drawn from public accounting, industry, academe, and government, plus support personnel. The staff works directly with the Board and task forces, conducts research, participates in public hearings, analyzes oral and written comments received from the public, and prepares recommendations and drafts of documents for consideration by the Board. FASB Fellows who are experienced professionals on leaves of absence from their firms or universities serve as project managers or consultants on a variety of projects and are an integral part of the research and technical activities staff. The fellowship program gives the Board the benefit of current experience in industry, academe, and public accounting and is similar to programs sponsored by the SEC and other government agencies.

Financial Accounting Foundation

The Financial Accounting Foundation, which is incorporated to operate exclusively for charitable, educational, scientific, and literary purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code, is responsible for selecting the members of the FASB and its Advisory Council, for funding their activities, and for exercising general oversight, except with regard to the FASB's resolution of technical issues. (The Foundation performs similar functions with respect to the Governmental Accounting Standards Board and the Governmental Accounting Standards Advisory Council. These two organizations started operating in 1984. The GASB develops standards for financial accounting and reporting by state and local government units.) The trustees of the Foundation are expressly forbidden from interfering in any way with the FASB's standard-setting work.

The Foundation also receives contributions and approves the FASB budget. The Board's 1985 budget is $9.9 million. Contributions and sales of publications each provide about half the Board's support. More than half the contributions received are from industry and the financial community, with the remainder coming largely from the public accounting profession.

The Foundation is governed by a sixteen-member board of trustees, thirteen of whom are elected for three-year terms by "Electors" appointed by the Foundation's sponsoring organizations, as follows: four trustees are certified public accountants in public practice at the time of their election and are nominated by the AICPA; three have extensive experience as financial executives, two of whom are nominated by the Financial Executives Institute and the other by the National Association of Accountants; one has extensive experience as a financial analyst and is nominated by the Financial Analysts Federation; one has extensive experience as an accounting educator and is nominated by the American Accounting Association; one has extensive experience as an investment banker and is nominated by the Securities Industry Association; and three have extensive experience as financial officers or as elected officials of state or local governmental entities and are nominated by the Government Finance Officers Association, the National Association of State Auditors, Comptrollers and Treasurers, the Council of State Governments, the International City Management Association, the National Association of Counties, the National Conference of State Legislatures, the National Governors Association, the National League of Cities, and the U.S. Conference of Mayors. Two members of the board of trustees are members at large, and are elected for three-year terms as follows: one has extensive experience as a commercial banker, and the other is an individual with business, professional, government or other experience. (The second position has not been filled.) The remaining member of the full Board of Trustees is the senior elected officer of the American Institute of Certified Public Accountants who serves, ex officio, as a Trustee during his term in such capacity with the AICPA. The trustees of the Foundation are listed in Appendix A.

The Foundation ensures that the Board, as an entity, is independent of any particular interest group. The By-Laws of the Foundation were adopted to ensure the independence of the members of the Board in their standard-setting responsibilities. In fulfilling its oversight responsibilities, the Foundation has conducted several reviews of the Board's procedures, structure, and operations. Recommendations made as a result of those reviews have resulted in numerous changes in the Board's procedures. The reviews and the resulting changes are described in greater detail later in this document.

Financial Accounting Standards Advisory Council

The Financial Accounting Standards Advisory Council (FASAC) has responsibility for consulting with the Standards Board on major policy questions, technical issues on the Board's agenda, project priorities, matters likely to require the attention of the FASB, selection and organization of task forces, and such other matters as may be requested by the FASB or its chairman.

FASAC members are appointed by the trustees of the Foundation for one-year terms. They serve without compensation and are eligible for reappointment for three additional terms. At present, the Council has 38 members who are broadly representative of the FASB's constituencies, including large and small businesses and accounting firms, investors, credit grantors, government, law, academe, and other users of financial information. FASAC has both a salaried chairman and an executive director. Members of FASAC are listed in Appendix A.

FASAC meets quarterly as a body with the members of the FASB. The Chief Accountant of the SEC is a participant in these meetings. Between meetings, FASAC operates via committees, special questionnaires, and correspondence. Committees include the (a) steering committee, (b) special process committee, (c) small business advisory committee, (d) committee on nonbusiness entities, (e) committee on FASAC's future role, (f) public forum committee, and (g) advisory committee on FASB agenda. Individual members of the FASB have liaison responsibilities with those committees and ordinarily attend committee meetings.

MISSION OF THE FASB

The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information.

Standards issued by the FASB are officially recognized as authoritative by the SEC (Financial Reporting Release No. 1, Section 101) and the AICPA (Rules of Conduct, as amended May 1973 and May 1979). The SEC has statutory authority to establish financial accounting and reporting standards for publicly held companies under the Securities Exchange Act of 1934. Throughout its history, however, the Commission's policy has been to rely on the private sector for this function to the extent that the private sector demonstrates ability to fulfill the responsibility in the public interest.

FASB standards are also recognized as authoritative under the ethics rules of the AICPA, which prohibit CPAs who audit a company's financial statements from expressing an opinion that those financial statements conform to generally accepted accounting principles (GAAP) if they contain any material departure from an accounting principle promulgated by the FASB. The financial statements of virtually all publicly owned companies are audited, as are those of thousands of privately owned firms. The financial statements of many other privately owned firms are reviewed or compiled by CPAs, and the CPA's review report on those statements has to indicate whether the CPA is aware of any material modifications that need to be made to the financial statements for them to comply with GAAP. Known departures from GAAP are also identified in the CPA's compilation report.

Authority for FASB pronouncements also comes from the state public accountancy licensing laws. Although the mechanisms differ among the 50 states and the District of Columbia, in each of those jurisdictions, in one way or another, a CPA would be subject to disciplinary action, including loss of license to practice, for not modifying his report on a client's financial statements that contain a material departure from an FASB pronouncement.

Accounting standards are essential to the efficient functioning of the economy because decisions about the allocation of resources rely heavily on credible, concise, and understandable financial information. Financial information about the operations and financial position of individual entities also is used by the public in making various other kinds of decisions.

To accomplish its mission, the FASB acts to:

1. Improve the usefulness of financial reporting by focusing on the primary characteristics of relevance and reliability and on the qualities of comparability and consistency
2. Keep standards current to reflect changes in methods of doing business and changes in the economic environment
3. Consider promptly any significant areas of deficiency in financial reporting that might be improved through the standard-setting process
4. Improve the common understanding of the nature and purposes of information contained in financial reports.

The FASB develops broad accounting concepts as well as standards for financial reporting. It also provides guidance on implementation of standards.

Concepts are useful in guiding the Board in establishing standards and in providing a frame of reference, or conceptual framework, for resolving accounting issues. The framework helps to establish reasonable bounds for judgment in preparing financial information and to increase understanding of, and confidence in, financial information on the part of users of financial reports. It also helps the public to understand the nature and limitations of information supplied by financial reporting.

The Board's work on both concepts and standards is based on research conducted by the FASB staff and by others. The Board's activities are open to public participation and observation under the due process mandated by formal Rules of Procedure. The FASB actively solicits the views of its various constituencies on accounting issues.

The Board follows certain precepts in the conduct of its activities. They are:

To be objective in its decision making and to ensure, insofar as possible, the neutrality of information resulting from its standards. To be neutral, information must report economic activity as faithfully as possible without coloring the image it communicates for the purpose of influencing behavior in any particular direction.

To weigh carefully the views of its constituents in developing concepts and standards. The ultimate determinant of concepts and standards, however, must be the Board's judgment, based on research, public input, and careful deliberation about the usefulness of the resulting information.

