Testimony of Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
Before the Subcommittee on Commerce, Trade, and Consumer Protection
of the Committee on Energy and Commerce
July 31, 2001

Attachment 1

An Introduction to the FASB

An Introduction to the FASB

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This paper answers some common questions for people who may have heard of "Fasbee" but know little about the Financial Accounting Standards Board (the FASB or the Board).

A Private-Sector Organization

Many assume that FASB stands for "Federal" Accounting Standards Board, but FASB is a private-sector organization. It receives no federal funding of any kind. It has no legislative charter or grant of enforcement power.

The Securities Exchange Act of 1934 gives the Securities and Exchange Commission (the SEC) authority over financial accounting and reporting standards for publicly held companies. Throughout its history, the SEC has relied on the private sector for this function, to the extent that the private sector demonstrates an ability to fulfill the responsibility in the public interest. The SEC and congressional committees maintain an active oversight of the FASB to ensure that the public interest is served.

Since 1973, the SEC and the American Institute of Certified Public Accountants (the AICPA) have recognized FASB pronouncements as authoritative accounting guidance. Before then, a series of AICPA committees and boards set accounting standards. The FASB was founded, in part, to bring a broader constituency into the setting of accounting standards. Unlike its predecessors, the FASB is not an arm of the AICPA. The FASB is an operating unit of the Financial Accounting Foundation, which is an organization independent of all other business and professional organizations.

The Board recognizes that its viability depends on its ability to produce accounting standards that enhance the credibility of financial reporting. The strength of the private sector lies in its ability to marshal expertise and resources not readily available to the federal government. The FASB strives to combine those resources with an open process that invites participation by all interested parties, an independence from special interests, and an objectivity in consideration of issues.

Standards of General-Purpose Financial Reporting

The FASB sets standards for use in *general-purpose* financial reporting. As the term suggests, general-purpose financial reporting attempts to provide useful information to a variety of financial statement users. These users lack the authority to prescribe the financial information they want from an enterprise. They must use the information that management provides. The framework of standards and practices that govern general-purpose financial reporting, commonly referred to as *generally accepted accounting principles* or *GAAP,* produces financial statements that are more useful and relevant than would exist without standards.

Accounting standards provide a framework of principles and requirements that:

- Govern the preparation of general-purpose financial statements
- Enhance the usefulness of financial statements by requiring the presentation of relevant information

- Create a reasonable degree of standardization among reporting entities, thus increasing the usefulness of financial statements and their credibility

An efficiently functioning economy requires credible financial information as a basis for decisions about allocation of resources. If financial information is to be useful, it must report economic activity without coloring the message it conveys to influence behavior in a particular direction. It must not intentionally favor one party over another. It must provide a neutral scorecard on the economic consequences of decisions.

Taxing authorities, government contracting agencies, and bank, insurance, and public utility regulators all impose special financial reporting requirements. In each case, these regulations allow the agency to use financial information to meet a specific legislative mandate. Thus, taxing authorities use financial information in the collection of revenue, financial regulators in regulation of solvency, and public utility regulators in setting prices. Those are all appropriate uses of financial information, and each serves a special need. But those special needs are not the Board's primary concern. The distinguishing characteristic of the FASB is its emphasis on general-purpose financial reporting to investors, creditors, and others who use financial information in making economic decisions.

Benefits and Costs of Accounting Standards

There are two inevitable characteristics of every issue addressed by the FASB. First, the issue, and any proposed answer, will be controversial. Easy questions do not need accounting standards. Difficult questions, the kind that need FASB action, engender strongly held views and disagreement. An accounting standard represents a loss of management control over information—loss of ability to decide whether, when, or how to present information. Second, an FASB pronouncement will have consequences that some consider undesirable. Without consequences, there is no reason for accounting standards.

Assessing the benefits and costs of issuing an accounting standard is integral to the Board's decision-making process. Every issue in an FASB project has its own mix of incremental improvement and incremental cost for the Board to consider. At the end of every project, the Board considers the accounting provisions in the aggregate and must conclude that issuance of the standard is a sufficient improvement in financial reporting to justify the perceived costs.

The objective, and implicit benefit, of issuing an accounting standard is increased credibility and representational faithfulness of financial reporting. However, the value of that improvement to financial reporting is usually impossible to measure. The Board's assessment of a standard's benefit to preparers, creditors, investors, and other users is unavoidably subjective. A standard's incremental costs are also diffuse. They are borne by users and attesters as well as preparers of financial statements. Some of those costs can be quantified, albeit imprecisely and with difficulty; but most of the benefits and many of the costs of adopting a new accounting standard cannot be quantified.

It also is in the nature of accounting standards that most costs accrue to financial statement preparers, while users receive the most direct benefit. There is a fundamental tension between those groups that affects the way they look at costs and benefits.

The Board's principal mission is to improve the usefulness of financial reporting. Accomplishing that mission requires change, and change, by its nature, imposes a cost.

The costs of change, both incurred costs and less tangible costs, may lead the Board to slow the pace of change. Change must continue, however, if financial reporting is to play the role for which it was originally conceived—to improve the function of the marketplace by providing useful information.

Economic Consequences of Accounting Standards

Some observers suggest that the FASB should consider the economic impact of accounting standards. The FASB should not act, they maintain, if a new accounting standard would have undesirable economic consequences.

Assertions about a proposal's economic consequences appear in many comments received by the FASB. For example, some commentators point to actions by employers to curtail retiree health benefits. Many of those employers cited accounting standards that require recognition of postretirement benefits, arguing that accounting caused them to curtail or eliminate benefits. Others suggest that reporting the fair value of financial instruments will create a new credit crunch. There is a common element in these assertions. Those who make them may pursue desirable goals, like providing retiree health care or managing financial risks. But, they hope to achieve the goal without clearly explaining its financial impact to those who use financial statements.

GAAP and GAAS

These two acronyms are often confusing to those not familiar with accounting jargon.

GAAP—generally accepted accounting principles—governs the preparation of financial statements. GAAP is a body of principles and accepted practices. It ranges from customs (like putting assets on the left-hand side of a balance sheet) to complex measurement (like computing the liability for employee pensions). There are several sources of GAAP, and FASB pronouncements stand at the top of a hierarchy of those sources.*

GAAS—generally accepted auditing standards—governs the performance of an auditor's examination of financial statements. Auditors, independent certified public accountants, attest to whether an entity's financial statements "present fairly in accordance with generally accepted accounting principles." The Auditing Standards Board, an organization operated by the AICPA, sets auditing standards.

While GAAP and GAAS are different, there is a clear relationship. The objective of an audit is the expression of an opinion on financial statements, usually statements prepared in accordance with GAAP. Auditors have a lively interest in accounting standards, because they must attest to an entity's compliance with those standards. The FASB has a clear interest in the "auditability" of its pronouncements.

*FASB pronouncements apply to private-sector organizations, including publicly owned corporations, closely held businesses, and private not-for-profit organizations. Accounting standards for state and local governmental entities are established by another branch of the Financial Accounting Foundation—the Governmental Accounting Standards Board or GASB. Neither organization sets standards for federal governmental agencies, although some federal agencies adopt GAAP for their reporting.

The Board disagrees. Like census data or SAT scores, financial statements must provide evenhanded data. One need only look to the collapse of the thrift industry to demonstrate the consequences of abandoning neutrality. During the 1970s and 1980s, regulatory accounting principles (RAP) were altered to serve other goals. Many argue that GAAP would force regulators to close institutions. They alleged that institutions using GAAP would be unable to compete in development and commercial lending. With RAP, regulators could forestall action, buying time for a hoped-for turnaround.

Most people condemn information slanting and bias, even in pursuit of laudable national goals. As a private entity, the FASB has neither the authority nor the competence to weigh various, and often conflicting, national goals. Nor does the FASB seek that authority or that competence. Its sole mission is to improve, through accounting standards, the usefulness of financial statements so that public and private decision makers can make better decisions. The Board understands that managers will sometimes alter their behavior in response to a new accounting pronouncement. This is a natural result of reporting information. If the information had no consequence, if it did not change the way markets and shareholders evaluate performance, it would have little benefit.

Accounting Standards in an International Capital Marketplace

One of the most vigorous trends in accounting standard setting in the past decade has been the intensifying demand for a single set of high-quality international accounting standards. Most domestic financial reporting issues have international implications, and national standard setters are under increasing pressure to eliminate national differences and move toward a single set of international solutions to those issues. The FASB is a proactive participant in cooperative efforts with other standard setters to meet its goals of (1) ensuring that international accounting standards are of the highest quality and (2) accelerating convergence of the accounting standards used in different nations. At the same time, the FASB believes it is important to maintain its program of improving U.S. national standards in order to meet the objective of high-quality accounting standards in the United States.

The FASB first formally recognized that demands for international comparability meant changes for U.S. standard setting in 1991, when it published "FASB's Plan for International Activities"[1] and subsequently amended the FASB's mission to require that the FASB "promote international comparability of accounting standards concurrent with improving the quality of financial reporting." Since then, the FASB has engaged in many different types of activities to further that aim, including joint projects with other standard setters to develop very similar standards on segment reporting and on earnings per share. The FASB also has regularly engaged in less formal group cooperative efforts with standard setters from various countries including Australia, Canada, Chile, France, Germany, Japan, Mexico, New Zealand, the Nordic Countries, and the United Kingdom. More recently, the FASB and other standard setters around the world have worked together to assist in the restructuring of the international accounting standard-setting process.

In 1999, the FASB and the Financial Accounting Foundation (FAF) published a report, *International Accounting Standard Setting: A Vision for the Future* (the FAF-

[1] The FASB's plan for international activities was revised and updated in 1995. Copies are available on the FASB's website (www.fasb.org).

FASB Vision).[2] The FAF-FASB Vision identified the establishment of a high-quality global standard-setting structure as essential to the future success of a truly international financial reporting system in which a single set of accounting standards could be used worldwide. Without such a structure, the continued independent processes of the various national and international standard setters would only result in increasing divergences among national financial reporting regimes and between national and international accounting standards. That would increase the difficulties of meeting market demands for international comparability. Continued differences would augment the risks and uncertainties surrounding cross-border investment opportunities and would raise questions about the relative quality of one set of standards compared to another.

In its vision, the FASB identified the restructuring of the existing international standard setter, the International Accounting Standards Committee (IASC),[3] as one way in which a quality global standard setter might be established. The IASC began the process of reorganizing itself to create a new global standard-setting structure in 1997. It appointed a Strategy Working Party to develop the IASC's strategy and structure. In November 1999, the Strategy Working Party published a report, *Recommendations on Shaping IASC for the Future,* which was unanimously supported by the IASC Board.[4] The recommendations describe a structure with many of the characteristics described in the FAF-FASB Vision. The IASC has already begun implementing the Strategy Working Party's recommendations, including the establishment of a group of trustees responsible for overseeing the new standard-setting body, the new IASC Board (the IASB). The members of the IASB also have been named and operations under the new structure began in 2001. Two members of the IASC trustees are also members of the FAF trustees, and two members of the IASB are former members of the FASB. One of those IASB members will be located in the United States and will be responsible for maintaining liaison between the FASB and the IASB.

As the national accounting standard setter for the world's largest market for investment capital, the FASB's support for and participation in a high-quality global standard-setting structure and process are crucial to meeting the market demands for convergence of national standards toward higher-quality, internationally comparable solutions and, thus, to serving the needs of constituents. The implications of the FASB's support for the new IASB structure in the near term will most likely be reflected in the FASB's agenda-setting process, as, for example, potential agenda topics are considered as prospective joint projects with the IASB. At the same time, the FASB's domestic-standard-setting efforts will continue to be a priority. It is not time to develop a phase-out plan for U.S. GAAP or for the FASB. On the contrary, domestic standard setting in some form may always exist—even as the IASB succeeds. For example, it may often be the case that U.S. markets experience highly specialized, complex, or unique transactions that may be most effectively addressed by a national-level standard-setting organization. Further, the large body of existing U.S. GAAP will require amendment from time to time,

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[2]Copies of the report, International Accounting Standard Setting: A Vision for the Future, are available from the FASB's website.

[3]The IASC was established in 1973 with the objective of harmonizing the accounting principles that are used by businesses and other organizations for financial reporting around the world.

[4]Copies of the Strategy Working Party's report are available from the IASC's website (www.iasc.org.uk).

which may not be a priority of the new IASB. Continued existence of the FASB as a national standard setter also is critical to ensuring that the U.S. perspective is fully considered in IASC debates and deliberations and ensuring that the IASC has an important vehicle through which it can maintain close contact with a key constituency. Thus, at least for the foreseeable future, the FASB's commitment to international standard setting will coexist with the FASB's commitment to domestic standard setting.

FASB's Relationship with the Federal Government

The Board recognizes the public policy implications of accounting standards and the obligation for regular liaison between the FASB and federal government. The FASB seeks no special advantage in its liaison with the federal government. Nor does it lobby for or against particular policy initiatives. The Board seeks only to fulfill the public responsibility embodied in its mission statement.

The pattern of relationships between the FASB, Congress, and federal agencies changes constantly, as the urgency of particular issues changes with time. The Board maintains regular contact with the SEC and financial institution regulators. The Board and its staff also regularly communicate with various federal departments, including the Department of Treasury and the Department of Commerce, on issues of common interest. Representatives of federal agencies frequently participate as advisors to FASB task forces and comment on FASB documents.

The Board sees itself as a resource to policymakers on matters that involve financial accounting questions. Board members and staff frequently meet with senators, congressional representatives, and their staffs to discuss accounting questions and provide information. From time to time, the Board provides written submissions and testifies on accounting matters.

The Board maintains a member of the staff in the Washington, D.C. area to coordinate its liaison with the federal government. Jeffrey P. Mahoney, project manager, can be contacted at (703) 243-9085 or by e-mail at fasbdc@bellatlantic.net.

