

A PRIVILEGE AND A RESPONSIBILITY: PARTICIPATING IN THE FASB'S STANDARD- SETTING PROCESS

Paulette R. Tandy, Ph.D., CPA
Associate Professor
Department of Accounting
College of Business
University of Nevada, Las Vegas
Las Vegas, NV 89154-6003
(702) 895-3226
FAX (702) 895-4306
tandy@ccmail.nevada.edu

Nancy L. Wilburn, Ph.D., CPA
Professor
Accounting Area
College of Business Administration
Northern Arizona University
Flagstaff, AZ 86011-5066
(928) 523-7395
FAX (928) 523-7331
Nancy.Wilburn@nau.edu

May 2004

**A PRIVILEGE AND A RESPONSIBILITY:
PARTICIPATING IN THE FASB'S STANDARD-SETTING PROCESS**

The collapse of Enron has put an unusual spotlight on accounting standards and the accounting standard-setting process. The Financial Accounting Standards Board (FASB) has stated that it is prepared and committed to proceed expeditiously to resolve any and all financial accounting and reporting issues that may arise as a result of Enron's bankruptcy. Throughout the discussions, Robert Herz (FASB chairman) and Edmund Jenkins (former FASB chairman) have stressed the importance of an independent, private sector, open due process system to establish financial accounting and reporting standards. This process is critically important in serving the investing public because the development of standards in an objective and unbiased manner results in financial information that is more transparent, credible and comparable than if the process were politicized. High-quality financial reporting standards contribute to the success and competitive advantage of U.S. capital markets.

The FASB's process of developing financial accounting standards, known as "due process," includes open Board meetings, public hearings, and solicitation of constituent comments during several stages in new standard development. Solicitation and analysis of comments from knowledgeable, interested constituents is a vital part of the FASB's efforts to make financial reports as useful and meaningful as possible. Participation is essential to develop the best solutions to accounting and reporting issues and prevent standards that are unworkable in application, too costly, or even inconsistent with basic concepts. For example, input received after the FASB issued *Statement of Financial Accounting Standards (SFAS) No. 91*, "Accounting for Nonrefundable Fees and Costs Associated With Originating or Acquiring Loans and Initial Direct Costs of Leases," revealed mechanical difficulties that literally precluded its application.

Such errors and ambiguities might have been avoided with appropriate constituent participation during the standard-setting process. As another example, input received during the formation of *SFAS No. 95*, “Statement of Cash Flows,” suggested that most companies could not obtain the amounts of gross operating cash receipts and payments directly from their accounting systems, information necessary to use the direct method of cash flow reporting. While financial statements users argued that the direct method would provide clearer cash flow information, the FASB realized that the costs of preparing statements using the direct method would be prohibitive. Although the FASB cannot satisfy the preferences of all of its diverse constituents, participation allows the Board to more effectively weigh each alternative’s consequences. The Board listens to what it hears and makes final decisions only after carefully considering and understanding the views of all parties.

Participation in the standard-setting process is necessary to help ensure the acceptance of FASB standards by the accounting community. When practicing accountants express their views to the FASB, they become a part of the standard-setting process. Despite the inevitable criticisms, the FASB has been strengthened by its ties to the accounting profession. By incorporating input from the profession into its decision-making processes, the FASB continues to promote private-sector standard setting.

The FASB’s Standard-Setting Process

The issuance of a final Statement of Financial Accounting Standards marks the culmination of a lengthy process. First, the FASB must agree to consider the issue and place it on the Board’s agenda. After a project is added to the agenda, the FASB staff carefully researches every aspect of the issue. For a major project, the Board creates Project Resource Group composed of individuals with relevant knowledge or experience. During this phase, the FASB

may issue a discussion memorandum (drafted by the FASB staff), an invitation to comment (drafted by an outside consultant), or another discussion document. These documents provide the public with information concerning possible resolutions and invite comments from the public, both in written format and at public hearings.