To promulgate standards only when the expected benefits exceed the perceived costs. While reliable quantitative cost-benefit calculations are seldom possible, the Board strives to determine that a proposed standard will fill a significant need and that the costs it imposes, compared with possible alternatives, are justified in relation to the overall benefits.

To bring about needed changes in ways that minimize disruption to the continuity of reporting practice. Reasonable effective dates and transition provisions are established when new standards are introduced. The Board considers it desirable that change be evolutionary to the extent that can be accommodated by the need for relevance, reliability, comparability, and consistency.

To review the effects of past decisions and interpret, amend, or replace standards in a timely fashion when such action is indicated.

The FASB is committed to following an open, orderly process for standard setting that precludes placing any particular interest above the interests of the many who rely on financial information. The Board believes that this broad public interest is best served by developing neutral standards that result in accounting for similar transactions and circumstances similarly and for different transactions and circumstances differently.

Agenda Decisions

The FASB receives many requests for action on various financial accounting and reporting topics from all segments of a diverse constituency, including the Securities and Exchange Commission. The auditing profession is sensitive to emerging trends in practice, and consequently it is a frequent source of requests. Overall, requests for action include both new topics and suggested review or reconsideration of existing pronouncements.

The FASB is alert to trends in financial reporting through observation of published reports and liaison with interested organizations. The Board's Emerging Issues Task Force is helpful in identifying areas where diversity in practice may potentially exist. The staff of the FASB receives many technical inquiries by letter and by telephone, which may provide evidence that a particular topic, or aspect of an existing pronouncement, has created confusion or that diversity in practice has developed. The FASB also is alert to changes in the financial reporting environment such as may be brought about by new legislation or regulatory decisions. Examples include the Board's recent pronouncements on the accounting by Domestic International Sales Corporations and stock life insurance companies affected by the passage of the Deficit Reduction Act of 1984.

The Board turns to many other organizations and groups for advice and information on various matters including its agenda. In addition to the FASAC and the Council's Advisory Committee on the Board's Agenda, liaison is maintained with the Accounting Standards Executive Committee and Auditing Standards Board of the AICPA, and the appropriate committees of such organizations as the Financial Analysts Federation, Financial Executives Institute, National Association of Accountants, and Robert Morris Associates. The Board has made special efforts to be sensitive to the views of small businesses through contact with various small business organizations.

Although input from the constituency is essential, the Board must make its own decisions regarding its technical agenda. To aid in the decision-making process, the Board has developed a list of factors to which it refers in evaluating proposed agenda topics. Those factors include consideration of:

1. Pervasiveness of the problem: the extent to which an issue is troublesome to users, preparers, auditors, or others; the extent to which there is diversity of practice; and the likely duration of the problem
2. Alternative solutions: the extent to which one or more alternative solutions that will improve financial reporting in terms of

relevance, reliability, and comparability are likely to be developed

3. Technical feasibility: the extent to which a technically sound solution can be developed or whether the project under consideration should await completion of other projects

4. Practical consequences: the extent to which an improved accounting solution is likely to be acceptable generally and the extent to which addressing a particular subject (or not addressing it) might cause others to act.

The evaluation of these factors may vary from one situation to another, but the regular consideration of each of them helps to ensure that the Board's technical agenda addresses issues of importance where significant improvements in financial accounting and reporting are feasible.

MAJOR PROJECTS

For each major project on its technical agenda, the Board appoints an advisory task force of outside experts, studies existing literature on the subject and conducts or commissions such additional research as may be necessary, publishes a Discussion Memorandum setting forth the issues and possible solutions as the basis for public comment, conducts a public hearing, and gives broad distribution to an Exposure Draft of the proposed Statement for public comment.

Actions of the FASB have an impact on many organizations within the Board's large and diverse constituency. It is essential that the Board's decision-making process be evenhanded. Accordingly, its Rules of Procedure require the FASB to follow an extensive "due process" that is open to public observation and participation. This process was modeled on the Federal Administrative Procedure Act.

Significant steps in the process are announced publicly. The Board's meetings are open to public observation and a public record is maintained.

The Task Force

Soon after a major project is placed on the Board's technical agenda, a task force of approximately 15 persons is appointed, including preparers, auditors, and users of financial information who are knowledgeable about the subject matter. Experts from other disciplines also may be appointed. Care is taken to select task force members who represent various points of view on the issues involved.

The task force meets with and advises the Board and staff on the definition and scope of the project, the nature and extent of any additional research that may be needed, and the preparation of a Discussion Memorandum and related material as a basis for public comment. Task force meetings are open to public observers.

Task forces play an important role in the standard-setting process by providing expertise, a diversity of viewpoints, and a mechanism for communication with those who may be affected by proposed standards. The Board and the staff also meet with other noted experts from public accounting, industry, and academe who are not serving on the task force to seek additional information on specialized aspects of certain projects.

Research

Most of the research necessary for a project is conducted by the FASB staff. At times, the FASB commissions studies by academic researchers or others on specific topics. The staff also makes use of research conducted independently by individuals or commissioned by groups such as the AICPA, the Financial Executives Research Foundation, the National Association of Accountants, industry associations, and accounting firms.

The Discussion Memorandum

As a basis for both written comment and oral presentations at a public hearing, a Discussion Memorandum is prepared by the FASB staff with the advice and assistance of the task force. The Discussion Memorandum generally sets forth the definition of the problem, the scope of the project, and the financial accounting and reporting issues. It also discusses research findings and relevant literature and presents alternative solutions to the issues under consideration (and the arguments and implications relative to each).

A Discussion Memorandum specifies a deadline for written comments, contains a Notice of Public Hearing with specific information as to dates, location, and format, and is distributed broadly to interested parties.

Invitations to Comment are sometimes issued instead of Discussion Memorandums. While the two documents are similar in that they identify issues prior to issuance of an Exposure Draft, an Invitation to Comment is generally more limited in the scope of the issues addressed, usually is an adaptation of material prepared by others, such as an AICPA Issues Paper, and is used to only solicit written comments while a Discussion Memorandum serves as the basis for a public hearing.

The Public Hearing

A public hearing is held to provide an opportunity for interested parties to emphasize important issues and considerations and for the Board and staff to ask questions about information and points of view offered by respondents. The Board publicly announces its intent to hold a public hearing, generally 60 days or more before the earliest hearing date and never less than 30 days. In some instances, the Board publishes its preliminary views on an issue in order to focus the comments at the hearings.

Any individual or organization may request to be heard at a public hearing, and the FASB attempts to accommodate such requests. Hearings are conducted by the Board plus the staff project manager and other staff personnel assigned to the project. Public observers are welcome; several hundred are often in attendance.

Most oral presentation time is reserved for questions from Board and staff members. Questions are based on written material submitted prior to the hearing as well as on oral comments. The hearing transcript and written comments, including those from persons who do not choose to make oral presentations, become part of the public record.

Analysis of Oral and Written Comments

The staff makes a thorough analysis of all comments, both oral and written. This is a search for information and persuasive arguments regarding the issues; it is not intended to be simply a "nose count" of how many support or oppose a given point of view. In addition to studying this analysis, Board members read the comment letters to help them in reaching conclusions. After available input is absorbed, formal Board deliberations begin.

Meetings of the Board

The Board meets as many times as necessary to resolve the issues. All meetings are open to public observers, although observers do not participate in the discussions. The agenda for each meeting is announced in advance.