Additional Information and Materials

The FASB maintains a web site at www.fasb.org. The web site provides a wealth of information and materials about the FASB and its current activities including:

- News releases
- Announcements of forthcoming meetings and Board actions
- Project summaries
- The quarterly plan for technical projects
- Exposure Drafts
- Articles and materials providing background information about the FASB and current accounting issues
- Reports, comment letters, and other materials relating to the Board's international activities and
- Information for ordering other FASB documents

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Attachment 2

FACTS about FASB

Facts about FASB 2000–2001

Financial Accounting Standards Board ● 401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116

Since 1973, the Financial Accounting Standards Board has been the designated organization in the private sector for establishing standards of financial accounting and reporting. Those standards govern the preparation of financial reports. They are officially recognized as authoritative by the Securities and Exchange Commission (Financial Reporting Release No. 1, Section 101) and the American Institute of Certified Public Accountants (Rule 203, Rules of Professional 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.

The Mission of the Financial Accounting Standards Board

The mission of the Financial Accounting Standards Board 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.

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. Promote the international comparability of accounting standards concurrent with improving the quality of financial reporting; and
5. 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 will help 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 will help 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 aimed at gaining new insights and ideas. Research is conducted by the FASB staff and others, including foreign national and international accounting standard-setting bodies. 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.

An Independent Structure

Financial Accounting Standards Board

The FASB is 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 by the Committee on Accounting Procedure of the

American Institute of CPAs (1936-59) and then by the Accounting Principles Board, also an arm of the AICPA (1959-73). Pronouncements of those predecessor bodies remain in force unless amended or superseded by the FASB.

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, funding their activities, and for exercising general oversight (except with regard to the FASB's resolution of technical issues).

In 1984, the Foundation established a Governmental Accounting Standards Board to set standards of financial accounting and reporting for state and local governmental units. As with the FASB, the Foundation is responsible for selecting its members and exercising general oversight.

The Foundation also receives contributions and approves the FASB budget. More than half the funds contributed are from the public accounting profession, with the remainder coming from industry and the financial community.

The Foundation is separate from all other organizations. However, its Board of Trustees is made up of nominees from sponsoring organizations whose members have special knowledge of, and interest in, financial reporting. There are also Trustees-at-large not nominated by those organizations but are chosen by the sitting Trustees. The sponsoring organizations are:

- American Accounting Association
- American Institute of Certified Public Accountants
- Association for Investment Management and Research
- Financial Executives Institute
- Government Finance Officers Association
- Institute of Management Accountants
- National Association of State Auditors, Comptrollers and Treasurers
- Securities Industry Association

Weygandt, Arthur Andersen alumni professor of accounting, University of Wisconsin - Madison.

Financial Accounting Standards Advisory Council
The Financial Accounting Standards Advisory Council has responsibility for consulting with the Standards Board as to 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. At present, the Council has more than 30 members who are broadly representative of preparers, auditors, and users of financial information. Robert C. Butler, former senior vice president and chief financial officer of International Paper Company, is chairman of the Council.

How Topics Are Added to the FASB's Technical Agenda

The FASB receives many requests for action on various financial accounting and reporting topics from all segments of a diverse constituency, including the SEC. 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, liaison with interested organizations, and from recommendations from and discussions with the Emerging Issues Task Force (see page six). In addition, the staff receives many technical inquiries by letter and by telephone, which may provide evidence that a particular topic, or aspect of an existing pronouncement, has become a problem. The FASB also is alert to changes in the financial reporting environment that may be brought about by new legislation or regulatory decisions.

The Board turns to many other organizations and groups for advice and information on various matters, including its agenda. Among the groups with which liaison is maintained are the Financial Accounting Standards Advisory Council, the Accounting Standards Executive Committee and Auditing Standards Board of the AICPA, and the appropriate committees of such organizations as the Association for Investment Management and Research, Financial Executives Institute, Institute of Management Accountants, and Robert Morris Associates.

After receiving input from the constituency, 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 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 (i.e., is it transitory, or will it persist)

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, e.g., the SEC or Congress.

It is not possible to evaluate the above factors in precisely the same way and to the same extent in every instance, but identification of factors to be considered helps to bring about consistent decisions regarding the Board's technical agenda.

An Open Decision-Making Process

Actions of the Financial Accounting Standards Board 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 and in several respects is more demanding.

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.

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 document 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.

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 ensure that various points of view on the issues involved are represented on the task force.

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 document 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 Discussion Document

As a basis for both written comment and oral presentations at a public hearing, a Discussion Memorandum or other discussion document is prepared by the FASB staff with the advice and assistance of the task force. The discussion document generally sets forth the definition of the problem, the scope of the project, and the financial accounting and reporting issues; 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 document specifies a deadline for written comments and generally contains a Notice of Public Hearing. It is distributed broadly to interested parties. In some circumstances, an Exposure Draft may provide the basis for a public hearing, either initially or at a later stage in the project.

The Public Hearing

A public hearing is held to provide an opportunity for the Board and staff to ask questions about information and points of view offered by respondents. The Board announces its intent to hold a public hearing generally 60 days or more before the earliest hearing date.

Any individual or organization may request to be heard at a public hearing and the FASB attempts to accommodate all 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.

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 an exhaustive 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 is required to present written material, including analysis and recommendations, to the Board members in advance as the basis for discussion in a Board meeting. The meeting format calls for 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. 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. Five votes of the seven-member Board are required to approve an Exposure Draft for issuance.

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.

At the end of the exposure period, generally 60 days or more, 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 deliberation 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 often incorporates suggested changes in the final Statement. If substantial modifications appear to be necessary, the Board may decide to issue a revised Exposure Draft for additional public comment. In such cases, the Board also may determine that a second public hearing is necessary. When the Board is satisfied that all reasonable alternatives have been considered adequately, a vote is taken on the final Statement. Five votes are 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 dissents.

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. Because of their long-range importance, 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.

IMPLEMENTATION AND PRACTICE PROBLEMS

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 document, 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 Accounting Procedure of the American Institute of Certified Public Accountants.

Under the Rules of Procedure, proposed Interpretations must be exposed for comment for a period of not less than 30 days.

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

Technical Bulletins

Technical Bulletins issued by the FASB staff may address issues not directly covered by existing standards and may provide guidance that differs, for particular situations, from the general application required by existing pronouncements. Generally, guidance can be provided in a Technical Bulletin if it is not expected to cause a major change in practice for a significant number of companies; the cost of implementation is not expected to be significant; and the guidance does not conflict with a broad fundamental accounting principle or create a novel accounting practice. Proposed Technical Bulletins must be discussed by the Board in a public meeting prior to distribution for public comment. The comments received on proposed Bulletins must be discussed by the Board in a public meeting prior to the issuance of a final Technical Bulletin. A Bulletin may not be issued if more than two of the Board members object to the guidance in it or object to communicating that guidance by means of a Technical Bulletin.

THE PUBLIC RECORD

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 records on all projects are available for inspection in the public reference room at FASB headquarters in Norwalk, Connecticut. Copies of public records also may be purchased at prices that vary according to the volume of material that has to be copied.

AVAILABILITY OF PUBLICATIONS

To encourage public comment, Discussion Memorandums and Exposure Drafts are distributed widely through the FASB's established mailing plans. Single copies are available without charge during the comment period to all who request them. Statements of Standards, Statements of Concepts, and Interpretations also are distributed broadly when published through FASB subscription plans and may be purchased separately.

The FASB strives to keep the public informed of developments on its projects through a newsletter *(Status Report)* and a weekly notice of upcoming Board meetings and their agendas with brief summaries of actions taken at previous meetings *(Action Alert)*.

FASB Staff

The Board is assisted by a staff of approximately 40 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 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 gives the Fellows first-hand experience in the accounting standard-setting process. Fellows take a leave of absence from their firms or universities and serve as project managers or consultants on a variety of projects.

Members of the FASB

The seven members of the Board 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. Expiration dates (at June 30) of current terms are indicated in captions beneath the members' photographs.

Edmund L. Jenkins 2002

Edmund L. Jenkins was named chairman of the FASB effective July 1, 1997. He was the managing partner of the Professional Standards Group of Arthur Andersen LLP's worldwide practice. Mr. Jenkins was chairman of the AICPA's Special Committee on Financial Reporting (the "Jenkins Committee"), which published its report on improving business reporting in 1994. He served on the Emerging Issues Task Force from 1984 to 1991 and on the FASB's Advisory Council from 1991 to 1995. He holds a BA from Albion College, an MBA from the University of Michigan, and he is a CPA.

Anthony T. Cope 2003

Anthony T. Cope was director of fixed income credit research and a senior vice president and partner of Wellington Management Company before his appointment to the FASB, effective July 1, 1993. He had been a security analyst since 1963 (at Wellington since 1969), specializing in financial securities. Mr. Cope is a chartered financial analyst and was active with the Boston Security Analysts Society and the Association for Investment

Management and Research. In 1992, he was awarded the AIMR's distinguished service award. He holds a master's degree from Cambridge University.

G. Michael Crooch 2005

G. Michael Crooch was a partner with Arthur Andersen and director of the firm's International Professional Standards Group before joining the FASB on July 1, 2000. Mr. Crooch was the American Institute of CPAs' delegate to the International Accounting Standards Committee and served on the IASC's Executive Committee. He also served on the Institute's Accounting Standards Executive Committee, including three years as the Committee chairman. Mr. Crooch earned bachelor's and master's degrees from Oklahoma State University and a Ph.D. from Michigan State University. Before joining Arthur Andersen, he taught at Oklahoma State University.

John M. Foster 2003

John M. (Neel) Foster was appointed as a member of the FASB effective July 1, 1993. He had been the vice president and treasurer of Compaq Computer Corporation since 1983. Mr. Foster also has worked in public accounting and was employed by Price Waterhouse for eight years, serving clients in the energy, construction, and electronics industries. He was a member of the FASB's Advisory Council from January 1992 until his appointment to the FASB. Mr. Foster holds a bachelor's degree with honors from Colorado College were he majored in economics and was Phi Beta Kappa.

Gaylen N. Larson 2001

Gaylen N. Larson joined the FASB on July 1, 1996. He is the former group vice president and chief accounting officer of Household International, Inc. Mr. Larson joined Household in 1979 after a long career at Deloitte, Haskins & Sells. At the time of his appointment to the Board, he was a director with Coopers & Lybrand L.L.P. Mr. Larson was a charter member of the Emerging Issues Task Force and a member of the Financial Accounting Standards Advisory Council and the FASB's Financial Instruments Task Force. Mr. Larson is a graduate of Northern Illinois University and received their distinguished alumni award in 1990.

Gerhard G. Mueller 2001

Gerhard G. Mueller was the Julius A. Roller professor of accounting at the University of Washington before he joined the FASB on July 1, 1996. He had been with the University since 1960, serving in various capacities. Mr. Mueller has extensive international accounting experience. He is the author, co-author, or co-editor of 18 books on accounting, as well as numerous articles. Mr. Mueller has served as president of both the American Accounting Association and the Washington Society of CPAs. He holds BS, MBA, and Ph.D. degrees from the University of California at Berkeley.

Edward W. Trott 2004

*Edward W. Trott was appointed as a member of the FASB effective Octo*ber 1, 1999. Since 1992, he headed the Accounting Group of KPMG's Department of Professional Practice. He started his career with the firm in 1968. Before joining the Board, he had been a member of the FASB's Emerging Issues Task Force, the Financial Reporting Committee of the Institute of Management Accountants, the FASB's Advisory Council, and the American Institute of CPAs' Accounting Standards Executive Committee. Mr. Trott holds a bachelor's degree from the University of North Carolina and an MBA from the University of Texas.

Timothy S. Lucas *is director of research and technical activities, a position equal to that of a Board member. Mr. Lucas was a project manager on the FASB staff in 1979-86 and later joined Gordon Capital, an investment banking firm. Before joining the FASB staff in 1979, Mr. Lucas was an audit manager with Deloitte Haskins & Sells and was a lecturer at the Jesse H. Jones Graduate School of Administration at Rice University. He holds BA, BS, and master's degrees from Rice University and is a certified public accountant.*

Carmen L. Bailey *is assistant director of research and technical activities. She rejoined the FASB in July of 1999 from the national office of KPMG LLP where she was a partner. Ms. Bailey previously worked at the Board as a practice fellow from 1994 through 1996. During that time, she was the staff administrator for the Emerging Issues Task Force. Ms. Bailey earned a bachelor's degree in accounting from the University of the State of New York.*

James J. Leisenring *is the FASB's first director of international activities. Mr. Leisenring was vice chairman of the FASB from 1988 until 2000 and a Board member since 1987. Prior to appointment on the Board, he was the FASB director of research and technical activities and was the initial chairman of the Emerging Issues Task Force. He currently serves as chairman of the Board's Derivatives Implementation Group and its Financial Instruments Task Force. He is also chairman of the G4 + 1 and a member of the International Joint Working Group on financial instruments. He holds a BA from Albion College and an MBA from Western Michigan University, where he was a member of the accounting faculty.*

Emerging Issues Task Force

The Emerging Issues Task Force (EITF) was formed in 1984 in response to the recommendations of the FASB's task force on timely financial reporting guidance and an FASB Invitation to Comment on those recommendations. Task Force members are drawn primarily from public accounting firms but also include representatives of large companies and major associations of preparers, such as the Financial Executives Institute and the Institute of Management Accountants. The chief accountant of the Securities and Exchange Commission attends Task Force meetings regularly as an observer with the privilege of the floor. Timothy S. Lucas, FASB director of research and technical activities, is chairman of the Task Force.

Make-up of the Task Force is designed to include persons in a position to be aware of emerging issues before they become widespread and before divergent practices regarding them become entrenched. Therefore, if the group can reach a consensus on an issue, usually that is taken by the FASB as an indication that no Board action is needed. If no consensus is possible, it may be an indication that action by the FASB is necessary.