After these early deliberations, the Board's position on the issues is described in an exposure draft, again providing constituents with an opportunity to express viewpoints. Public roundtable meetings are also held during this phase. If necessary, the FASB issues a revised exposure draft and again solicits input. The Board considers all input received in the preparation of the final pronouncement.

The Board encourages participation during each phase of the process from interested parties to express their views. Constituents most often participate in the process by submitting comment letters and presenting testimony at public hearings. Although constituent participation is very valuable to the FASB, actual participation levels are often quite low. On the first 100 standards issued by the FASB, an estimated 0.002% of corporations in the U.S. and 0.06% of public accounting firms submitted a comment letter to the FASB. Who does submit comment letters? Exhibit 1 presents the percentage of comment letters submitted by various constituents in response to exposure drafts preceding SFAS Nos. 1-133. Industry constituents (i.e. financial statement preparers) submitted a majority of the comment letters. Respondents from the banking industry and from public accounting also submitted significant percentages of the comment letters.

[Insert Exhibit 1 about here.]

How to Participate in the FASB's Standard-Setting Process

In order to participate in the FASB's standard-setting process, you must stay current on

the issues being deliberated by the FASB. The FASB has found many outlets to keep the accounting profession aware of its activities. The *CPA Letter* (available at www.aicpa.org) publishes lists of outstanding FASB documents and their comment deadlines (the comment period typically lasts 60 days or more).

Information is also available directly from the FASB. One copy of each discussion document or exposure draft is available by written request without charge during the comment period. A convenient and complete way to receive current documents on a timely basis is to purchase a FASB subscription plan as described in Exhibit 2. *The FASB Report* newsletter carries news of developments in the standard-setting process and the status of each technical project. The *Action Alert* publishes the dates, times, locations, and agendas of upcoming meetings and summaries of significant actions taken by the Board at prior meetings. The *Action Alert* is now available by e-mail at no cost, by sending an e-mail to: join-actionalert@listserv.lists.fasb.org.

[Insert Exhibit 2 about here.]

In addition, much information concerning the FASB, its agenda, and outstanding documents can be found on the FASB's website (www.fasb.org). The website includes the *FASB Report*, the *Action Alert*, project updates and plans, summaries and status of all FASB Statements, and other FASB documents. Outstanding exposure drafts and other documents can be downloaded at no cost.

How to Write and Submit an Effective Comment Letter

Comment letters can be mailed to the FASB at the address listed in the exposure draft or can be submitted via e-mail to director@fasb.org. Although the FASB reads and analyzes each comment letter received, letters will be more effective if they provide articulate, well-presented

arguments that emphasize the theoretical support for their positions. Reasoning should be concise, while covering all necessary points. Clear examples or addressing specific implementation problems will create a more compelling position. Board members have stated that they are not persuaded by comment letters that merely promote the respondent's own self-interest or that simply state disapproval of the FASB's position without supporting reasons. Exhibit 3 provides actual quotes from ineffective comment letters. These quotes illustrate a tone and lack of courtesy and respect that are likely to be counterproductive in persuading FASB members to advocate a particular position.

[Insert Exhibit 3 about here.]

The FASB has stated that the analysis of written and oral comments 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. Therefore, letter-writing campaigns with form letters, such as that conducted in response to the Exposure Draft, "Accounting for Stock-Based Compensation," have little usefulness to the FASB.

In a recent article in *The FASB Report* (March 31, 2004), the FASB stresses that the Board welcomes communication from any interested member of the public about its deliberations at any stage. Besides comment letters, the FASB welcomes emails, telephone calls, or any other means of sharing information and views with the Board.

Current Board Agenda Projects

Current FASB projects, and their status, are listed in Exhibit 4. The FASB's technical plan indicates that 13 new exposure drafts are expected to be issued for comment in 2004 or early 2005. Major projects include business combinations, equity-based compensation, fair value measurements, financial instruments-liabilities and equity, revenue recognition, and short-term international convergence. In addition, the FASB has research projects including agenda

planning with the International Accounting Standards Board, the conceptual framework, international convergence, financial instruments, and consolidations: policy and procedures. Additionally, the Board has been pursuing a number of initiatives related to the codification and simplification of accounting literature, including initiatives regarding moving towards principles-based standards. Current updates and more detailed discussion of these projects are available on the FASB website.