The staff presents written material, including analysis and recommendations, to the Board members in advance as the basis for discussion in a Board meeting. A typical meeting involves oral presentation of a summary of the written materials by the staff, followed by Board discussion of each issue presented, and questioning of the staff on the points raised. Outside experts are frequently invited to participate in Board meetings to assist the Board and the staff in developing an understanding of an issue. When the Board has reached conclusions on the issues, the staff is directed to prepare a proposed Exposure Draft for consideration by the Board. After further discussion and revision, a vote is taken. A majority of the seven-member Board is required to approve issuance of an Exposure Draft of a proposed Standard.

The Exposure Draft

The Exposure Draft sets forth the proposed standards of financial accounting and reporting, the proposed effective date and method of transition, background information, and an explanation of the basis for the Board's conclusions. The Board requests written comments on the proposed standard. In some instances, the Board has determined it necessary to hold additional public hearings after issuing an Exposure Draft.

At the end of the exposure period, generally 60 days or more and never less than 30 days, all comment letters and position papers again are analyzed by the staff, and again Board members read or refer to them. When analysis and review are completed, the Board is ready to resume deliberations leading to issuance of a final Statement.

Further Deliberation of the Board

As in earlier stages of the process, all Board meetings are open to public observation. The Board considers comments received on the Exposure Draft and decides what, if any, changes should be made in the final Statement. If the Board should conclude that substantial modifications are necessary, it may decide to issue a revised Exposure Draft for additional public comment. In rare instances the Board also may determine that another public hearing is necessary. After considering the information in the exposure process and making any necessary changes, a vote is taken on the final Statement. A majority is required for adoption of a pronouncement.

Statements of Financial Accounting Standards

Like the Exposure Draft, the Statement sets forth the actual standards, the effective date and method of transition, background information, a brief summary of research done on the project, and the basis for the Board's conclusions, including the reasons for rejecting significant alternative solutions. It also identifies members of the Board voting for and against its issuance and includes comments of dissenting members in support of their minority views.

Statements of Financial Accounting Concepts

Statements of Concepts do not establish new standards or require any change in the application of existing accounting principles but are intended to provide guidance in solving problems. Statements of Concepts are developed under the same extensive due process the FASB must follow in developing Statements of Financial Accounting Standards on major topics. Statements of Concepts are parts of the Board's conceptual framework and represent the theoretical underpinnings of the detailed standards and other pronouncements that the Board issues.

Post-Issuance Review

The Board has procedures that achieve the objectives of a formal review program: requests received by the Board to interpret, amend, or replace an established standard are analyzed by the staff and brought before the Board for consideration. The Board constantly seeks to determine whether new information affecting the rationale and effects of the original decision has become available. As a result of such reviews FASB Statement No. 52, Foreign Currency Translation, was issued in 1981 to replace FASB Statement No. 8, Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements. In the case of the Board's pronouncement on accounting for changing prices, the Board committed itself to a review of that pronouncement after five years.

The FASB also funds research to monitor the effects of its standards. Such research has been conducted with respect to the Board's pronouncements on contingencies, foreign currency translation, oil and gas accounting, leases, and accounting for changing prices. The Board has also sponsored conferences on topics such as the economic consequences of accounting standards and accounting for changing prices.

The maintenance of a public record by the Board has proven to be a valuable resource to researchers investigating the economic consequences of standards. The Board has also subsidized the creation of computerized data banks on changing prices and on pensions to assist research efforts.

IMPLEMENTATION AND PRACTICE PROBLEMS

In addition to broad issues of financial accounting and reporting, the Board considers certain issues related to implementation of existing standards and other problems arising in practice. Though rigorous, the "due process" required to be followed on such projects is not as extensive as that for projects dealing with major issues. Depending on their nature, implementation and practice problems may be dealt with by the Board in Statements or Interpretations, or by the staff in Technical Bulletins.

When a Statement is to be developed to amend an existing standard or establish a new standard on a relatively narrow subject, the Board may determine that it is appropriate to proceed without appointing a task force, issuing a Discussion Memorandum, or holding a public hearing. However, the Rules of Procedure require that an Exposure Draft of the proposed Statement be issued for public comment, generally for at least 60 days but a minimum of 30 days.

Written comments are analyzed and considered to the same extent as on a major project. Board deliberations are open to public observation and a public record is maintained.

Interpretations

The Board issues Interpretations to clarify, explain, or elaborate on existing FASB Statements of Financial Accounting Standards or the effective pronouncements of its predecessors, the Accounting Principles Board and the Committee on AICPA.

Under the Rules of Procedure, proposed Interpretations must be submitted to the members of the FASAC and other interested parties for comment for a period of not less than 15 days. Generally, however, proposed

Interpretations are made available to all interested parties for a 30-day period or longer and may be exposed broadly.

Written comments on proposed Interpretations constitute a part of the FASB's public record.

Technical Bulletins

Technical Bulletins are issued to provide guidance on certain financial accounting and reporting problems on a timely basis. They are used to clarify an underlying standard, specify applications in a particular situation, or address areas not directly covered by existing standards. The guidance in a Technical Bulletin is expected to not cause a major change in accounting practice for a significant number of entities, to not involve significant costs in implementation, and to not conflict with a fundamental principle or create a new or novel accounting practice.

Proposed Technical Bulletins are released for comment for a period of not less than 15 days to selected knowledgeable persons or groups, and their availability to interested parties is publicized. Written comments on proposed Technical Bulletins constitute part of the FASB's public record. All Technical Bulletins are discussed by the Board at public meetings prior to release for comment and prior to final issuance. A Bulletin is not issued if a majority of the Board members object either to the guidance in it or to communicating that guidance in a Technical Bulletin.

AVAILABILTY OF DOCUMENTS

Transcripts of public hearings, letters of comment and position papers, research reports, and other relevant materials on projects leading to issuance of pronouncements become part of the Board's public record. The public record on all projects is available for inspection in the Public Reference Room at FASB headquarters in Stamford, Connecticut. Copies of public record also may be purchased at prices that vary according to the volume of material requested.

To encourage public comment, Discussion Memorandums, Invitations to Comment, and Exposure Drafts are distributed widely through the FASB's established mailing plans. Approximately 25,000 copies of each Discussion Memorandum and Invitation to Comment and 35,000 copies of each Exposure Draft are distributed. In addition, single copies of those documents and proposed Interpretations and proposed Technical Bulletins are available without charge during the comment period to all who request them. Statements of Standards, Statements of Concepts, Interpretations, and Technical Bulletins also are distributed broadly when published through FASB subscription plans and may be purchased separately. Approximately 100,000 copies of each final pronouncement are distributed.

The FASB strives to keep the public informed of developments on its projects through a newsletter, STATUS REPORT, that is published at least monthly (distribution of 66,000), and a weekly notice, ACTION ALERT (distribution of 2,200), of upcoming Board meetings and their agendas with brief summaries of actions taken at previous meetings. Task Force and other public meetings are also announced in advance. Each quarter, the Board publishes its current plans for all technical projects on its agenda in STATUS REPORT. A copy of the most recent STATUS REPORT containing the Board's technical plan is attached as Appendix B. A summary of FASB pronouncements is provided in Appendix C.

FOUNDATION OVERSIGHT

The FASB recognizes its public responsibilities and responds to criticisms and suggestions. Under the By-Laws of the Financial Accounting Foundation, the Foundation's trustees have a responsibility to oversee the structure and operations of the FASB and its Advisory Council. In connection with that responsibility, the trustees undertook comprehensive reviews of the FASB and FASAC starting in 1976. The Structure Committee conducted personal interviews with about 100 individuals representing groups affected by the Board's activities and also devoted about 600 hours to a review of the Board's internal organization and operations. The April 1977 Structure Review report included 17 recommendations for improving the structure for establishing financial accounting and reporting standards. Basically, those recommendations suggested (1) more participation of the Board's constituents in the standard-setting process, (2) more openness of the Board's operations and (3) greater efficiency in fulfilling the Board's mission.