Meetings of the Task Force are open to the public and generally are attended by substantial numbers of observers. Because interest in the Task Force is high, the FASB has separate subscription plans for keeping up to date on the issues. One, *EITF Abstracts,* is a summary of the proceedings of the Task Force and includes a separate abstract for each issue considered by the EITF since its inception, plus a topical index. *EITF Abstracts* comes in a loose-leaf version, which is updated after each Task Force meeting. A soft-bound version of *EITF Abstracts,* which is updated annually, is sold separately. Copies of issue summaries and minutes also are available from the FASB either individually for a fee or as part of a combined subscription plan that also includes *EITF Abstracts*. Contact the FASB Order Department at the address listed below for subscription information.

Additional Information

General information. For further information about the FASB, including Board meeting schedules, call or write Financial Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856–5116, telephone (203) 847–0700.

To order publications. Statements, Interpretations, Exposure Drafts, and other documents published by the FASB may be obtained from the FASB Order Department at the address listed above.

Public hearings and comment letters. For information about submitting written comments on documents or about public hearings, contact the project administration department (203) 847–0700, ext. 389.

Public reference room and files. The FASB maintains a public reference room open during office hours, Monday through Friday. The public reference room contains all FASB publications, comment letters on documents, and transcripts of public hearings. Copies of this material may be obtained for a specified charge. Contact Records Retention (203) 847–0700, ext. 270, for an appointment.

Fax on demand. A fax-on-demand system is available, enabling callers to receive information either by calling from their fax machine or directing information to their fax machine. Information available through this service includes the most frequently asked-for documents. To use this fax service, call: (203) 847–0700, press 14, and follow the prompts.

FASB web site. The FASB web site includes announcements of Board actions and upcoming meetings, summaries and status of all FASB Statements and Interpretations, the quarterly plan for FASB projects, and membership information, as well as ordering information and prices of FASB documents. The web site can be accessed at either of two locations:

http://www.fasb.org

http://www.rutgers.edu/accounting/raw/fasb

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To order additional copies of this FACTS about FASB without charge, contact Public Relations at (203) 847–0700, ext. 252.

Testimony of Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
Before the Subcommittee on Commerce, Trade, and Consumer Protection
of the Committee on Energy and Commerce
July 31, 2001

Attachment 3

FASB Viewpoints, *The Meaning of Neutral Financial Reporting*

Viewpoints

The Meaning of Neutral Financial Reporting
by James J. Leisenring, Vice Chairman, Financial Accounting Standards Board

"The purpose of accounting standards is to assure that financial information is presented in a way that enables decision makers to make informed judgments. To the extent that accounting standards are subverted to achieve objectives unrelated to a fair and accurate presentation, they fail in their purpose."

SEC Chairman Richard C. Breeden
Testimony to Senate Banking Committee
September 10, 1990

Persons who study the role of financial reporting in a free-market economy will find the words of Chairman Breeden to be obvious. To try and achieve any other purpose when establishing the standards by which companies report financial information would destroy the value of the reported information, contradict the purpose of financial reporting, and potentially undermine the capital markets.

Fortunately our predecessors at the Financial Accounting Standards Board (FASB or Board) understood the role of financial reporting in our capital markets.1 The Board's mission statement indicates: "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."

Fundamental to providing information useful to readers of financial reports is that the information be neutral. Neutral information reports economic activity as faithfully as possible, without coloring the image communicated in order to influence behavior in any particular direction. Neutral information is information free from bias towards a predetermined result.

Neutrality in accounting is an important criterion by which to judge financial reporting standards, for information that is not neutral does lose credibility and value. Presumably, we would all agree there would be little value to purposely altered information about inflation, census data, or unemployment. That information would no longer be useful for decision making. If information can be verified and can be relied on faithfully to represent what it purports to represent—and if there is no bias in the selection of what is reported—it cannot be slanted to favor one set of interests over another. Remember, there are two parties in any marketplace—buyer and seller. If accounting information favors one side, it must disfavor the other. Neutral financial information may in fact favor certain interests, but only because the verifiable information points that way, much as a good examination grade favors a good student who has honestly earned it.

That is not to say that reporting neutral information will not have consequences. Of course neutral information, if relevant and useful, has consequences. To the extent that financial reporting provides information that helps distinguish between efficient and inefficient uses of resources, or helps assess relative returns and risks of alternative investment opportunities, it will discriminate between entities. When that occurs, financial information is playing an important role in both pricing capital provided or even in denying capital to some entities or for some activities. Financial reporting will be properly doing its intended job by providing the information useful in making economic decisions that result in the efficient allocation of capital across entities and activities.

Unfortunately, it is once again fashionable to suggest that the FASB should abandon the notion that decision-useful information must be neutral and should consider the "economic consequences" of its decisions. Some would even assert that the FASB should try to determine in advance who will be relatively helped or hurt by the result of applying a particular accounting standard, and consider "public policy implications" when it establishes accounting standards. In a word, bias the information reported to influence the capital allocation or other economic decisions toward some predetermined objective, thereby undermining the proper functioning of the capital markets and impairing investors' and creditors' capital allocation decisions.

The FASB must resist any inclination to try and manage or otherwise influence the capital allocation process by distorting financial information. The Securities and Exchange Commission and Congress must do the same. One of the primary reasons the United States enjoys the most efficient capital market in the world is that investors and creditors can depend on receiving relevant and reliable financial information. It is essential to our market place that the providers of capital perceive that the information they receive is credible. Protecting the public confidence in financial reporting is the goal of the FASB and the only defensible public-policy objective to be pursued by anyone interested in preserving an effective and efficient capital allocation process in a market economy. The dissemination of biased and thus potentially misleading information is bad for all interests in market-driven economies. Even a perception that the information has been manipulated may have significant adverse consequences for the cost and availability of capital.

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[1]*The points raised in this* Viewpoints *are for the most part included in FASB Concepts Statement No. 2,* Qualitative Characteristics of Accounting Information, *particularly in paragraphs 98–110.*

James J. Leisenring is Vice Chairman at the FASB. The views expressed in this article are those of Mr. Leisenring. Official positions of the FASB are determined only after extensive due process and deliberations.

Testimony of Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
Before the Subcommittee on Commerce, Trade, and Consumer Protection
of the Committee on Energy and Commerce
July 31, 2001

Attachment 4

Excerpts from Selected Letters and Other Constituent Input about the Project on Business Combinations and the Importance of the FASB's Independence

Excerpts from Selected Letters and Other Constituent Input about the Project on Business Combinations and the Importance of the FASB's Independence

"Political intervention by the Congress of the United States is likely to impede the FASB's ability to promulgate and issue standards for financial reporting that serve the capital markets of the United States. Accounting standards must faithfully represent the economic substance of business transactions and provide information in a neutral manner to all financial market participants. In the specific case of business combinations, the financial markets require an accounting standard that reports the value of those transactions regardless of the 'currency' used to effect a combination. Such a standard would provide transparency, and in turn, enhance the ability of financial market participants to assess properly the economic position and future viability of the combined enterprises these transactions produce.

. . . .

We continue to believe strongly that political intervention should be kept to a minimum with regard to setting accounting standards. Accounting standards should not be promulgated to serve the special interests of select groups of constituents or certain industries. Instead, they should serve the capital markets of the United States and those of its citizens who invest in securities directly or indirectly, through pension funds, mutual funds, and other financial intermediaries."

Gabrielle U. Napolitano, CFA, Chair, Financial Accounting Policy Committee, and Georgene B. Palacky, CPA, Associate, Advocacy, Association for Investment Management and Research (an organization of over 40,000 investment professionals), 2/23/00

"The Council applauds the FASB's deliberative process for considering this significant change. The many hearings and long period for comments has given all interested parties an opportunity to voice their opinions on the issue. The FASB's role as an independent agency is critical, and its ability to make the tough policy decisions without legislative interference is essential."

Sarah A. B. Teslik, Executive Director, Council of Institutional Investors (an association of more than 100 public, corporate and union pension funds with more than $1 trillion in investments), 2/28/00

"There is more at stake here, however, than the outcome of this particular proposal. Once again, those who object to a FASB proposal are asking members of Congress to intervene and get the proposal overturned. We are concerned that, if narrow interest groups are able to turn to Congress for relief every time they disagree with a FASB decision, the survival of FASB as an independent standard-setting body will be seriously threatened."

Barbara Roper, Director of Investor Protection,
Consumer Federation of America (an association of 260
consumer groups), 2/24/00

"Pooling and purchase accounting each have advantages and disadvantages. The primary issue here is which one provides shareholders with the most accurate picture of the combined company's value. This is precisely the kind of issue that FASB is uniquely able to resolve, and your careful process and independent, comprehensive review have produced the right result. We must not let that result be subject to political partisanship."

Nell Minow, Editor, The Corporate Library, 2/29/00

"The political jockeying taking place is due to the technology industry's apparent fear that more information available to free markets would somehow harm them – almost suggesting that they have something to hide. If a particular industry – whether semiconductors or steel – doesn't like the way capital is allocated by free markets, the right solution is not to have Congress rig the scorecard used by free market investors to allocate capital. Government intervention in setting accounting standards is simply not the solution.

In sum, I support the FASB's efforts and deplore the political intervention being sought by an industry as strong as our nation's technology sector. In free markets, capital goes where it is best served; I cannot believe that a vibrant national treasure such as our technology firms could be so harmed by an accounting rule that the capital markets would punish them unfairly. To posture accounting information this way suggests that capital markets do not value their much-vaunted innovation and collective brainpower."

Jack T. Ciesielski, President, R.G. Associates, Inc.,
Investment Research/Investment Management, 10/9/00

"High quality accounting standards must have their roots in strong conceptual foundations that can endure changing conditions. Shifting legislative agendas, which can undermine their effectiveness and credibility, as evidenced in many countries around the world, should not influence such standards. Led by the independent Financial Accounting Standards Board (FASB), the private-sector system in the U.S. is responsible for developing financial accounting and reporting standards that are widely recognized as the best in the world. Those standards contribute, in large measure, to the efficient functioning of our capital markets and the strength of our economy.

. . . [W]e continue to be committed to a standard setting process independent from government.

The current structure . . . provides for the opportunity to participate for all of financial reporting's various constituencies with differing views, and for participants to feel free to voice their opinions without fear of undue consequences. We believe government involvement in this process, however, could jeopardize the vigorous exchange of ideas in the search for solutions we enjoy today under the private-sector system."

Philip B. Livingston, President and CEO, Financial Executives Institute, 9/8/99

"The amount of time spent by the FASB, and the breadth of input that the Board solicits through due process in connection with all standards setting, is ample evidence of the FASB's effectiveness in gathering and balancing the interests of all constituencies prior to the promulgation of new accounting pronouncements. Such 'reaching out' and deliberation of all views has been demonstrated particularly convincingly by the accounting for business combinations projects.

FASB's efficient and impartial standard setting has been developed, tested and refined through the years of dedicated effort by not only the FASB and its staff, but also by those who willingly participate in the standards setting process. In light of the lack of any evidence whatsoever of ineffectiveness on the part of the FASB in carrying out its mission, we once again express very strong opposition to any initiative which would reduce its role."

William C. Nunan, World Savings and Loan Association, Chairman, the Financial Institutions Accounting Committee of the Financial Managers Society, 11/14/00

"As in other instances where significant proposed change is under deliberation, selective constituents seek a rush to legislative participation without allowing the private standard setting process to move through it's due process and develop final recommendations. I urge against such interference in a process that is recognized as the premier process in the world in setting financial accounting standards.

. . . .

The FASB seeks to set neutral standards that provide a complete and faithful picture for **investors,** and is able to make decisions without bending to changing political forces. Legislative interference in this process always carries with it the threat of lost independence and objectivity and, thus, it's viability."

R. C. Oelkers, President, Texaco International Trader Inc

“. . . I understand that hearings are going to be held about the FASB’s proposed rules for business combinations. While I disagree in an important way with the FASB’s position, I think it would be a terrible mistake to have accounting standards be set – or even influenced – by Congress.

. . . I hope that the FASB modifies its position in certain respects, but I also hope that it can make its evaluation absent any political pressures.”

Warren E. Buffett, Chairman, Berkshire Hathaway Inc., 2/16/00

“The current private sector accounting standard setting process of the Financial Accounting Standards Board (“FASB”), together with the public sector Securities and Exchange Commission, effectively promote uniformity of accounting measurement principles and full disclosure of relevant financial information. . . . This process is complete with effective and adequate public oversight; accordingly, increased legislative activity is neither required nor desirable.

We strongly support the current FASB process. Their efforts have contributed to creating the best and most effective financial accounting and reporting standards in the world.”

Robert T. Blakely, Executive Vice President & Chief Financial Officer, Lyondell Chemical Company, 3/13/00

“As Chairman of the Senate Banking Committee, I whole-heartedly support the continued independence of FASB and would be very much opposed to government intervention in the process of setting accounting standards.”

The Honorable Phil Gramm, United States Senate, 3/15/00

“Investors place their trust as well as their dollars in U.S. capital markets. That trust is a key factor in the unparalleled success and competitive advantage of our markets. The source of that trust is the knowledge that the financial reporting of U.S. companies is credible, transparent, and comparable. High-quality financial reporting depends on high-quality accounting standards and the extensive, open, and unbiased process by which they have been developed in the U.S. for over twenty-five years. It is critical that accounting standard setting remains insulated from the influence of special interest groups and politics to ensure that accounting standards, and the resulting financial reporting, continue to provide investors with an unbiased and informative picture of a company’s activities.

Congress should not politicize or interfere with the FASB’s independence and professionalism in setting accounting standards for business combinations or for any other project.”