[Insert Exhibit 4 about here.]

Summary and Conclusions

Setting standards in an open due process system with meaningful participation by users, preparers, auditors, and others, is essential to the credibility and acceptance of financial accounting and reporting standards. The standard-setting process needs constituent participation and support to ensure the continuation of development of high-quality standards by an independent, private-sector body. Objective, unbiased standards will result in more transparent financial reports, contributing to the success and competitive advantage of U.S. capital markets.

Exhibit 1: Participation in Standard-Setting

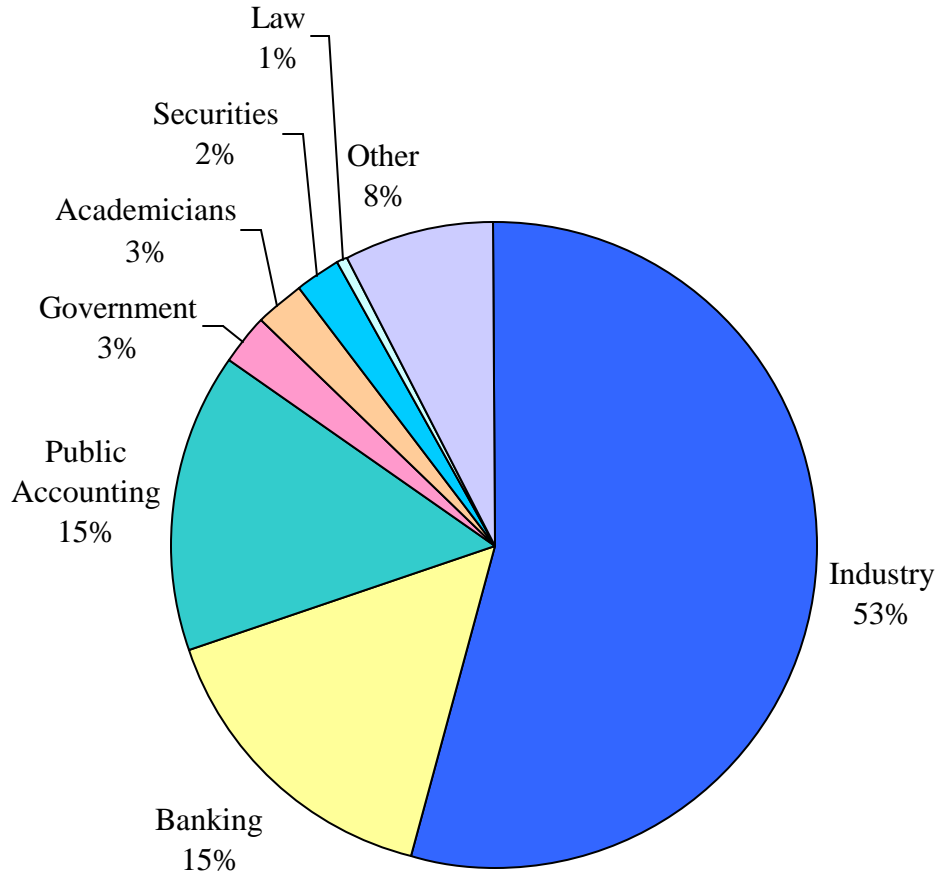


Exhibit 2: FASB Subscription Plan*

FASB Subscription (24 months, \$320; 12 months, \$175)

Includes printed copies of newly issued *Statements*, *Interpretations*, and *The FASB Report* newsletter, in addition to special email notifications about *Exposure Drafts*, *Discussion Memorandums*, *Invitations to Comment*, and research reports as available for downloading at the FASB website.

* See www.fasb.org for more information.