In its November 1977 report entitled "Improving the Accountability of Publicly Owned Corporations and Their Auditors," the Senate Governmental Affairs Subcommittee on Reports, Accounting, and Management expressed support for the recommendations in the trustees' structure review report:

> The Financial Accounting Foundation (FAF)--the private organization which sponsors FASB--has demonstrated a willingness to respond to criticism with constructive changes intended to correct deficiencies in the standard-setting process. The FAF Structure Committee issued a report in the spring of 1977 listing several recommendations for improving the responsiveness of the FASB to the public. The Subcommittee supports such initiative, and looks for further action by the FAF and the SEC to fully implement the goals set forth in this Subcommittee's report.

A joint committee of FAF trustees and FASB Board members was established to consider how best to implement the structure review recommendations, and within two years after the report was published, the recommendations were adopted and in effect.

Some of the more significant changes made as a result of the 1977 Structure Review are:

- o Greater involvement of the Board's publics via expanded use of task forces, drawing more heavily on outside experts and available resources; public hearings outside New York City; layman's language communications; greater consultation with FASAC by the Board; program of informal meetings with constituent groups; broadened membership of Foundation, FASAC, and FASB; sharing of authority to appoint Foundation trustees among all sponsoring organizations; special steps to focus on the needs of small business

- o Greater efficiency via expanded staff size and increased staff responsibilities; publication of short and long range plans; changed FASB voting requirements; and streamlined procedures for issuing relatively minor pronouncements

- o Openness via public discussion of issues being deliberated; expanded public announcements of Board actions; expanded public speaking program by Board and staff members; and meetings with interested constituents.

Also, since January 1978 the Board has operated "in the sunshine" and all meetings of the Board and its task forces have been open to public observation.

In May 1979 the trustees completed an "Interim Review of the FASB and FASAC" to monitor the progress of the two groups. Interviews were conducted with each present and several past members of the Board, representatives of the six sponsoring organizations, and a number of financial executives, among others. The report of that interim review concluded:

> In the time that has passed since the April 1977 report, the Board and FASAC have shown significant improvement in the efficiency and openness of their operations and their responsiveness to the constituency. Support for maintaining the standard-setting process in the private sector not only continues but has increased.
> We are pleased to note that the Board is well aware that the process requires continuing review and efforts toward self-improvement and that both it and FASAC have initiated desirable changes going beyond our original report. The Metcalf Subcommittee Report and the July 1978 Oversight Report of the SEC are in general agreement with this observation and are supportive of the steps taken as a result of 1977's congressional and Structure Committee inquiries. We agree that continuing efforts to improve the process are an ongoing responsibility.

The May 1979 interim review also identified a number of further ideas for strengthening the FASB and FASAC. Recommendations included the need to attract additional high-quality staff, to increase public awareness of the Board and its activities, and to increase the involvement of FASAC and task forces in the Board's projects. The review committee supported enhancing the Board's role as the sole accounting standard-setting body by urging it to deal with the kinds of issues that previously had been the subject of AcSEC Statements of Position and AICPA Industry Audit and Accounting Guides. As a result of this recommendation the Board issued Statement 32, <u>Specialized Accounting and Reporting Principles and Practices in AICPA Statements of Position and Guides on Accounting and Auditing Matters</u>, and took over the responsibility for specialized industry accounting principles from the AICPA.

The progress made by the Board in implementing the recommendations of the 1977 and 1979 reviews was reported to the Senate subcommittee with oversight responsibilities.

In 1980, the Foundation commissioned a comprehensive study by Louis Harris and Associates, Inc. of attitudes toward the FASB. In connection with the study, 415 leaders from among the Board's constituencies were interviewed. They included chief financial officers from the Fortune 1250 list, chief executive officers from the Fortune 500 list, top officers of investment and brokerage firms, leading scholars in accounting from U.S. universities, key government officials, representatives of the financial media, top officials of large, medium, and small sized accounting firms, and both chief executive officers and financial officers of medium and smaller sized business corporations. The overall assessment of the 1980 Harris survey was that "there is a distinct sense that progress is being registered and things are on the right course."

In January 1982 the trustees of the Foundation asked the Structure Committee to undertake a review that would focus primarily on the operating efficiency of the Board. The trustees asked the committee to look particularly at the effectiveness of the Board's due process procedures, the FASB's workload and output, and cost-saving opportunities.

The review by teams directed by individual trustees was undertaken in two parts--an internal review to assess the efficiency and effectiveness of the FASB's operations given the projects with which the Board had determined to deal and an external review to assess the perceptions of knowledgeable individuals regarding the FASB's operating efficiency and effectiveness, including their perceptions regarding whether the Board was dealing with the right issues.

The major sources of information for the internal segment of the review were interviews, observation of work performance and the work environment, and examination of internal procedures documentation, budgetary and accounting records, and time reports, among other documents. The interviewees included all Board members, the chairman of the Financial Accounting Standards Advisory Council, the director of research and technical activities, the director of administration, selected task force members, key staff members, and independent audit personnel and EDP consultants.

In the external segment of the review, the Structure Committee solicited the views of individuals and representatives of organizations who are familiar with the operations of the FASB. These included representatives and members of the FASAC, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants, the Committee on Corporate Reporting of the Financial Executives Institute, the Management Accounting Practices Committee of the National Association of Accountants, the Financial Accounting Policy Committee of the Financial Analysts Federation, the Securities and Exchange Commission, the AICPA Special Committee on Accounting Standards Overload, and the six sponsoring organizations of the Financial Accounting Foundation.

In developing the conclusions and recommendations in its 1982 review, the Structure Committee also considered the findings of the 1980 Harris survey. The Structure Committee concluded that:

> The principal overall findings resulting from the Structure Committee's review is that the FASB is operating efficiently and effectively. Appropriate standard-setting systems are in place and functioning well. The due process mechanisms are well designed and followed conscientiously; the professional staff develops drafts efficiently; input from outside parties is carefully considered; and the Board's decision making is supported by research on significant issues. The staff at all levels is dedicated, concerned, and competent, and the office environment is conducive to productivity. The resources currently devoted to support services are used efficiently and effectively.

Major recommendations of the Structure Committee included:

- o Providing more timely guidance for implementation questions and emerging issues
- o Broadening the public's understanding of the Board's work and achievements and better communicating the process by which a subject is considered for addition to the FASB agenda.

The first recommendation was intended to maintain the Board as the sole financial accounting standard-setting body by having it deal with all emerging issues with important financial reporting implications on a timely basis. The second recommendation was based upon a finding of the 1980 Harris survey that when people were informed about the Board they were much more understanding and positive about its work and that the "biggest single problem for the FASB is the uncertainty that is generated through lack of information rather than the substance or procedures the Board follows." As a result of the recommendations of the Structure Committee and of the Board's task force on timely guidance, the Board instituted its Emerging Issues Task Force, changed its procedures for issuing Technical Bulletins, and issued a Mission Statement that sets forth the mission of the Board and explains its procedures. In attempting to improve communications with the preparers of financial statements the Board mails its STATUS REPORT to the chief executive officers of the 1500 largest corporations and to the audit committees of 400 of those corporations.