The Honorable Clay Shaw, Owen Pickett, Collin Peterson, and Brad Sherman, United States House of Representatives (Members who have attained the professional status of licensed Certified Public Accountants), 10/5/00

"Recently, some segments of the business community, the "high-tech" sector in particular, are expressing concern about the FASB's project on business combinations. This project proposes to eliminate the 'pooling-of-interests' method to account for corporate mergers and require only the use of the 'purchase' method for all business combinations. There have been and will continue to be debates among preparers and users of financial statements over the appropriate accounting treatment for certain transactions. The AICPA believes accounting standards should be set by the private sector and is unalterably opposed to having them set by the government. Even though the SEC has the statutory authority to set accounting standards for public companies, the SEC agrees with the accounting profession that accounting standards are best set by the private sector. The capital markets will continually call upon standards-setters, preparers and users to improve and produce more transparency. This call will be reflected in future private sector projects within the accounting profession. It is a process that must proceed one step at a time following the long-established and recognized process in the private sector for project agenda setting and due process."

J. Thomas Higginbotham – Vice President, Congressional and Political Affairs, American Institute of Certified Public Accountants, 5/2/00

"We view as inappropriate the appeals by some to Congress for intervention in the FASB's well-established due process. In our opinion, congressional intervention with the current FASB project on business combinations or any other project would politicize the process and impair, if not eventually eliminate, private sector standard setting to the detriment of our capital markets."

C.S. Kulesza, CMA, CFM, President, Institute of Management Accountants, 5/1/00

". . . [I]n order to maintain the integrity of our financial markets, we believe it is critically important to maintain the setting of accounting standards in the United States in the private sector. In our view, intervention of the federal government in the setting of standards, including delaying the implementation of a standard, would seriously undermine the independence and neutrality of the Financial Accounting Standards Board.

. . . .

The development of accounting standards is best done impartially and neutrally based on a consistent framework, rather than one subject to the sway of political influence that could change from year to year. Further, government involvement in the setting of standards would unnecessarily delay the issuance of new standards that are needed to appropriately report events currently impacting businesses. Such delays would not be in the best interests of financial statement users. Finally, Congress should be guided by experience in the United States (the regulatory forebearance extended to savings and loans in the 1980s) and elsewhere in the world (the Asian crisis a few years ago) that demonstrates that government intervention in accounting and financial reporting can be harmful to the capital markets."

Ernst & Young LLP, 10/5/00

"We strongly encourage Congress and the SEC to refrain from intervention in the private standard setting process. We fully support the independence of FASB and the integrity of the private sector standards setting process and oppose legislation of accounting standards."

KPMG LLP, 2/24/00

"We strongly support the independence of the FASB and the process it uses in developing accounting standards.

. . . .

It isn't by accident that U.S. financial reporting is the envy of the world. This is true because the standards that have been produced in the private sector have resulted in financial statements that are reliable, relevant, impartial, and comparable among industries and companies. It is important to the future of financial reporting that this process remains independent and objective and free from the influence of politics."

PricewaterhouseCoopers LLP, 10/13/00

"While we welcome the ongoing healthy debate about the merits of various proposals making their way through the standard setting process, we believe that the process must remain neutral, impartial and free from undue political pressure.

. . . [W]e hope that legislation does not ensue that would remove accounting standard setting from the private sector or otherwise inject government intervention in the standard setting process. . . .

In sum, we continue to be committed to the existing private sector standard setting process."

Arthur Andersen LLP, 2/23/00

"The U.S. securities markets depend on accurate, unbiased financial information in order to operate effectively. Information provided to investors and potential investors must be totally free from political influence and the demands of special interest groups. For 30 years the FASB has operated effectively as an independent private-sector standards setter, which has contributed in large measure to the strength of the U.S. securities market. I strongly believe that the FASB's proposed standards regarding business combinations are a significant improvement in financial reporting, as they provide investors with the true cost of a business combination. Under pooling-of-interests accounting, the true economic value of consideration given a pooling-of-interests transaction is totally obscured by the use of book values to value the purchased. Requiring an acquiring company to use current market value to value an acquisition gives investors the ability to evaluate the acquisition in relation to the true value of alternative uses of the investment. Acquisitions that make economic sense will continue to happen regardless of whether or not pooling-of-interests accounting is eliminated, while economically unsound acquisitions can be totally hidden from investors through continuation of the use of pooling-of-interests accounting. Any attempt to exert political influence on the FASB's deliberations in order to benefit a limited-interest group would be a dangerous precedent that would jeopardize the entire U.S. securities market and be a giant step backwards."

Henry L. Wilson, CPA, 10/5/00

"We write to express our views regarding efforts by some industry groups to undermine the current system where accounting standards are set in the private-sector. We believe these efforts have the potential to threaten the vitality of America's capital markets.

. . . .

We urge the Congress to endorse the current system of independent, open, private-sector standard setting by qualified individuals as one of the institutional arrangements that has contributed greatly to the preeminence of U.S. capital markets and serves as a cornerstone of our financial reporting system."

Joseph H. Godwin, Ph.D., CPA, Chair, Department of Accounting and Taxation, Grand Valley State University, 1998-99 Academic Fellow, and 14 Other Former Academic Fellows in the Office of the Chief Accountant of the Securities and Exchange Commission, 10/15/99

"As current and past presidents of the AAA, we express to you our strong opinion that standard setting should remain in the private sector. We believe that the current relationship between the Securities and Exchange Commission and the FASB is in the public interest of investors, creditors, and others who rely on high quality financial information. The U.S. capital markets are the strongest in the world. This is due, in large measure, to the quality of information that supports the exchange of securities in these markets. The independence and lack of politicization that characterize our standard-setting process have resulted in great confidence by the investing community. We are, in fact, envied throughout the world with regard to both the process and outcome of our standard-setting. This has become increasingly evident as interest in developing global accounting standards has intensified."

Jan R. Williams, American Accounting Association President, University of Tennessee, and on Behalf of 9 Former AAA Presidents, 2/29/00

"The biggest reason for Congress to butt out is that it will undermine accounting standards-setting in this country. The FASB, consisting of 7 men who are experts in accounting and finance, conducts its operations in full sunshine, it hears from all constituents, and it deliberates openly and fairly. If Congress intervenes, it would damage whatever authority and credibility that FASB possesses. My advice to Congress is to leave FASB alone unless you have evidence that it is unfair in its due process. Knowing that no such evidence exists, I suggest you stick to issues such as national security, education, Medicare, and social security."

J. Edward Ketz, Associate Professor of Accounting, The Pennsylvania State University, Department of Accounting, The Mary Jean and Frank P. Smeal College of Business Administration, 10/23/00

"At the present time, a few constituents are, unfortunately, encouraging Members of Congress to intervene in the independent private-sector standard-setting process. While full public debate of the technical merits of a proposed standard is encouraged and appropriate, we do not believe that the standard-setting process should be subject to governmental intervention when, in the judgment of the Trustees of the FAF, appropriate and extensive due process procedures have been, and continue to be, followed by the FASB. Explicit or implicit threats of increased legislative activity create a real risk to the continued viability of private-sector standard setting.

As Trustees of the FAF, we strongly support private-sector standard setting, including the existing structure and processes of the FASB . . . ."

Trustees of the Financial Accounting Foundation, 5/1/00

"I believe the single most important aspect of the FASB process is its independence, free from the pressure of special interests and government intervention. The U.S. accounting and reporting standards are arguably the best in the world and have contributed significantly to investor confidence and flourishing U.S. capital markets."

Robert C. Butler, Chairman, Financial Accounting Standards Advisory Council, 4/25/00

Testimony of Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
Before the Subcommittee on Commerce, Trade, and Consumer Protection
of the Committee on Energy and Commerce
July 31, 2001

Attachment 5

Summary of Statement of Financial Accounting Standards No. 141, ***Business Combinations***

NO. 221-B ½ JUNE 2001

Financial Accounting Series

Statement of Financial Accounting Standards No. 141

Business Combinations

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Summary

This Statement addresses financial accounting and reporting for business combinations and supersedes APB Opinion No. 16, *Business Combinations,* and FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises*. All business combinations in the scope of this Statement are to be accounted for using one method, the purchase method.

Reasons for Issuing This Statement

Under Opinion 16, business combinations were accounted for using one of two methods, the pooling-of-interests method (pooling method) or the purchase method. Use of the pooling method was required whenever 12 criteria were met; otherwise, the purchase method was to be used. Because those 12 criteria did not distinguish economically dissimilar transactions, similar business combinations were accounted for using different methods that produced dramatically different financial statement results. Consequently:

- Analysts and other users of financial statements indicated that it was difficult to compare the financial results of entities because different methods of accounting for business combinations were used.
- Users of financial statements also indicated a need for better information about intangible assets because those assets are an increasingly important economic resource for many entities and are an increasing proportion of the assets acquired in many business combinations. While the purchase method recognizes all intangible assets acquired in a business combination (either separately or as goodwill), only those intangible assets previously recorded by the acquired entity are recognized when the pooling method is used.
- Company managements indicated that the differences between the pooling and purchase methods of accounting for business combinations affected competition in markets for mergers and acquisitions.

Differences between This Statement and Opinion 16

The provisions of this Statement reflect a fundamentally different approach to accounting for business combinations than was taken in Opinion 16. The single-method approach used in this Statement reflects the conclusion that virtually all business combinations are acquisitions and, thus, all business combinations should be accounted for in the same way that other asset acquisitions are accounted for—based on the values exchanged.

This Statement changes the accounting for business combinations in Opinion 16 in the following significant respects:

- This Statement requires that all business combinations be accounted for by a single method—the purchase method.
- In contrast to Opinion 16, which required separate recognition of intangible assets that can be identified and named, this Statement requires that they be recognized as assets apart from goodwill if they meet one of two criteria—the contractual-legal criterion or the separability criterion. To assist in identifying acquired intangible assets, this Statement also provides an illustrative list of intangible assets that meet either of those criteria.
- In addition to the disclosure requirements in Opinion 16, this Statement requires disclosure of the primary reasons for a business combination and the allocation of the purchase price paid to the assets acquired and liabilities assumed by major balance sheet caption. When the amounts of goodwill and intangible assets acquired are significant in relation to the purchase price paid, disclosure of other information about those assets is required, such as the amount of goodwill by reportable segment and the amount of the purchase price assigned to each major intangible asset class.

This Statement does not change many of the provisions of Opinion 16 and Statement 38 related to the application of the purchase method. For example, this Statement does not fundamentally change the guidance for determining the cost of an acquired entity and allocating that cost to the assets acquired and liabilities assumed, the accounting for contingent consideration, and the accounting for preacquisition contingencies. That guidance is carried forward in this Statement (but was not reconsidered by the Board). Also, this Statement does not change the requirement to write off certain research and development assets acquired in a business combination as required by FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method.*

How the Changes in This Statement Improve Financial Reporting

The changes to accounting for business combinations required by this Statement improve financial reporting because the financial statements of entities that engage in business combinations will better reflect the underlying economics of those transactions. In particular, application of this Statement will result in financial statements that:

- *Better reflect the investment made in an acquired entity*—the purchase method records a business combination based on the values exchanged, thus users are provided information about the total purchase price paid to acquire another entity, which allows for more meaningful evaluation of the subsequent performance of that investment. Similar information is not provided when the pooling method is used.
- *Improve the comparability of reported financial information*—all business combinations are accounted for using a single method, thus, users are able to compare the financial results of entities that engage in business combinations on an apples-to-apples basis. That is because the assets acquired and liabilities assumed in all business combinations are recognized and measured in the same way regardless of the nature of the consideration exchanged for them.
- *Provide more complete financial information*—the explicit criteria for recognition of intangible assets apart from goodwill and the expanded disclosure requirements of this Statement provide more information about the assets acquired and liabilities assumed in business combinations. That additional information should, among other things, provide users with a better understanding of the resources acquired and improve their ability to assess future profitability and cash flows.

Requiring one method of accounting reduces the costs of accounting for business combinations. For example, it eliminates the costs incurred by entities in positioning themselves to meet the criteria for using the pooling method, such as the monetary and nonmonetary costs of taking actions they might not otherwise have taken or refraining from actions they might otherwise have taken.

How the Conclusions in This Statement Relate to the Conceptual Framework

The Board concluded that because virtually all business combinations are acquisitions, requiring one method of accounting for economically similar transactions is consistent with the concepts of representational faithfulness and comparability as discussed in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information.* In developing this Statement, the Board also concluded that goodwill should be recognized as an asset because it meets the assets definition in FASB Concepts Statement No. 6, *Elements of Financial Statements,* and the asset recognition criteria in FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*.

The Board also noted that FASB Concepts Statement No. 1*, Objectives of Financial Reporting by Business Enterprises,* states that financial reporting should provide information that helps in assessing the amounts, timing, and uncertainty of prospective net cash inflows to an entity. The Board noted that because the purchase method records the net assets acquired in a business combination at their fair values, the information provided by that method is more useful in assessing the cash-generating abilities of the net assets acquired than the information provided by the pooling method.

Some of the Board's constituents indicated that the pooling method should be retained for public policy reasons. For example, some argued that eliminating the pooling method would impede consolidation of certain industries, reduce the amount of capital flowing into certain industries, and slow the development of new technology. Concepts

Statement 2 states that a necessary and important characteristic of accounting information is neutrality. In the context of business combinations, neutrality means that the accounting standards should neither encourage nor discourage business combinations but rather, provide information about those combinations that is fair and evenhanded. The Board concluded that its public policy goal is to issue accounting standards that result in neutral and representationally faithful financial information and that eliminating the pooling method is consistent with that goal.

The Effective Date of This Statement

The provisions of this Statement apply to all business combinations initiated after June 30, 2001. This Statement also applies to all business combinations accounted for using the purchase method for which the date of acquisition is July 1, 2001, or later.

This Statement does not apply, however, to combinations of two or more not-for-profit organizations, the acquisition of a for-profit business entity by a not-for-profit organization, and combinations of two or more mutual enterprises.