Exhibit 3: Don't Write to the FASB Like This!

(Actual quotes from comment letters)

“I seldom write to the FASB because experience has taught me that it is usually a useless exercise...”

“In all my years in the financial arena, I have never seen such an absolutely ridiculous proposal...”

“In general, this document seems to be the ultimate in bastardizing accounting in order to avoid an uproar amongst the companies that would be affected by the proposal...”

“I suggest you table the proposal and spend a little more time on something worthwhile...”

“For God’s sake, use common sense just this once...”

“The Board and its staff must recognize that previous FASB pronouncements have already fouled up quality and useability of many balance sheets...”

“...I do strongly suggest that matters of this kind should not be decided by the views of a small minority of financial accounting theoreticians who seem to spend their time contemplating obscure, almost metaphysical, relationships between the numbers and economic reality. It doesn’t make any difference how many of what size angels can do what type of dance on how large the head is on any particular pin. I believe that the FASB is continuing to put itself in increasing jeopardy of being widely regarded as an agency of ‘angel counters’ and I sincerely hope that resolution of the compensation and post-retirement benefit issue does not become another instance of the financial community’s further reduced confidence in, and respect for the FASB.”

“We need to have private sector rule-making in financial accounting but, even more so, we need to have private sector respect for the process and the results, as, if and when that respect and support for the FASB would have sufficiently eroded, the alternative – government rule-making – is something that none of us would like to see occur.”

“If such positions are arbitrarily enacted, it will do much to eliminate what little credibility the Financial Accounting Standards Board still retains.”

“The words that keep coming to mind are recalled because Easter was not so long ago: ‘Forgive them Lord for they know not what they do.’”

“If you do not understand this or care not for the consequences, then your powers should be taken from you and vested in the Securities and Exchange Commission.”

“The ... most disturbing aspect of anything that FASB does is the continual emphasis on trying to straitjacket the vast and varied American business community into a rigid set of rules for whatever proposition FASB is attacking.”

Exhibit 4: Outstanding and Upcoming FASB Documents for Comment

Project	Status
<p>Business Combinations:</p> <p>Purchase Method Procedures including Combinations between Mutual Enterprises</p> <p>Noncontrolling Interests</p> <p>Combinations of Not-for Profit Organizations</p>	<p>ED expected 2nd quarter 2004; Roundtable Discussion expected 3rd quarter 2004</p> <p>ED expected 2nd quarter 2004; Roundtable Discussion expected 3rd quarter 2004</p> <p>ED expected 3rd quarter 2004</p>
<p>Equity-Based Compensation:</p> <p>Transactions with Employees</p>	<p>Exposure Draft (ED) outstanding; comment period ends on June 30, 2004</p>
<p>Fair Value Measurements Statement</p>	<p>ED expected 2nd quarter 2004; Roundtable Discussion expected 3rd quarter 2004</p>
<p>Financial Instruments—Liabilities and Equity:</p> <p>Amendment to Concepts Statement 6</p> <p>Instruments with Characteristics of Equity and of Liabilities, Assets, or Both</p>	<p>ED expected 1st quarter 2005</p> <p>ED expected 1st quarter 2005</p>
<p>Revenue Recognition:</p> <p>Amendment to Concepts Statements</p> <p>Broad-Based Revenue Recognition Statement</p>	<p>ED expected 4th quarter 2004</p> <p>ED expected 4th quarter 2004</p>
<p>Short-Term International Convergence:</p> <p>Liability Classification</p> <p>Income Taxes</p>	<p>ED expected 2nd quarter 2004</p> <p>ED expected 4th quarter 2004</p>
<p>Statement 140 Issues:</p> <p>Qualifying Special-Purpose Entities and Isolation of Transferred Assets</p>	<p>ED expected 3rd quarter 2004</p>
<p>Interpretation of Statement 87</p>	<p>ED expected 2nd quarter 2004</p>
<p>Interpretation of Statement 143</p>	<p>ED expected 2nd quarter 2004</p>