At the time of the Board's formation, and also as a part of the 1977 and 1982 reviews, it had been suggested that the trustees should review the size of the Board after a period of experience with a seven-member body. In 1983, the Structure Committee conducted a study of whether the size of the FASB should be reduced from seven members to five. The committee developed an issues paper, that was sent to over 100 individuals familiar with the operations of the FASB. A substantial majority of respondents favored retaining the seven-member size. Frequently cited reasons included the greater diversity and balance of viewpoints and expertise on a seven-member Board. The committee unanimously concluded that the size should remain unchanged.

When the FASB was organized in 1973, a 5-2 vote was required to adopt a standard or interpretation. The requirement was changed to a simple majority as one result of the review of FASB operations by the Foundation's Structure Committee in 1977. That committee was asked by the trustees to restudy the voting requirement in 1981 following a formal request that the 5-2 requirement be reinstated. The board of trustees voted unanimously to retain the requirement of a simple majority vote of the seven-member FASB to adopt standards for financial reporting and interpretations of existing standards. The committee noted that the courts and government commissions, including the SEC, can act on a simple majority and that a more stringent requirement for the FASB could result in fewer pronouncements, affect the quality of the Board's work, and leave more issues unresolved.

In January 1985, the trustees appointed a special review committee of 6 trustees to update the 1980 Harris survey of the Board's constituencies as well as to examine the composition of the Board and the criteria for selecting Board members. The committee will also examine whether a comprehensive structure review of the Board should be conducted prior to the review presently scheduled for 1988-1989, and, if so, what direction should be taken by the trustees in conducting it. This committee is expected to complete its review and present its report in 1985.

RELATIONSHIPS WITH FEDERAL AGENCIES

Because of the public implications of its work, the Board recognizes an obligation to maintain effective liaison with the federal government. The purpose is not to seek advantages, but to fulfill a public responsibility. Liaison is most active with, but not limited to, the Securities and Exchange Commission.

The FASB and the SEC

Interaction between the FASB and government began in the Board's first year. The SEC has statutory authority under the Securities Act of 1933 and the other securities laws to develop financial accounting and reporting standards, but in its Accounting Series Release 150 (December 1973) the SEC recognized FASB pronouncements as authoritative accounting and reporting standards and announced that it would look to the FASB for leadership in establishing and improving standards. In ASR 150, the Commission reaffirmed its decision in ASR 4, issued in 1938, that financial statements filed with the Commission should be prepared in accordance with principles for which there is substantial authoritative support. In April 1982, ASR 150 was codified in SEC Financial Reporting Release No. 1, Section 101. Since 1978, the SEC has reported annually to Congress on the performance of the FASB. The general tenor of these reports has been that the FASB has performed satisfactorily. The 1984 report concluded that "although generally satisfied with the FASB's performance, the Commission believes that there is need for more timely guidance on emerging issues." (The Board's actions to address the Commission's concern are discussed later in this document.)

The Standards Board and the Commission maintain a close working relationship to foster cooperation and a climate that a former SEC chief accountant described as one of "mutual nonsurprise." The Board members and the commissioners meet together on a regular basis to discuss matters that are of concern to both bodies. The chief accountant of the SEC participates as an observer, but with the privilege of the floor, in quarterly meetings of the FASAC and reports on current SEC developments related to Board activities. The chief accountant also attends meetings of the FASB's Emerging Issues Task Force and FASAC's Advisory Committee on the FASB agenda as an observer with the privilege of the floor. Members of the chief accountant's staff are assigned to follow the development of specific FASB technical projects. They participate in meetings of advisory task forces on those projects and frequently observe meetings of the Board. The staff of the FASB meets regularly with the Commission staff and the commissioners to discuss progress on, and concerns about, accounting issues. For the past three years an FASB representative has served on the Executive Committee and Securities Task Force of the SEC Government-Business Forum on Small Business Capital Formation.

The Commission often refers financial reporting problems to the Board for solution. When appropriate, the SEC has withdrawn its own rules after the Board has acted; for example, FASB Statements on accounting for changing prices, disclosures of segment information, and accounting for leases replaced the Commission's rules on those issues.

In 1978, however, the Commission decided not to require all registrants to adopt the FASB standard for reporting by oil-and gas-producing companies for financial statements filed with it. This was a special situation in which Congress (in the Energy Policy and Conservation Act of 1975) directed the SEC to develop a reporting system for oil and gas producers and explicitly permitted the Commission to rely on the FASB for accounting and reporting standards. The FASB issued such standards in 1977, within the timeframe specified in the Act. After extensive consideration, including its own public hearings and those conducted by the Department of Energy, the SEC concluded in 1978 that existing accounting practices, including the one favored by the FASB, were inadequate. The Board in 1979, suspended the effective date of its requirements. The Commission set out to develop a new system of "reserve recognition accounting," but in 1981 announced that it no longer considered reserve recognition accounting to be a potential method of accounting in the primary financial statements and that it would support an FASB effort to develop disclosure requirements for oil and gas producers. An FASB Statement specifying those disclosures was issued in November 1982.

Other issues on which the Board has been responsive to SEC concerns include troubled debt restructurings, prior period adjustments, reporting the effects of changing prices, capitalization of interest cost, research and development arrangements, acquisitions of banking and thrift institutions, in-substance defeasance, junior stock, and computer software.

The SEC has continually stressed the importance of the Board's conceptual framework project as an aid to the FASB and others in reaching decisions and in better understanding the FASB's decision-making process. In December 1984 the Board issued Concepts Statement No. 5, Recognition and Measurement in Financial Statements of Business Enterprises, the last scheduled document in the conceptual framework for business enterprises.

FASB and GAO

The General Accounting Office is another federal agency with which the Board interacts. The Comptroller General is a member of the Financial Accounting Standards Advisory Council, and GAO staff provide input to Board projects and participate in task force meetings.

Other Relationships

The pattern of FASB relationships with the federal government changes constantly, reflecting the issues that are of greatest urgency and interest at any time. Agencies that have been interested in one or more of the Board's projects include the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Federal Reserve Board, the Comptroller of the Currency, the Pension Benefit Guaranty Corporation, the Department of Labor, the Department of Energy, and the Treasury Department. When appropriate, the Board conducts briefing sessions in Washington to inform those in government about specific agenda projects or other activities. The chairman of the FASB has testified before congressional committees in response to issues of oversight as well as of capital formation. The Board is responsive to requests from Congress for material and the FASB's Internal Policy Bulletin 4.02, Responding to Requests from Congress, states that:

> Because of the public implications of its work the Board must be impartial in dealing with Congress. The Board must not appear to be an advocate of any political viewpoint. This particularly applies to views on legislation. Therefore, responses should be provided to both the majority and minority sides, unless the Chairman finds some compelling reason for responding only to the person making the request. The person making the request must be advised that the same material will be given to the other side.

The FASB'S Washington Office

To improve communication with government, the Board, in 1978, began to staff a Washington office and appointed a government relations manager. The Washington office is able to provide FASB documents and other information to the Congress, executive departments, independent federal agencies, and other interested parties on request. The office also is prepared to arrange for the FASB to provide input to federal officials on specific subjects about which the FASB has special knowledge. The office also monitors legislative and regulatory activity to identify potential financial reporting issues that may require FASB action.