Testimony of Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
Before the Subcommittee on Commerce, Trade, and Consumer Protection
of the Committee on Energy and Commerce
July 31, 2001

Attachment 6

FASB Viewpoints, *Why Eliminate the Pooling Method?*

Viewpoints

Why Eliminate the Pooling Method?

by L. Todd Johnson and Kimberley R. Petrone,
Financial Accounting Standards Board

As has been widely reported in the business and financial media, the Board has proposed that all business combinations should be accounted for by one method, the purchase method, and that the pooling-of-interests method (pooling method) should be eliminated. That proposal would have significant ramifications for how future mergers and acquisitions would be accounted for. Why did Board members unanimously conclude that the pooling method should be eliminated?

Provides Less Useful Information

The pooling method produces dramatically different results than the purchase method and was not intended as an alternative to that method. However, in practice, the transactions to which the pooling method is applied are similar to those that are accounted for by the purchase method. As a result, investors are provided with less information—and less-relevant information—than provided by the purchase method. That is because the pooling method ignores the values exchanged in a business combination transaction whereas the purchase method records those values. As a result, the pooling method does not provide users of financial statements with information about how much was invested in the combination. It also does not provide them with the information they need to assess the subsequent performance of that investment and compare it with the performance of other companies.

The information that the pooling method provides about individual assets and liabilities also is less complete and less comparable than that provided by the purchase method. It is less complete because the pooling method does not record any acquired assets or liabilities that were not previously recorded and thus masks their presence, whereas the purchase method reveals those hidden assets and liabilities by recording them. Moreover, the acquired assets and liabilities that the pooling method does record are not measured on a basis that is comparable with how acquisitions generally are measured (that is, at the values exchanged in those transactions), as does the purchase method. Because the values exchanged are not recorded, management is not held accountable for either the investment made in the business combination or the subsequent performance of that investment. Moreover, subsequent rate-of-return measures are artificially inflated because the numerator (earnings) is higher and the denominator (investment) is lower.

Imposes Added Costs

The Board observed that, as a second method of accounting for business combinations, the pooling method imposes additional costs on those involved in financial reporting. The

Board acknowledged that the costs of actually applying the pooling method are usually less than those of applying the purchase method because applying the pooling method primarily involves adding together the book values in the financial statements of the companies being combined. No effort is made to identify all of the assets and liabilities acquired or to measure their fair values, as is the case with the purchase method. However, the costs of applying the pooling method do not reflect the full picture—there are other costs associated with it that also must be considered.

Costs to Users of Financial Statements

Because most business combinations are accounted for by the purchase method, the Board noted that investors and others who use financial statements must bear added costs of analysis in trying to compare the financial statements of companies that have used the pooling method with those of companies that have used the purchase method. Users of financial statements also must bear added costs of analysis in trying to compare financial statements of companies that employ the pooling method with those of companies that acquire their assets and liabilities individually or in groups rather than in business combinations.

Furthermore, investors increasingly are seeking investment opportunities globally. Because the pooling method is employed far less often outside of the United States (being either prohibited or limited to combinations such as so-called mergers of equals), investors face difficulties in comparing domestic and foreign investment alternatives if the US companies being considered have used the pooling method and the foreign companies have used the purchase method. Indeed, the growing use of the pooling method in the United States has exacerbated differences in financial statements of US and foreign companies.

The matter of financial statement comparability was the focus of one of the issues raised in the FASB Invitation to Comment, *Methods of Accounting for Business Combinations: Recommendations of the G4+1 for Achieving Convergence*. Respondents were asked whether the differences in the methods of accounting for business combinations make it difficult to compare the financial statements of companies that apply different methods. Most of those who responded to that question agreed that it did make comparison more difficult.

Costs to Companies

The Board observed that companies also bear significant costs related to the pooling method. The availability of the pooling method often puts companies under pressure to employ that method because it typically produces higher reported earnings and rates of return subsequent to the combination than the purchase method. Moreover, because the pooling method is applied *retroactively,* the comparative earnings reported for periods *preceding* the combination are also higher than under the purchase method—even before the companies were in fact combined.

As a result of those pressures, companies often must bear significant costs, both monetary and nonmonetary, in seeking to use the pooling method. In positioning themselves to try to meet the 12 criteria for applying that method, companies may refrain from engaging in appropriate economic actions that they might otherwise undertake, such as asset dispositions or share reacquisitions. They also may incur substantial fees to auditors and consultants in seeking to meet those criteria. The efforts to meet those criteria also may lead to conflicts between companies, auditors, and regulators with respect to judgments about whether the criteria have been met, thereby adding uncertainties and their attendant costs to the process, and raising questions about the operationality of those criteria.

Adversely Affects the Allocation of Economic Resources

Another issue raised in the Invitation to Comment focused on whether the markets for mergers and acquisitions are affected by the use of the pooling method compared to the use of the purchase method for accounting for business combinations. Most of those who responded to that issue agreed that the pooling method creates an unlevel playing field for companies that compete for mergers and acquisitions because the ability—or inability—to use that method affects whether they enter into those transactions and the prices that they negotiate for those transactions.

Companies that cannot use the pooling method because they cannot meet the criteria required for its use often conclude that they cannot compete for targets with those that can meet the criteria. Companies that can use the pooling method often are willing to pay higher prices for targets than they would if they had to use the purchase method because they do not have to account for the full cost of the resulting investment and the subsequent performance of that investment. Thus, by using the pooling method, they can avoid the "earnings penalty" associated with the purchase method that they believe would penalize their share prices.

Although the consideration paid in a business combination accounted for using the pooling method is in the form of shares rather than cash or other assets, the higher prices that companies making takeover offers are often willing to pay—provided that they can use the pooling method—are nonetheless real prices. Those prices must be borne by the shareholders of those companies in the form of greater dilution of their equity interests because a higher price conveys more of the equity interests in the resulting combined company to the shareholders of the target company.

Moreover, even though using the pooling method rather than the purchase method might result in being able to report higher per-share earnings following the combination, the fundamental economics are not different because the actual cash flows generated following the combination will be the same regardless of which method is used. As a result, the added earnings reported under the pooling method reflect artificial accounting differences rather than real economic differences.

To the extent that the markets respond to artificial differences, they direct capital to companies whose financial reporting benefits from those differences and away from companies whose financial reporting do not. As a result, markets allocate capital inefficiently rather than efficiently. While inefficient allocation of capital may benefit some companies and even some industries, it imposes added costs on a great many others, depriving them of capital that they need and could employ more productively. That outcome is detrimental to those companies—but more importantly, to the economy as a whole.

"Public Policy" Considerations

Many of the respondents to the Invitation to Comment urged that the pooling method be retained primarily because of what some have termed public policy considerations. Some, for example, argued that eliminating the pooling method would discourage the desirable consolidation that is now occurring in certain industries and reduce the flow of capital into certain industries, thereby stifling the entrepreneurial culture, impeding the development of new products, and impairing job growth.

The Board has from time to time heard similar arguments that accounting standards should assist in achieving certain public policy goals. However, it observed that there would have to be agreement on what those goals should be. Moreover, since those goals often change with changes in government or for other reasons, there would be questions about whether accounting standards should change every time public policy changes. Perhaps most important, if accounting standards were to become a tool for facilitating or implementing public policy, their ability to help guide policy and measure its results would be impaired.

For those reasons, the Board concluded long ago that the only public policy position that can be sustained is to maintain and enhance the integrity of accounting information so that capital market participants are on an equal footing. Indeed, one of the precepts that the Board follows in the conduct of its activities, as stated in the Board's mission statement, is as follows:

> 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.* [FASB *Rules of Procedure,* page 3]

In the context of business combinations, that means that accounting standards should not themselves seek to encourage or discourage combinations. Instead, those standards should portray the results of those combinations fairly and evenhandedly so that investors and others can form judgments about those combinations and their subsequent performance, and so that capital can be allocated efficiently in the capital markets. Those standards should not tilt the playing field to favor certain companies competing in the markets for mergers and acquisitions.

The Board concluded that those who argued that the pooling method should be retained for public policy purposes do not in fact favor neutrality and evenhandedness in financial reporting. Instead, they view accounting standards as a means for tilting the playing field and diverting capital to particular companies and industries and away from those to which that capital might otherwise flow, thereby disrupting the efficient allocation of capital in the markets.

Has a Flawed Conceptual Basis

Because the rationale that underpins the pooling method has been widely criticized, the Board considered various aspects of that rationale in reaching its decision.

Nature of Consideration

The use of the pooling method is predicated on the use of a particular form of consideration and it can only be used when the consideration is substantially in the form of stock. That is in contrast to the purchase method, which can be—and is—used regardless of the nature of the consideration tendered, whether it is in the form of cash, other assets, debt, or stock.

The Board observed that the nature of what is given up in consideration does not alter what is received in exchange for that consideration, namely, the net assets of the target company, and that the values of the assets acquired and the liabilities assumed are not dependent on the nature of the consideration tendered for them. Thus, regardless of the form of the consideration if $5 million is paid to acquire the target company and its net assets, those net assets should be recorded at that amount, even if their previous book value was $3 million.

Moreover, the consideration paid for a target company can be interchangeable. For example, new shares could be issued for cash and the cash then used to acquire the target company. Alternatively, cash could be used to purchase treasury shares and those shares then used to acquire the target company. The net result would be that the consideration can be viewed as either cash or stock. However, if the pooling method is used in the second scenario (the purchase method would have to be used in the first), the net assets would be recorded at different amounts, depending on the sequence of the transactions.

Furthermore, if the net assets are recorded at the book value in the records of the acquired enterprise rather than at the values actually exchanged, a hidden reserve would be created in the amount of that difference. That hidden reserve would ultimately inflate future earnings, either gradually over time by means of lower reported expenses or when those net assets were sold by increasing the reported gain on sale. In either case, the combined company would report earnings that it did not earn but, rather, obtained from the hidden reserve. For example, if A acquired B (whose net assets have a book value of $10 million) for $100 million, use of the pooling method would result in creating a hidden reserve of $90 million. Assuming no other changes, if A later sold B for $100 million, A would report a $90 million gain that it did not earn. Alternatively, if A later sold B for $60 million, A would report a $50 million gain, even though economically it would have suffered a $40 million loss.

Owner Involvement

The pooling method is based on the assumption that the business combination is a transaction between the owners of the combining companies and that the companies themselves and their managements are essentially little more than interested bystanders. The Board observed that that assumption is contrary to fact because corporate mergers and acquisitions are negotiated between the managements of the companies themselves. Shareholders rarely have any role at all in those negotiations and frequently first hear of the deal when it is announced to the general public, at which time it is presented to them for their approval as a *fait accompli.*

Continuity of Ownership Interests

The pooling method is also based on the assumption that ownership interests are continued following the combination. That is, the owners of the combining companies decide to cast their lots with each other and go forward together. The Board observed, however, that holdings can and often do change following business combinations (often soon afterward) and that owners may sell their interests in the combined company for a variety of reasons. Owners of target companies, for example, may seize the opportunity to cash in their gains, and owners of both the acquiring and target companies may decide that the resulting combined company does not fit the needs of their investment portfolios and sell their interests.

The Board further observed that even if predecessor ownership interests are continued following a business combination, they are no longer the *same* interests. That is because the owners of the predecessor companies were exposed to risks and rewards that are likely to have been quite different from those associated with the combined company. Moreover, the ownership interests themselves change following the combination, as the owners of the target company own a smaller share of a larger company following the combination.

"Mergers of Equals"

Some have argued that the pooling method is appropriate only for what are variously described as "true mergers," "mergers of equals," or combinations in which the acquirer cannot be identified and therefore its application should be limited to those combinations. The Board further noted that, to the extent that the pooling method is permitted in jurisdictions outside of the United States, it commonly is used only on that basis (although what constitutes "equals" is interpreted differently in different jurisdictions).

The Board therefore considered limiting the use of the pooling method to such transactions. However, it concluded that mergers of true equals are so rare that they may never occur. Instead, one of the predecessor companies can be seen as surviving the combination and thus can be viewed as the acquiring company. Thus, business combinations are acquisitions and should be accounted for as such.

The Board also concluded that even in a merger of equals, it does not necessarily follow that the book values of the predecessor companies should be carried forward into the combined company. Instead, a method under which the net assets of all combining companies are recorded at their fair values might more appropriately reflect the consequences of the transaction. That is because a merger of equals can be viewed as one in which a new economic and accounting entity has been created and none of the predecessor companies has survived the combination.

Changing Applications of the Method

Transactions that the pooling method is used to account for today are quite different than those for which it originally was conceived. Those transactions typically were where the principal change was that of legal form rather than of economic substance, such as when a parent company combined two of its wholly owned subsidiaries. Today, however, the pooling method is routinely used to account for transactions in which the economic substance has changed. Indeed, those transactions are among the most significant economic events that occur in the histories of the combining companies, if not *the* most significant event in their histories. Such sharply disparate applications of the method raise doubts about the soundness of its underlying rationale.

In view of that, together with its assessments of other aspects of the rationale that underlies the pooling method, the Board concluded that the conceptual basis of that method is flawed. That basis essentially is a means of rationalizing a desired end result, which is to report higher earnings without having to earn them, rather than a sound basis that distinguishes between real economic differences that are relevant in making investment and credit decisions.

The Board's Decision

Based on its conclusions that the pooling method (1) provides information that is less useful than that provided by the purchase method, (2) imposes added costs on users of financial statements and the companies that prepare those statements, (3) adversely affects the allocation of economic resources, and (4) has a flawed conceptual basis, the Board decided that the pooling method should be eliminated. In the final analysis, acquisitions—whether they are of individual assets, groups of assets, or entire businesses—should be recorded in the same way, based on the value of what is given up in exchange for them, regardless of whether that is cash, other assets, debt, or equity shares. The pooling method does not do that, but the purchase method does.

L. Todd Johnson is a senior project manager at the FASB. Kimberley R. Petrone is a project manager at the FASB. The views expressed in this article are those of Mr. Johnson and Ms. Petrone. Official positions of the FASB are determined only after extensive due process and deliberations.

Why Eliminate Pooling?

- The pooling method provides investors with less information—and less-relevant information—than that provided by the purchase method.
- The pooling method ignores the values exchanged in a business combination, while the purchase method reflects them.
- Under the pooling method, financial statement readers cannot tell how much was invested in the transaction, nor can they track the subsequent performance of the investment.
- Having two methods of accounting makes it difficult for investors to compare companies when they have used different methods to account for their business combinations.
- Because future cash flows are the same whether the pooling or purchase method is used, the boost in earnings under the pooling method reflects artificial accounting differences rather than real economic differences.
- Business combinations are acquisitions and should be accounted for as such, based on the value of what is given up in exchange, regardless of whether it is cash, other assets, debt, or equity shares.

Testimony of Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
Before the Subcommittee on Commerce, Trade, and Consumer Protection
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July 31, 2001

Attachment 7

Excerpts from Selected Letters and Other Constituent Input about the Project on Business Combinations and the Elimination of the Pooling-of-Interests Method

Excerpts from Selected Letters and Other Constituent Input about the Project on Business Combinations and the Elimination of the Pooling-of-Interests Method

"We are writing you not only to express our views, but also to speak on behalf of thousands of investment professionals, current and potential investors, creditors, and other users of financial statements.

. . . .

The FAPC is unequivocal in its support of the FASB's proposal that there be only one method of accounting for business combinations in the United States. We also agree that the purchase method is the one that reflects properly the economics of all business combinations, and that pooling-of-interests should be eliminated.

. . . .

The pooling method fails to revalue the assets and liabilities of the acquired enterprise at fair value and the excess, commonly called 'goodwill,' is not recorded. Hence, pooling does not faithfully represent the values of the assets and liabilities exchanged, nor does it reveal the actual premium paid by the acquirer in the transaction. Users of financial statements are thus impeded in their attempts to understand the underlying economics of the business combination."

Gabrielle U. Napolitano, CFA, Chair, Financial Accounting Policy Committee, Georgene B. Palacky, CPA, Associate, Advocacy, Association for Investment Management and Research (an organization of over 40,000 investment professionals), 2/23/00

"'*Moody's supports the objectives of accounting standards setters to improve the harmonization of accounting standards globally, and welcomes the FASB's proposal to eliminate the pooling of interests method. We believe that a single method can improve analytic efficiency, especially in cases where a single transaction or essentially identical transactions would produce dramatically different accounting results, and thus enhance the ability of cross border capital market participants to compare, easily and accurately, alternative investments.'*"

Michael R. Foley, Managing Director, Corporate Finance, Moody's Investors Service, 3/6/00

"Taking an overall view of the document, I think the Board should be applauded for taking on such a project. There are few areas in the current accounting literature that need reform more than business combination accounting . . . .

. . . .

I believe that the financial reporting that results from a pooling transaction is flawed and provides irrelevant information to users. When one company acquires another, the amount of resources used by the acquirer is relevant information for the acquirer's shareholders. That relevant information is provided by the purchase method; it would reflect the fair value of the business combination on the acquirer's balance sheet. Treating an acquisition as a pooling would show the acquiree's basis in the assets transferred, which says nothing about the way the acquirer used its shareholder resources.

If generally accepted accounting principles legitimately allowed buying companies to record the seller's cost in the inventory, equipment or land that they acquire, no serious user of financial statements would have respect for the results. Yet pooling legitimizes such an accounting treatment, on a grand scale, when *all* of the assets of a firm have been acquired. It's an inconsistency in GAAP that should be remedied by this proposed Statement."

Jack T. Ciesielski, CPA, CFA, President, R.G. Associates, Inc., Investment Research/Investment Management, 11/29/99

"The Council of Institutional Investors, an association of more than 100 public, corporate and union pension funds with more than $1 trillion in investments, supports the Financial Accounting Standards Board's proposal to eliminate the pooling-of-interests method of accounting for business combinations.

. . . .

While neither accounting method is perfect, the purchase method offers a number of benefits for investors. First, it reflects fair market values involved in a deal; pooling only considers book values. Second, it improves comparability of deals in the U.S. and abroad, where purchase accounting is the predominant standard. Finally, it eliminates the use of pooling as a defense against other combination proposals."

Sarah A.B. Teslik, Executive Director, Council of Institutional Investors, 2/28/00

"Over the last decade, a tidal wave of merger activity has swept through nearly every corner of the American economy. According to the Federal Trade Commission, the number of federal pre-merger filings has nearly tripled since the beginning of the decade, from 1,529 in 1991 to an estimated 4,500 last year. The market value of those mergers has risen even more dramatically, from $600 billion in the previous peak year of 1989 to more than $2 trillion in 1998. And several factors, not least passage this year of the financial modernization legislation, lead us to conclude that this activity is unlikely to abate any time soon. Ensuring that investors get complete and accurate information about the effects of mergers is, thus, a timely and important issue for the Financial Accounting Standards Board to tackle.

. . . .

Some, particularly in the high tech and financial services industries, have argued that mergers and acquisitions will grind to a halt if the proposal to eliminate use of the pooling method of accounting is adopted. Leaving aside the accuracy of that argument – which is certainly subject to debate – it is worth examining its underlying assumptions. In essence, this argument presupposes that many of the mergers being conducted or considered today would not go forward if investors had access to the more complete, accurate information provided under the purchase method of accounting. But surely, mergers that cannot withstand careful investor scrutiny should not be promoted, and certainly not at the cost of distorting the information provided to investors.

CFA believes the proposal to require the use of the purchase method of accounting for all business combinations would improve the ability of investors to make sound investment decisions and, by extension, would contribute to the efficient functioning of the capital markets. For these reasons, CFA urges the proposal's approval."

***Barbara Roper, Director of Investor Protection,
Consumer Federation of America (an association of 260
consumer groups), 11/30/99***

"I write in support of FASB's proposal to eliminate the pooling-of-interests method of accounting for business combinations.

. . . .

Pooling permits companies to disregard the substantial value of goodwill, eliminating charges that impose a crucial discipline. It encourages short-term maneuvering that can distort the real consequences of a deal and make mergers seem deceptively attractive. In this era of over-managed earnings, we must be deeply cautious about manipulation of accounting practices. The result is paper profits, not real profits, quick gains, not real growth."

Nell Minow, Editor, The Corporate Library, 2/29/00

"The prohibition of the pooling method is consistent with our position that share-for-share transactions should be accounted for as purchases. We believe that it is important to have the fair value of the exchanged shares recognized in the financial statements of the combined enterprise. The purchase method is much more revealing about the (1) economic nature of the transaction that has taken place, (2) the transaction values involved, and (3) the transaction's effect on the continued operations and financial position of the combined entity. Moreover, the purchase method will provide financial statement users with essential information that will better enable them to:

(1) assess the economic benefits and risks of M&A transactions; and
(2) forecast the amount, uncertainty, and timing of the combined enterprise's future cash flows and reported earnings with greater accuracy."

Gabrielle U. Napolitano, CFA, Chair, Financial Accounting Policy Committee, Ashwinpaul C. Sondhi, Subcommittee Chair – Business Combinations, Georgene B. Palacky, CPA, Associate, Advocacy, Association for Investment Management and Research (an organization of over 40,000 investment professionals), 12/7/99

"IBM agrees with the FASB that all business combinations are acquisitions and, thus, we support the FASB's proposal to eliminate the pooling-of-interests method of accounting for a business combination. We believe that financial statement users are ill-served by the existence of two methods to account for the same economic transaction. We agree with the FASB that using the purchase method to account for all business combinations will increase the comparability of financial statements and will reflect the true economics of the transaction, that is, an arm's length investment that should be accounted for at the fair value of the assets and liabilities that are acquired."

Joseph J. Martin, Office of the Assistant Controller, Corporate Headquarters, IBM Corporation, 12/7/99

"We agree with the Board's decision that the pooling-of-interests method should not be used to account for any business combination."

Peter R. Bible, Chief Accounting Officer, General Motors, 12/14/99

"We agree with the elimination of the Pooling of Interests method of accounting for a business combination and fully support the directive to use only the purchase method of accounting for all business combinations . . . ."

R. R. Gallagher, Corporate Controller, Caterpillar, Inc., 12/1/99

". . . IMC agrees with the Financial Accounting Standards Board (Board) that all business combinations are acquisitions, and therefore, are accounted for by using the purchase accounting method. As a result the pooling-of-interests method should be eliminated from use."

Anne M. Scavone, Vice President and Controller, IMC Global Inc., 12/7/99

"We agree with the Board's conclusion that all business combinations should be accounted for by the purchase method. . . . In particular, we agree with the Board's assessment that shareholders of the target enterprise typically enjoy an increase in the value of their exchanged shares following a pooling that the other shareholders do not. Further, we believe that control over the assets has changed (even though it is accomplished through a sharing arrangement) and, therefore, the purchase method is the appropriate basis of accounting under the circumstances."

William H. Hernandez, Senior Vice President, Finance, PPG Industries, Inc., 12/7/99

"We support the concept of getting rid of pooling accounting. We have dealt with business combinations for over 20 years, with hundreds if not thousands of deals. Without exception there is always a buyer and always a seller. There may be 'mergers of equals,' but we have never seen one in our professional practice."

Alfred M. King, Chairman of the Board, Valuation Research Corporation, 9/30/99

"FIAC is a group of 15 financial professionals working in executive level positions in the thrift and banking industries and is sponsored by the Financial Managers Society. FIAC's primary responsibility is to evaluate those accounting and regulatory matters that affect financial institutions.

. . . FIAC members concur with the decision to eliminate pooling of interests as a method of accounting for business combinations. We believe it is clearly desirable to have only one method to account for the same type of transaction and that the purchase method provides investors and analysts with more useful information."

Remee Nichols Tucei, EVP, Controller, California Federal Bank, Chairman, Financial Institutions Accounting Committee, Financial Managers Society, 12/6/99

"Overall, we support issuance of the proposed Statement. We agree with the Board's conclusion that all business combinations are acquisitions. We also agree that using a single method – the 'purchase' method – to account for all business combinations is preferable to various alternatives."

Timothy J. Stier, Chief Accountant, Office of Thrift Supervision, Department of the Treasury, 12/6/99

“The Department agrees with treating all business combinations as acquisitions, thereby eliminating the need for the pooling-of-interests method. The complexities of meeting the pooling criteria justify the FASB’s decision to eliminate a separate accounting method for rare true ‘mergers of equals.’ The Department cautions against providing any exception to the purchase method. Any exception that permits a poolings approach will be seized upon and result in numerous attempts to meet the exception. This would effectively eviscerate this proposal.”

John McEnerney, New York State Banking Department, 12/17/99

“One of the objectives that the Council of the American Institute of CPAs established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms’ interests in professional issues, primarily through the Technical Issues Committee (“TIC”). This communication is in accordance with that objective.

. . . .

TIC members agree with the Board’s conclusion that all business combinations are acquisitions and that the pooling-of-interests method should be eliminated. This view is based on the same reasons set forth in paragraphs 143 to 153 of the exposure draft.”

Candance Wright, Chair, PCPS Technical Issues Committee, American Institute of CPAs, 12/14/99

“We support the FASB’s decision to require the purchase method of accounting for all business combinations. The current criteria that determine whether the pooling or purchase method should be applied to a particular combination are arbitrary and can be manipulated to give the desired result. However, the differences in the resulting accounting can be significant.”

Grant Thornton LLP, The US Member Firm of Grant Thornton International, 12/8/99

“I favor eliminating pooling. In my view, basic accounting theory says that the cost of any asset, as measured by the consideration given, be it cash, common stock, other securities, or other assets, should be recorded and charged against future operations over the period benefited. Failure to require that allows the acquirer to spend assets without accounting for them. In my view, it has led to many acquisitions that are unsound or where an excessive price in stock was paid. It may be argued that the acquirer’s’ stock is selling for more than it is worth and the acquirer should not be penalized by having to charge the excess against its earnings over time. Yet the stock could have probably been sold for cash for the same amount. Who would say that the company should not have to account for the excess cash received over fair value on a stock sale?”

Stanley F. Dole, Certified Public Accountant, 12/4/99

"The Financial Accounting Standards Board has decided to put an end to the Pooling-of-Interests accounting method . . . , whereby a rather expensive common-stock-financed deal may be dressed up like a great bargain because instead of recording on the financial statements the market value of the stock (and God knows, we have had by now years of quite lofty stock prices), the purchaser opted to copy over the obsolete figures appearing on the books of the acquired company.

The FASB decision to require recording all acquisitions at actual cost—the so-called Purchase accounting method—no matter how they were financed (by cash, stock, a combination thereof, etc.) will enhance the transparency of major business transactions entered into by public companies in the U.S. and usher in greater uniformity and consistency in their financial reporting."

Itzhak Sharav,
Graduate School of Business,
Columbia University

"Some make the various but overstated claim that the elimination of pooling will negatively affect the economy and result in loss of jobs and needed advances in technology and medicine. These claims ignore the fundamental economics driving business combination, and the current practice of permitting different accounting treatments for similar combinations leads to information that is not as transparent and useful to investors as it could be.