COMPARABILITY OF ACCOUNTING INFORMATION

In the Board's judgment, accounting for similar transactions and circumstances similarly and for different transactions and circumstances differently is a desirable objective in establishing standards of financial accounting and reporting. When the same or similar facts and circumstances exist, intercompany comparability requires a single method of accounting. Comparable reporting by companies competing for capital is clearly in the public interest. The Board's record, as evidenced in the pronouncements it has issued, has been one of consistently eliminating optional accounting alternatives and establishing mechanisms to avoid a proliferation of additional alternatives.

However, sometimes significant operational and environmental differences among companies in different industries, among companies within a particular industry, or even within a single company make different accounting appropriate in order to reflect the substance of different circumstances. When the FASB believes different accounting is required to reflect different facts and circumstances, the Board's pronouncements specify those differences.

The Board's approach to achieving comparability has been guided by the philosophy expressed in its Concepts Statement No. 2, Qualitative Characteristics of Accounting Information:

> Comparability should not be confused with identity, and sometimes more can be learned from differences than from similarities if the differences can be explained. The ability to explain phenomena often depends on the diagnosis of the underlying causes of differences or the discovery that apparent differences are without significance. Much insight into the functioning of the capital market, for example, has been obtained from observing how market forces affect different stocks differently. Something has been learned, too, from observing that the market generally ignores apparent

> (cosmetic) differences among stocks that were formerly thought to be significant. Greater comparability of accounting information, which most people agree is a worthwhile aim, is not to be attained by making unlike things look alike any more than by making like things look different. The moral is that in seeking comparability accountants must not disguise real differences nor create false differences. [paragraph 119]

In an attempt to facilitate analysis and provide a basis for consistent resolution of financial accounting issues, the Board has developed a conceptual framework for financial accounting and reporting. It recently completed a 10-year effort during which the following FASB Statements of Concepts were issued:

a. No. 1, Objectives of Financial Reporting by Business Enterprises (November 1978)
   This Statement emphasizes that financial reporting should provide information that is useful to present and potential investors, creditors and other users in making rational investment, credit, and similar decisions.
b. No. 2, Qualitative Characteristics of Accounting Information (May 1980)
   This statement examines the characteristics, such as relevance, reliability, and comparability (including consistency) that make accounting information useful. It also stresses that the Board should always be concerned about the understandability and the cost-effectiveness of its standards.
c. No. 3, Elements of Financial Statements of Business Enterprises (December 1980)
   This Statement defines the 10 building blocks of financial statements--assets, liabilities, equity, investments by owners, distribution to owners, comprehensive income, revenues, expenses, gains, and losses.

d. No. 4, Objectives of Financial Reporting by Nonbusiness Organizations (December 1980)

This Statement establishes the objectives of general purpose financial reporting by nonbusiness organizations.

e. No. 5, Recognition and Measurement in Financial Statements of Business Enterprises (December 1984)

This Statement sets forth recognition criteria and guidance on what information should be incorporated into financial statements and when.

The Board has referred to these concepts as a starting point for resolving many significant and long-standing issues of financial accounting and reporting. Alternatives have been eliminated in several areas, such as research and development costs; loss contingencies; reporting by development stage companies; accounting for leases; segment reporting; accounting by debtors and creditors for troubled debt restructurings; prior period adjustments; capitalization of interest costs; defined benefit pension plans; compensated absences; product financing arrangements; revenue recognition by franchisors and when right of return exists; foreign currency translation; the effects of rate regulation on accounting for regulated enterprises; special termination benefits paid to employees; mergers of financial institutions; extinguishment of debt; transfers of receivables; and accounting for futures contracts.

With the issuance of FASB Statement No. 32, Specialized Accounting and Reporting Principles and Practices in AICPA Statements of Position and Guides on Accounting and Auditing Matters, in 1979, took over responsibility for specialized industry accounting principles from the AICPA. FASB standards now address accounting issues in the following industries: mortgage banking; broadcasting; real estate; record and music; insurance;

franchising; motion picture production and distribution; title insurance; and cable television.

Some important projects now on the Board's agenda involve cases where alternatives for accounting for similar facts and circumstances exist. These include accounting by employers for pensions, accounting for computer software, and accounting for consolidated financial statements. It is expected that pronouncements in these areas will lead to a significant narrowing of alternative accounting and reporting treatments presently available.

In only a very few situations in financial reporting are two or more methods of accounting equally acceptable for identical situations. When such alternatives exist, for example with cost methods for inventory, there are practical reasons why the alternatives continue.

NEUTRALITY IN STANDARD SETTING

Neutrality in setting standards is of great importance to the FASB. Neutrality means that either in formulating or implementing standards, the primary concern of the FASB is the relevance and reliability of the information that results, not the effect that the new rule may have on a particular interest.

Neutrality in accounting would be negated by the predetermination of a desired result and the selection of information to induce that result. To be neutral, accounting information must report economic activity as faithfully as possible, without coloring the image it communicates for the purpose of influencing behavior in some particular direction. Accounting information cannot avoid affecting behavior, nor should it. If it were otherwise, the information would be valueless--by definition, irrelevant--and the effort to produce it would be futile. Behavior is influenced by financial information just as it is influenced and changed by the results of elections, college examinations, and sweepstakes. Elections, examinations, and sweepstakes are not unfair--nonneutral--merely because some people win and others lose.

While rejecting the view that financial accounting standards should be slanted to favor one economic interest or another, the Board recognizes that it must be alert to the economic impact of the standards that it promulgates. The consequences of those standards are usually not easy to isolate from the effects of other economic events, and they are even harder to predict with confidence when a new standard is under consideration but before it has gone into effect. Nevertheless, the Board considers the probable economic impact of its standards as best it can and monitors that impact after a standard goes into effect. For one thing, a markedly unexpected effect on business behavior may point to an unforeseen deficiency in a standard in the sense that it does not result in the faithful representation of economic phenomena that was intended. It would then be necessary for the standard to be revised. The consequences may indeed be bad for some interests. But the dissemination of unreliable and potentially misleading information is, in the long run, bad for all interests. The Board's responsibility is to the integrity of the financial reporting system, which it regards as its paramount concern.

SMALL BUSINESS

The challenge to pay special attention to the needs of small businesses, of the users of their financial statements, and of the accountants who serve them constantly confronts the FASB. In 1978, the Board adapted its conceptual framework project to address separately two questions:

1. What types of information should be disclosed in financial reporting, and how much of that information should be reported within the financial statements themselves?

2. What types of information should all types of enterprises be required to disclose, and what types of information should only certain types of enterprises be required to disclose?

This second question would specifically address unique small business reporting considerations.

As the first step in addressing the concerns of smaller businesses the Board, in April 1978, issued FASB Statement No. 21, Suspension of the Reporting of Earnings per Share and Segment Information by Nonpublic Enterprises. This was the first in a series of pronouncements issued by the FASB that specifically exempt small businesses from compliance with certain financial statement disclosure requirements based on an analysis and conclusion by the Board that the costs of compliance with that requirement exceed the benefits to the users of the financial statements of small businesses. Other FASB Statements that provide exemptions for small business include:

- o FASB Statement No. 33, Financial Reporting and Changing Prices
- o FASB Statement No. 69, Disclosures about Oil and Gas Producing Activities
- o FASB Statement No. 79, Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises.

Providing differences in reporting for small business through exemptions is not without controversy. Some of the FASB's constituents believe that GAAP should be the same for all entities, thus enhancing uniformity and comparability in financial reporting. Wherever possible, the Board attempts to keep financial reporting requirements simple and understandable for all enterprises and considers special exemptions for small businesses as a less preferable, second choice. If the Board tentatively decides to provide an exemption for small businesses, that proposal is subjected to the same due process (including a public comment period) that is required for the imposition of any financial reporting requirement.