The academic literature provides little support for the use of pooling as an economically superior alternative. Indeed, the literature suggests that firms pay an average premium of sixty million dollars to structure a transaction as a pooling in order to obtain that method's ability to manage earnings. Davis (1996) concludes that acquisitions accounted for with the purchase method are associated with higher stock returns than are mergers accounted for with the pooling method. This suggests that pooling masks the economics of transactions, encouraging managers to pursue low-quality mergers/acquisitions. Loughren and Vijh (1997) examines post-combination benefits to target firm shareholders who received shares of an acquirer's stock (a condition for pooling) and finds that any premium received dissipates over the subsequent five-year period." (footnotes omitted)

Joseph H. Godwin, Ph.D., CPA, Chair, Department of
Accounting and Taxation, Grand Valley State University,
1998-99 Academic Fellow, and 14 other former Academic
Fellows in the Office of the Chief Accountant of the
Securities and Exchange Commission, 10/15/99

"As one of the original dissenters to APB 16 I am enthusiastically in agreement with the conclusions in Issue 3 [to eliminate the pooling method]. The dissent of Messers

Horngren, Seidman and myself to that Opinion, spells out in some detail our reasons for requiring the purchase method for all business combinations. I would not change a word of it."

Sidney Davidson, Distinguished Service Professor Emeritus of Accounting, Graduate School of Business, The University of Chicago, 9/24/99

"Undoubtedly the longest running con game in U.S. financial reporting is the pooling-of-interests method of accounting for business combinations. As accountants know, this procedure carefully adds irrelevant historical-cost book values in the acquired company's accounts to equally irrelevant historical-cost book values in the acquiring company's accounts. As noted in the FASB's June 1997 report on combinations, most of the rest of the world actually or virtually bans this deceptive practice."

J. Edward Ketz, Associate Professor of Accounting, The Pennsylvania State University, Department of Accounting, The Mary Jean and Frank P. Smeal College of Business Administration, 3/2/00

"To begin with, I wholeheartedly concur with the FASB's conclusions that all business combinations should be accounted for as a purchase. I agree with the FASB's conclusions that pooling is contrary to the accounting model that assets and liabilities are initially recorded at fair value. Furthermore, the financial community values these transactions as well. Any announcement in the financial press about a pending merger or acquisition is accompanied by the phrase, 'in a deal valued at $xx.' To me, the obvious question is, if the financial community is already valuing these transactions, why don't the financial statements?

I know that the FASB will or has received statements from some of its constituents that without pooling accounting sound acquisitions simply can't be done. I am not swayed by these claims. These types of claims have been made in the past and history has shown that it is not the accounting that makes or breaks the deal. If the deal makes sense economically, it can get done. Conversely, however, if the deal does not make economic sense, then purchase accounting will make that readily apparent. As similar analogy is the FASB's deliberations leading to the issuance of SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.* At the time FASB was deliberating this issue, there were claims about this standard leading to the end of these benefits. I think it is generally accepted that companies have curtailed these benefits since the issuance of the document. However, I think that a cogent argument can be made that it was not the accounting that caused these reductions of benefits. Rather, it was the fact that companies had to measure and report their liabilities that caused them to examine the economic consequences of the benefits which had been promised.

To me, it seems highly likely that the same phenomenon will occur with a purchase-only model. Companies will have to more closely examine the purchase price decisions and ‘sharpen their pencils’ to make sure that the deal makes economic sense since the consequences would be more transparently reported in the financial statements.”

Paul Munter, PhD, CPA, Department of Accounting, University of Miami, 12/7/99

“We agree with the Board’s conclusion that the pooling-of-interest method should be eliminated and all business combinations should be accounted for using the purchase method. Using two different methods for what is essentially the same transaction can be confusing to many investors. The pooling-of-interest method ignores the values exchanged in a business combination. This makes it difficult for investors to tell what price was paid for the business. It would be better to have one standard so that it is easier for investors to understand the transaction and have the ability to compare companies.

Allen W. McConnell, Professor of Accounting, University of Northern Colorado, and the Advanced Accounting Class, 12/6/99

Testimony of Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
Before the Subcommittee on Commerce, Trade, and Consumer Protection
of the Committee on Energy and Commerce
July 31, 2001

Attachment 8

Summary of Statement of Financial Accounting Standards No. 142,
Goodwill and Other Intangible Assets

NO. 221-C ½ JUNE 2001

Financial Accounting Series

Statement of Financial Accounting Standards No. 142

Goodwill and Other Intangible Assets

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Summary

This Statement addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, *Intangible Assets.* It addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This Statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements.

Reasons for Issuing This Statement

Analysts and other users of financial statements, as well as company managements, noted that intangible assets are an increasingly important economic resource for many entities and are an increasing proportion of the assets acquired in many transactions. As a result, better information about intangible assets was needed. Financial statement users also indicated that they did not regard goodwill amortization expense as being useful information in analyzing investments.

Differences between This Statement and Opinion 17

This Statement changes the unit of account for goodwill and takes a very different approach to how goodwill and other intangible assets are accounted for subsequent to their initial recognition. Because goodwill and some intangible assets will no longer be amortized, the reported amounts of goodwill and intangible assets (as well as total assets) will not decrease at the same time and in the same manner as under previous standards.

There may be more volatility in reported income than under previous standards because impairment losses are likely to occur irregularly and in varying amounts.

This Statement changes the subsequent accounting for goodwill and other intangible assets in the following significant respects:

- Acquiring entities usually integrate acquired entities into their operations, and thus the acquirers' expectations of benefits from the resulting synergies usually are reflected in the premium that they pay to acquire those entities. However, the transaction-based approach to accounting for goodwill under Opinion 17 treated the acquired entity as if it remained a stand-alone entity rather than being integrated with the acquiring entity; as a result, the portion of the premium related to expected synergies (goodwill) was not accounted for appropriately. This Statement adopts a more aggregate view of goodwill and bases the accounting for goodwill on the units of the combined entity into which an acquired entity is integrated (those units are referred to as reporting units).
- Opinion 17 presumed that goodwill and all other intangible assets were wasting assets (that is, finite lived), and thus the amounts assigned to them should be amortized in determining net income; Opinion 17 also mandated an arbitrary ceiling of 40 years for that amortization. This Statement does not presume that those assets are wasting assets. Instead, goodwill and intangible assets that have indefinite useful lives will not be amortized but rather will be tested at least annually for impairment. Intangible assets that have finite useful lives will continue to be amortized over their useful lives, but without the constraint of an arbitrary ceiling.
- Previous standards provided little guidance about how to determine and measure goodwill impairment; as a result, the accounting for goodwill impairments was not consistent and not comparable and yielded information of questionable usefulness. This Statement provides specific guidance for testing goodwill for impairment. Goodwill will be tested for impairment at least annually using a two-step process that begins with an estimation of the fair value of a reporting unit. The first step is a screen for potential impairment, and the second step measures the amount of impairment, if any. However, if certain criteria are met, the requirement to test goodwill for impairment annually can be satisfied without a remeasurement of the fair value of a reporting unit.
- In addition, this Statement provides specific guidance on testing intangible assets that will not be amortized for impairment and thus removes those intangible assets from the scope of other impairment guidance. Intangible assets that are not amortized will be tested for impairment at least annually by comparing the fair values of those assets with their recorded amounts.
- This Statement requires disclosure of information about goodwill and other intangible assets in the years subsequent to their acquisition that was not previously required. Required disclosures include information about the changes in the carrying amount of goodwill from period to period (in the aggregate and by reportable segment), the

carrying amount of intangible assets by major intangible asset class for those assets subject to amortization and for those not subject to amortization, and the estimated intangible asset amortization expense for the next five years.

This Statement carries forward without reconsideration the provisions of Opinion 17 related to the accounting for internally developed intangible assets. This Statement also does not change the requirement to expense the cost of certain acquired research and development assets at the date of acquisition as required by FASB Statement No. 2, *Accounting for Research and Development Costs,* and FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method.*

How the Changes in This Statement Improve Financial Reporting

The changes included in this Statement will improve financial reporting because the financial statements of entities that acquire goodwill and other intangible assets will better reflect the underlying economics of those assets. As a result, financial statement users will be better able to understand the investments made in those assets and the subsequent performance of those investments. The enhanced disclosures about goodwill and intangible assets subsequent to their acquisition also will provide users with a better understanding of the expectations about and changes in those assets over time, thereby improving their ability to assess future profitability and cash flows.

How the Conclusions in This Statement Relate to the Conceptual Framework

The Board concluded that amortization of goodwill was not consistent with the concept of representational faithfulness, as discussed in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information.* The Board concluded that nonamortization of goodwill coupled with impairment testing *is* consistent with that concept. The appropriate balance of both relevance and reliability and costs and benefits also was central to the Board's conclusion that this Statement will improve financial reporting.

This Statement utilizes the guidance in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements,* for estimating the fair values used in testing both goodwill and other intangible assets that are not being amortized for impairment.

The Effective Date of This Statement

The provisions of this Statement are required to be applied starting with fiscal years beginning after December 15, 2001. Early application is permitted for entities with fiscal years beginning after March 15, 2001, provided that the first interim financial statements have not previously been issued. This Statement is required to be applied at the beginning of an entity's fiscal year and to be applied to all goodwill and other intangible assets recognized in its financial statements at that date. Impairment losses for goodwill and indefinite-lived intangible assets that arise due to the initial application of this Statement (resulting from a transitional impairment test) are to be reported as resulting from a change in accounting principle.

There are two exceptions to the date at which this Statement becomes effective:

- Goodwill and intangible assets acquired after June 30, 2001, will be subject immediately to the nonamortization and amortization provisions of this Statement.
- The provisions of this Statement will not be applicable to goodwill and other intangible assets arising from combinations between mutual enterprises or to not-for-profit organizations until the Board completes its deliberations with respect to application of the purchase method by those entities.

Testimony of Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
Before the Subcommittee on Commerce, Trade, and Consumer Protection
of the Committee on Energy and Commerce
July 31, 2001

Attachment 9

FASB Viewpoints, *Why Did the Board Change Its Mind on Goodwill Amortization?*

Viewpoints
Status Report Feature

Why Did the Board Change Its Mind on Goodwill Amortization?

by L. Todd Johnson, FASB Senior Project Manager and Kimberley R. Petrone, FASB Project Manager

At its meeting on December 6, 2000, the Financial Accounting Standards Board tentatively decided that all goodwill acquired in business combinations *should not be amortized* but instead should be reviewed for impairment. As a result, income statements would not be charged except when goodwill is deemed to have been impaired. Because goodwill often is one of the largest assets recorded in business combinations, that would be a dramatic change not only from the present requirements of APB Opinion No. 17, *Intangible Assets,* but also from what the Board proposed in its Exposure Draft, *Business Combinations and Intangible Assets*.[1] Why did the Board change its mind?

Actually, the Board *did not* "change its mind." It had explicitly stated in the Exposure Draft that, conceptually, some goodwill may have an indefinite useful economic life that could be as long as that of the company itself. However, Board members believed that there were some barriers to accounting for goodwill as a nonwasting asset and thus not amortizing it and only testing it for impairment. What really changed since the Exposure Draft is that they were able to overcome those barriers.

The barriers to a nonamortization approach mainly stemmed from three views:

1. That impairment reviews of purchased goodwill have to be conducted at the level of either the acquired company or the acquiring company as a whole (that is, an entity-level review)
2. That impairment reviews should follow a two-step approach, with the first step being based on undiscounted cash flows
3. That any purchased goodwill having a finite useful economic life must be amortized.

The changes in those views were facilitated by certain constituents that offered specific suggestions about how goodwill might be reviewed for impairment and by those that participated in field visits exploring how those reviews might work. With their assistance, Board members gained the insights necessary to overcome those barriers.

Board members also learned that the amortization charge for goodwill had little, if any, information value to most investors and that operating management generally was not held responsible internally for goodwill. However, the investment in the asset, goodwill, was important to both investors and management. Those insights motivated the Board to develop an approach that would produce information that was more useful to investors and management in making their decisions.

The Level at Which to Conduct Reviews

One important insight concerned the level at which impairment reviews of purchased goodwill are to be conducted. Goodwill does not generate cash flows by itself, only in concert with other assets. Because recorded goodwill is a residual, determining the cash flows associated with goodwill generally involves comparing the cash flows of the entity as a whole with those of its assets other than goodwill. Thus, if the acquired company remains a stand-alone unit after the acquisition, the cash flows of that entity can be compared with those of its other assets.

Acquirers, however, usually integrate acquired companies into their own operations to realize the synergies that they sought in making the acquisitions. As a result, the purchased goodwill becomes intermingled with the acquirer's recognized goodwill from other acquisitions and its unrecognized internally generated goodwill. In those cases, Board members believed that comparing the cash flows of the acquirer as a whole with those of its assets other than goodwill would be too broad a test.

In the Exposure Draft, the Board indicated that purchased goodwill consisted of two "core" components: (1) "going concern" goodwill that relates to the acquired company as a stand-alone entity and (2) "synergistic" goodwill that arises from combining the assets of the acquired company with those of the acquirer. However, many Board members believed that the benefits associated with purchased goodwill related principally to the acquired company's assets, not to the acquirer's assets, and that it therefore consisted primarily of the first component. They believed that reviewing purchased goodwill for impairment in the context of the acquirer as a whole would introduce too much extraneous "noise" into the process.

As a result, the Board considered the possibility of conducting the reviews at a somewhat lower level, on the basis of the acquirer's segments, along the lines of segment reporting under FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*. That would reduce the noise somewhat—although not eliminate it—and that was the model that the Board explored in its field visits. During those visits, however, Board members learned that much, if not most, of what is paid for goodwill in many acquisitions today relates to synergistic goodwill rather than going concern goodwill. That is because an acquiree's technologies, know-how, and the like can be leveraged by the acquirer, with the consequence being that the benefits of the purchased goodwill can be extended to the acquirer's assets.

That leveraging often does not extend to the acquirer as a whole or to its reporting segments, however, but rather to lower-level reporting units. Indeed, field visit participants indicated that they commonly assign purchased goodwill to those units. For example, 70 percent of the purchased goodwill in a given acquisition might be assigned to Reporting Unit A and 30 percent to Reporting Unit B, with none being assigned to Reporting Units C, D, or E, even though all were part of the same reporting segment. The Board therefore concluded that relating purchased goodwill to reporting units would significantly reduce the amount of noise that otherwise might be present in the impairment review. In effect, the reporting unit becomes the *unit of account* for purposes of impairment reviews rather than the acquired company, a reporting segment of the acquirer, or the acquirer as a whole. Accordingly, that conclusion overcame one of the major barriers to nonamortization.