To understand better the relative costs and benefits of financial reporting requirements for small business, the FASB initiated a major research effort in 1981. That research included issuance of an Invitation to Comment, Financial Reporting by Private and Small Public Companies, in November of that year. More than 800 responses to the Invitation to Comment were received from small business owners and managers, users of small business financial statements (primarily bankers), and public accountants. In February 1983 the FASB published the results of that effort in a Special Report, Financial Reporting by Privately Owned Companies: Summary of Responses to FASB Invitation to Comment. During this same period the FASB and the National Association of Accountants jointly sponsored research by

Professor A. Rashad Abdel-khalik of the University of Florida. In August 1983 the results were published in a Research Report, Financial Reporting by Private Companies: Analysis and Diagnosis. In addition to the FASB's research efforts during the period from 1981 to 1984, two other groups conducted research efforts directed at specific issues affecting small business. The major finding of the researchers was that the users of the financial statements of small businesses did not want a different set of accounting principles to be applied in those statements.

After a two-year effort, the AICPA's Special Committee on Accounting Standards Overload published a report in February 1983. The FASB discussed that report with both the Special Committee and the Board of Directors of the AICPA, and in November 1983 published a formal response.

Meanwhile, the Financial Executives Research Foundation of the Financial Executives Institute conducted a study of the financial reporting needs of small public companies, publishing a report in November 1983. The FASB discussed the report with the Foundation on several occasions, both prior to its issuance and at a public meeting in April 1984.

In 1984 the FASB largely completed its own research efforts as well as its evaluations of the research of others. The Board appointed a Small Business Advisory Group in August 1984 whose members include small business managers and owners, bankers who work closely with small businesses, and CPAs with small business practices. The FASB uses the Small Business Advisory Group as a sounding board for issues of particular concern to small business. Each quarter, as the FASB updates its technical plan of agenda projects, a summary of the projects and related small business issues and developments is prepared by the FASB staff and provided to the advisory group for comment. Individual FASB project teams also consult with the advisory group as each project progresses. The Small Business Advisory Group also is consulted on all issues to be discussed by the FASB Emerging

Issues Task Force.

One project currently on the Board's agenda and of particular interest to small business is the project to reconsider the accounting for income taxes. This project was added to the agenda in January 1982 partly in response to concerns expressed by the small business constituency about the complexity and understandability of existing requirements. Due to the vital importance of this issue to small businesses and their accountants, the FASB has taken some special steps to obtain their views.

A Discussion Memorandum was published in August 1983, describing the accounting issues and soliciting comments prior to the Board's beginning deliberations. That Discussion Memorandum included a special chapter addressing issues of particular concern to small business and soliciting comment. In addition to the normal distribution, additional copies were mailed without charge to small business owners, managers, bankers, and accountants identified from the FASB's mailing list, as well as those of other organizations. Two groups also conducted surveys of the issues in the Discussion Memorandum and provided the results to the Board. The National Association of Accountants surveyed all of the company controllers in its membership and was able to stratify the results by size of company. The Private Companies Practice Section of the AICPA also completed a survey of its membership, which was recently provided to the FASB.

Public hearings on income tax accounting were held in April 1984 in New York City. Because few small business representatives participated in those hearings, special meetings on small business issues were sponsored by the FASB in San Francisco, Dallas, and Chicago, where small business constituents had the opportunity to express their views to members of the Board and the staff.

Other current projects of the FASB, including the pensions project, also are giving special attention to small business concerns. Beyond those efforts to address small business concerns on new projects, however, a significantly larger amount of the FASB's resources are devoted to making existing pronouncements easier to understand and apply. For example, one major ongoing commitment is the maintenance of the Current Text of authoritative accounting literature, a commitment first undertaken in 1982, with annual updates since. The Current Text integrates the requirements of past pronouncements by topic area, organized alphabetically, with superseded material deleted and amended material changed.

The FASB has also taken steps to augment its staff by the addition of persons with direct small business experience. The present director of research and technical activities, a position considered equal to that of a Board member, is an individual whose background in public accounting practice was exclusively with a small firm. In 1983, the Board brought a manager of the small business department of a large accounting firm into its practice fellow program. In 1984 another practice fellow, this time from a smaller firm that has predominantly small business practice joined the program. Also during 1984, the FASB attracted a faculty fellow whose principal area of research is small business reporting.

Much of the Board's effort to reach small business comes as part of an organized communications program. During the past 5 years, Board and staff members have addressed approximately 170 audiences in which the majority was made up of small business constituents. The FASB also arranges meetings with small business representative groups. During the past 12 months the FASB has met with the National Council of CPA Practitioners, the National Society of Public Accountants, the AICPA's Standards Overload Committee, and the Small Business Administration and the SEC Office of Small Business Policy. In 1985 the FASB has scheduled meetings with the chairmen of state CPA societies' accounting committees and will conduct regional meetings of general interest to small business this spring.

In addition to addressing small business groups, Board and staff members sometimes have shared their small business experiences with broader audiences through publications. Articles addressing small business issues have been published by current and former members of the Board and the staff.

Finally, at the beginning of 1984, the FASB initiated a new publication to help small businesses and their accountants keep abreast of new developments at the FASB. News Notes, an informal publication provided free of charge to state CPA societies, associations of small accounting firms, accounting journals, and any requesting party, includes a one-paragraph synopsis of new projects, final pronouncements issued, and other events of interest to small business.

Efforts to address separately small business concerns and to keep the small business community informed about the activities of the FASB have involved a significant expenditure of resources of the Board.

TIMELY GUIDANCE

A continuing challenge for the FASB is the ability to provide timely solutions to new accounting problems without compromising due process. A significant delay between the emergence of a new accounting issue and the issuance of reporting guidance can lead to diverse accounting practices for similar transactions and often to the entrenchment of less desirable alternatives. To provide prompt solutions, the Board must shorten its normal due process procedures, running the risk that some constituents' views will not be heard before the Board decides an issue or even before a pronouncement is issued.

Recognizing the need to respond quickly to new questions, the FASB staff frequently responds to specific inquiries on accounting issues. Initially these responses were documented by letter to the inquirer, with a synopsis of the question and response published in Status Report and copies of the correspondence made available to interested parties. In an effort to formalize the procedures for responding to inquiries on specific accounting questions, in 1979 the FASB staff began issuing Technical Bulletins. Technical Bulletins provided a means for indexing and disseminating responses to inquiries of the FASB staff. Board members could require discussion of the subject of a Technical Bulletin at a public Board meeting and could object to issuance of a Technical Bulletin.

In August 1982, after receiving the Report of the Financial Accounting Foundation's Structure Committee, the Board reexamined its procedures for providing timely guidance, including the procedures for the issuance of Technical Bulletins. One of the observations in the Structure Committee Report was that, while the Board's due process procedures are appropriate, ". . . more timely guidance on implementation questions and emerging issues is needed . . . ." The report recommended that the Board develop a plan to provide more timely guidance.

In response to that recommendation, the Board appointed the FASB Task Force on Timely Financial Reporting Guidance in October 1982. Its mission was to study the Structure Committee's recommendation and to advise the Board on how best to respond. In December 1982, the timely guidance task force published an Invitation to Comment, soliciting public views on approaches to providing timely guidance, and in March 1983 the task force held a public hearing.

In July 1983, the task force submitted its final report to the Board. That report included two recommendations:

1. The scope of FASB Technical Bulletins should be broadened, allowing them to address emerging and implementation issues as well as specialized industry issues of the type that the Board has previously addressed in FASB Statements and Interpretations.

2. An advisory group should be established to assist the Board and FASB staff in identifying and defining financial reporting issues and to suggest solutions if possible.

In December 1983, the Board issued an Invitation to Comment, Proposed Procedures for Implementing Recommendations of the FASB Task Force on Timely Financial Reporting Guidance, describing the proposed changes to implement those two recommendations. Most of the responses to the Invitation to Comment were supportive of the proposed changes. On May 9, 1984 the Board, in a public meeting, agreed to adopt changes to its procedures to implement the recommendations of the timely guidance task force.

Under the new procedures, FASB Technical Bulletins can address broader issues than previously possible, and they require more significant due process procedures commensurate with their broadened scope. For example, the subject of each Technical Bulletin must be discussed at a public Board meeting prior to release of a proposed Technnical Bulletin for comment. A mimimum 15-day comment period is required, with announcement of the availability of the proposed Technical Bulletin. Generally, proposed Bulletins are made available for 30-60 days to all interested parties and may be exposed broadly. A summary of the comments received and any changes to the proposed Bulletin must be discussed at a public Board meeting prior to the issuance of a final Technical Bulletin.

These new procedures were first used in response to some questions raised by the Deficit Reduction Act of 1984. Significant uncertainties had arisen with respect to the accounting by Domestic International Sales Corporations (DISCs) and stock life insurance companies. On July 18, 1984, the day the president signed the Deficit Reduction Act into law, the Board met to consider two proposed Technical Bulletins clarifying the accounting issues. Five days later, copies of the proposed Technical Bulletins were released for comment for a 30-day period. The comments received were discussed at a public meeting on September 5, and, after revisions were made, the final Technical Bulletins were issued on September 18, 1984. Because of the ability to deal with the issues expeditiously through Technical Bulletins, the needed accounting guidance was issued in the same calendar quarter as the new tax law was enacted.

In response to the second recommendation of the FASB Task Force on Timely Financial Reporting Guidance, the FASB established the Emerging Issues Task Force on an experimental basis in June 1984. The task force held its first meeting on July 24, 1984, and has met six times since. (The most recent meeting was held February 14, 1985).

The task force has 16 members including 11 practicing CPAs and 4 industry representatives. The FASB director of research and technical activities serves as chairman. The chief accountant of the SEC also participates as an observer in the meetings of the Emerging Issues Task Force and has the privilege of the floor. At least one of the seven FASB Board members also has attended each meeting.

All meetings of the task force are open to public observation. The agenda for each meeting is announced in advance (in the FASB's weekly publication, ACTION ALERT). Interested parties may obtain from the FASB copies of background materials on the issues to be discussed. Minutes of each meeting of the task force are available by calling or writing to the FASB. In addition, when task force members believe that a particular group can aid their understanding of an issue, a representative of that group may be invited to participate in the meeting. This has occurred several times. When financial institution issues were discussed, representatives of the Federal Home Loan Bank Board, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency participated in the discussions. Additionally, the views of knowledgeable industry officials and AICPA industry committees were solicited and discussed. Further, all materials considered by the task force are sent to a separate FASB advisory group on small business issues.

Thus the mission of the task force is two-fold. On issues the FASB needs to address with its full due process, the task force can bring the issue to the Board's attention more quickly, so that guidance can be issued before there is widespread diversity in practice. The more challenging part of its mission, though, is to encourage consensus among practitioners on issues not addressed by the FASB. If the task force reaches a consensus that one method of accounting for a new transaction is particularly compelling, usually based on the accounting requirements for a similar transaction covered in an existing pronouncement, that consensus solution is likely to be generally applied in practice, eliminating the need for an FASB pronouncement on the issue.

In a footnote to Staff Accounting Bulletin No. 57, the SEC stressed the importance of the Emerging Issues Task Force for public companies:

> The authoritative accounting literature cannot specifically address all the novel and complex business transactions into which registrants might enter. Accordingly registrants and their independent accountants must determine the appropriate accounting for such transactions based on some pervasive, fundamental principle or on an analogy to transactions with similar economic substance for which the accounting literature does provide specific guidance. . . .
>
> . . . It is intended that [the Emerging Issues Task Force] assist the FASB staff in identifying, and in some cases resolving, emerging issues for which specific accounting guidance does not exist. The [SEC] staff intends to participate in the activities of this group and believes that the group's efforts will be most effective if preparers of financial statements and/or their independent accountants apprise the group of intended accounting for new business transactions.

To date the group has addressed more than 40 accounting issues. More than half have involved financial institutions and have been issues caused by deregulation, reregulation, and volatile interest rates, as well as issues relating to the new financial instruments they have developed in response to the changing environment. Many of the issues addressed by the task force have involved questions relating to consolidation, the use of "off-balance sheet" financing, the ability to offset assets and liabilities, and write-downs to recognize impairment of assets. Several acquisition and merger issues also have been discussed. Most of the issues have been raised by individual task force members who present background materials for discussion by the task force, though occasionally the FASB or SEC has added a topic to the agenda.

The Emerging Issues Task Force has already brought several new issues quickly to the attention of the FASB for expeditious resolution. Indications are that a consensus of the Emerging Issues Task Force will be applied in practice. The number of individuals observing the public meetings has increased, as have requests for copies of the minutes of task force meetings. On one recent occasion, the presence of the task force and the expanded scope of Technical Bulletins permitted particularly prompt dispatch of an issue arising from actions taken by the Federal Home Loan Mortgage Corporation.

Interest in the transaction was widespread and included an inquiry from the Office of Management and Budget. The issue concerned the proposed accounting for a distribution of a new issue of preferred stock of the Federal Home Loan Mortgage Corporation to savings and loan institutions throughout the country. Because the distribution had already been made (effective December 31, 1984), it was important that guidance be given before institutions had to report their 1984 earnings. On January 14, 1985 the FASB called a joint meeting between the Board and the Emerging Issues Task Force for January 17. Representatives of the Office of Management and Budget, Federal Home Loan Mortgage Corp., Federal Home Loan Bank Board, and other interested parties met for two days in public session. On the following Wednesday, January 23, 1985, the Board met again and announced its tentative decision. The staff of the FASB was directed to communicate that decision in a proposed Technical Bulletin, which was released for a 15-day comment period on January 25, 1985. The final Technical Bulletin is expected to be issued shortly.

In the Emerging Issues Task Force and the expanded scope of Technical Bulletins, the FASB has two new tools to help it to provide prompt guidance on new accounting issues.

CONCLUSIONS

Most of the questions facing the Board have no easy answers. The Board is an agent of change in financial reporting and is therefore always at the center of controversy. Problems amenable to clear-cut solutions that are acceptable to all affected parties never reach the Board. Matters that the Board is asked to deal with are typically those on which reasonable and informed people differ.

In reaching their decisions, Board members balance several conflicting factors. The need for stability has to be balanced against the desirability of change, while the benefits derived from a standard have to be weighed against the costs involved. A balance has also to be struck between having a few broad and general standards on the one hand and many detailed and complex standards on the other. The need to maintain comparability across all companies through uniformity has to be tempered by management's need to innovate and experiment. The balancing of these conflicting demands by individual Board members necessarily requires subjective judgments. Even with agreement on the overall mission of the FASB, those decisions inevitably arouse controversy, as many among the Board's constituency reach a different balance of the various conflicting factors. However, the Board has not hesitated in its duty to set standards and has done so within a framework and with procedures that ensure its independence, objectivity, and exposure to the full range of diverse opinions.