Consistency with Statement 121

Board members also questioned the ability of impairment reviews to be used as the sole means of accounting for goodwill subsequent to its acquisition, especially if those reviews were to be consistent with FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*. Because they are based on anticipated cash flows, impairment reviews inherently involve a considerable degree of subjectivity. That subjectivity, however, is compounded with goodwill because the cash flows relating to it may extend many years into the future, much longer than is the case with most assets. Thus, impairment reviews based on undiscounted cash flows, as under Statement 121, might not be sensitive enough to detect many impairments of goodwill, particularly if those cash flows are expected to increase over time.

In the Exposure Draft, the Board proposed a different approach for impairment reviews than that under Statement 121 for other purchased intangible assets that have indefinite economic lives. Under that "one-step" approach, the recognition of an impairment loss would be based on the fair value of the assets without first performing the recoverability test,[2] which would be inconsistent with—and thus an exception to—Statement 121. (However, consistent with Statement 121, the impairment losses would be measured as the excess of the carrying amount over fair value.) Given the similarities of goodwill to those intangible assets, together with the reduction of the noise associated with impairment reviews of goodwill, the Board concluded that the intangible asset impairment approach proposed in the Exposure Draft should be extended to purchased goodwill, thereby overcoming another barrier to nonamortization.

Amortizing Finite-Lived Goodwill

Since not *all* goodwill is nonwasting, Board members believed that some goodwill would have to be amortized. For example, in some instances, the acquired entity is a mature "cash cow" that will be milked dry, and its goodwill therefore has a finite life. Moreover, because recognized goodwill is a residual, it can include certain tangible and intangible assets that are wasting and thus should be amortized. However, Board members believed that distinguishing the portion of goodwill that is wasting from that which is nonwasting would not, as a general rule, be feasible. As a result, the Board—like the Accounting Principles Board before it—concluded that, as a practical matter, goodwill should be amortized.

Many respondents to the Exposure Draft stated, however, that while goodwill might decrease over time, it does not do so in the "rational and systematic" manner that periodic amortization suggests. Instead, its pattern of decline is irregular, being sharp in some periods, less so in other periods, and perhaps nonexistent in yet other periods. Moreover, although the economic life of goodwill might be finite, predicting with any degree of accuracy what that life will be is virtually impossible. As a result, those respondents argued that amortization is not representationally faithful of the pattern of decline.

Board members agreed with that view. They noted that the refinements made during the redeliberation process to the criteria for recognizing other intangible assets would result in most intangible assets that are wasting being recognized separately from goodwill rather than being subsumed into it. Thus, what is included in goodwill is more likely to be nonwasting—that is, capable of being replenished or able to maintain its value. Board members also noted that since the Board had developed an impairment review that it believed would be sufficiently rigorous to be used for goodwill that has an indefinite life, that same test should be sufficiently rigorous to use for any portion of goodwill that might have a finite life. As a result, there no longer was a need to distinguish any portion of goodwill that might be wasting from that which is nonwasting, thereby eliminating the last barrier.

The End Result: An Improvement in Financial Reporting

By overcoming the barriers to nonamortization, the Board believes that the impairment model that it has now developed to account for purchased goodwill is superior to the one in Opinion 17, as well as to the one that it proposed in the Exposure Draft. As a result, the Board believes that the financial statement information that will result from applying the goodwill impairment model will be both more relevant and more reliable, and thus more decision useful—which is consistent with the objectives of financial reporting.

[1]In the September 1999 Exposure Draft, the Board proposed that any goodwill acquired in business combinations being accounted for by the purchase method should be amortized as an expense over its useful economic life, not to exceed 20 years. That proposed requirement was similar to the current requirement under Opinion 17 except for the maximum period of amortization, which is 40 years under Opinion 17.

[2]Under that recoverability test, an impairment is deemed to have occurred if the carrying amount of the asset or group of assets in question exceeds the undiscounted future cash flows expected to be generated by it.

The views expressed in this article are those of Mr. Johnson and Ms. Petrone. Official positions of the FASB are determined only after extensive due process and deliberations.

Testimony of Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
Before the Subcommittee on Commerce, Trade, and Consumer Protection of the Committee on Energy and Commerce
July 31, 2001

Attachment 10

Excerpts from Selected Letters and Other Constituent Input about the Project on Business Combinations and the Nonamortization of Goodwill

Excerpts from Selected Letters and Other Constituent Input about the Project on Business Combinations and the Nonamortization of Goodwill

"We believe the ED represents a significant advance in the accounting in this area, in that it more closely aligns the accounting with the economics of a purchase business combination. As we have noted in the past, we believe that the key element of goodwill is the synergies that are expected from combining the assets of the two companies, and that business combinations are effected with the expectation that this value will increase over time. Accordingly, we support the basic proposal of the ED, which recognizes that goodwill is not a wasting asset, and therefore should not be charged off systematically via amortization, but rather should be periodically tested for impairment."

Esther Mills, Director, Accounting Policy, Merrill Lynch & Co., Inc., 3/16/01

"We agree with the fundamental conclusion in the ED that goodwill is a not a wasting asset if a reporting unit is able to maintain its value. We believe the proposed nonamortization approach with periodic review for impairment more closely mirrors economic reality than the arbitrary, straight-line amortization approach currently used and proposed in the 1999 Exposure Draft. We therefore generally support the basic premise of the ED."

Peggy H. Capomaggi, Managing Director – Accounting Policy, Bankers Trust Company, 3/30/01

"We agree with the Board that goodwill should not be amortized under any circumstances, but instead should be reduced in value when it is impaired. We believe this approach will enhance the credibility and utility of financial reporting for business combinations."

Sarah G. Smith, Managing Director, Principal Accounting Officer, and Paul Efron, Managing Director, Investment Banking Division, The Goldman Sachs Group, Inc., 3/16/01

"As expressed in more detail in our June 16, 2000 and December 22, 2000 letters on this subject, we fully agree with the direction the Board has taken on this subject. We believe that replacing the goodwill amortization with periodic impairment testing will result in a significant improvement in the quality and usefulness of reported financial information and will cause reported net income to present a much clearer and more transparent picture of the profitability of reporting companies."

Thomas S. Johnson, Chairman and CEO, Greenpoint Financial, 3/16/01

"We agree that goodwill is not a wasting asset and amortization should not be required to be recorded. This proposal will produce more useful financial information, as evidenced by the fact that company internal profitability analyses and industry analysts' comparisons of companies' results of operations generally focus on cash or operating earnings, rather than reported earnings.

The proposal will increase comparability of financial statements of companies within industries, as well as comparison of companies across different industries."

Steven G. Elliot, Senior Vice President and Chief Financial Officer, Mellon Financial Corporation, 3/14/01

"The approach of not amortizing goodwill, as proposed in the Revised Exposure Draft, is consistent with our previous comment letters. In our prior comments, we urged the Board to eliminate the systematic amortization of goodwill. We believe that an impairment approach to accounting for goodwill provides far more meaningful information to the users of financial statements than does the current amortization approach. We are pleased to note that many of the reasons cited by the Board in the Revised Exposure Draft for adopting an impairment approach are similar to the supporting rationale that we provided in our earlier comment letters."

Casey J. Trumble, Senior Vice President, Tax & Reporting, Lincoln National Corporation, 3/16/01

"We agree with the Board's proposal that goodwill would not be amortized but reduced when it is impaired. We believe this approach reflects the economic reality and promotes transparency in reporting."

Dennis D. Powell, Vice President, Corporate Controller, Cisco Systems, 3/15/01

"We agree that goodwill is generally not a wasting asset and that the proposed non-amortization will result in more useful financial reporting."

Connie D. McDaniel, Vice President and Controller, The Coca-Cola Company, 3/16/01

"We agree that goodwill is not a wasting asset if a reporting unit is able to maintain the value of goodwill and that the proposed non-amortization will result in more useful information."

Michael P. Coghlan, Vice President, Controller and Chief Accounting Officer, and Kim Adamson, Assistant Controller, Financial Reporting and Accounting, Coca-Cola Enterprises Inc., 3/15/01

"In general, we support the revisions proposed to the original exposure draft. We agree that goodwill balances should be subject to impairment reviews, particularly in light of the proposed nonamortization approach."

Douglas Shuma, Corporate Controller, Baxter International Inc., 3/15/01

"We agree with the Board's conclusion that goodwill should not be amortized. To the extent that some portion of goodwill would be deemed to be a wasting asset, we strongly believe that these amounts are more than replaced by internally generated goodwill and goodwill-like assets that are not recognized on our balance sheet today. These internally generated intangibles are an outgrowth of our acquisition activity and include items such as intellectual property, worldwide distribution capability and our brand. The market clearly values these 'unrecognized intangibles' as evidenced by the difference between Aon's market capitalization and its book value."

Patrick G. Ryan, Chairman and Chief Executive Officer, Aon Corporation, 3/27/**01**

"We agree with the Board's conclusion that goodwill is not a wasting asset if a reporting unit is able to maintain the value of goodwill. We also agree with the Board's conclusion that requiring all goodwill *not* to be amortized (but reduced in value when it is impaired) will result in more useful financial reporting."

William H. Hernandez, Senior Vice President, Finance, PPG Industries, Inc., 3/15/01

"We concur with the Board's view that amortization of goodwill is not appropriate for financial reporting purposes if the book value of goodwill is equal to or less than the value of total goodwill. Because there is no evidence that goodwill declines in value systematically over a specific period of time, an impairment approach will minimize income statement distortion and provide better and more useful information."

John Doerr, Partner, Kleiner Perkins Caulfield & Byers, and James L. Barksdale, Managing Partner, The Barksdale Group, The Technology Network, 3/16/01

"AGA supports the Financial Accounting Standards Board's efforts to improve the accounting and reporting for goodwill. AGA agrees that goodwill is not a wasting asset and should not be required to be amortized. Acquired goodwill may have an indefinite useful economic life, as it is replaced with internally generated goodwill resulting from reduced costs and synergies achieved as a result of a business combination. While some goodwill might decrease over time, periodic amortization is not representative of its pattern of decline. Recording goodwill charges in the income statement only when goodwill is impaired, rather than on a systematic basis over an arbitrary period of time, will result in financial statements that are more relevant and comparable."

Richard Bange, Chairman, Accounting Advisory Council, American Gas Association, 3/16/01

"EEI believes that requiring all goodwill not to be amortized, but to be tested for impairment, is a logical conclusion by the FASB. The impairment testing approach should permit flexibility in the level at which goodwill is tested for impairment that allows for differences as appropriate from company to company and industry to industry. To assign an arbitrary life to goodwill misrepresents the underlying economic life that at origination of the goodwill is generally indeterminable."

David K. Owens, Executive Vice President, Business Operations, Edison Electric Institute, 3/16/01

"We appreciate the FASB's efforts to reach out to affected constituencies like APTC's members and to address the shortcomings in the treatment of goodwill under purchase accounting. We commend the FASB for this thoughtful proposal and offer our general support for the impairment approach to the treatment of goodwill . . . ."

Robert S. Merritt, Chairman, and Brian T. Borders, President, Association of Publicly Traded Companies, 3/15/01

"The Board's major decisions on this topic—to prohibit the use of pooling and not to require the amortization of goodwill but to test it for impairment—are a constructive solution to a major and long-lasting problem. More than thirty years ago in our dissents to Accounting Principles Board Opinions 16 and 17 Charles Horngren and I specifically called for an end to pooling and an end to the required amortization of goodwill. I commend the Board for having come to a logical conclusion on this important issue."

Sidney Davidson, Distinguished Service Professor of Accounting Emeritus, Graduate School of Business, The University of Chicago, 3/7/01

"I enthusiastically support the substance of the revised limited Exposure Draft 'Business Combinations and Intangible Assets – Accounting for Goodwill.' I think the new position of requiring goodwill to remain as an asset subject to periodic impairment evaluation will produce the best possible reporting to users on this contentious topic. Coincidentially, the Board's new position is essential what I proposed in my op ed piece published in the Financial Times of London on December 4, 1997."

Dennis R. Beresford, Ernst & Young Executive Professor of Accounting, J.M. Tull School of Accounting, Terry College of Business, The University of Georgia, 3/5/01

"'I want to congratulate the FASB for its innovative solution to a very difficult problem. . . . This is a solution that makes sense economically and will improve the quality of American accounting standards.'

. . . .

'Rather than having a mechanical approach that forces a company to write off goodwill, the FASB has found a common-sense solution in the impairment test' . . . ."

The Honorable Phil Gramm, United States Senate, 12/6/00

Testimony of Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
Before the Subcommittee on Commerce, Trade, and Consumer Protection
of the Committee on Energy and Commerce
July 31, 2001

Attachment 11

FASB Status Report, *Conversations with Constituents*

No. 221-A / June 29, 2001

Financial Accounting Series

Financial Accounting Standards Board
Serving the investing public through transparent information resulting from high-quality financial reporting standards, developed in an independent, private-sector, open due process.

Status Report

(Status Report No. 337)

Conversations with Constituents

Introduction

In this issue of *Status Report,* we feature *Conversations with Constituents* in which we consider a current issue on the Board's agenda. In this case, we focus on the two new standards on business combinations and conduct a question-and-answer session with members of the Board's constituencies.

The FASB recently had an opportunity to speak with two FASAC members: Fred Anderson, Executive Vice President and Chief Financial Officer, Apple Computer, Inc., and Ray Krause, National Director of Accounting, McGladrey & Pullen, LLP. FASB Board member Mike Crooch spoke with Fred and Ray about their views on the Board's decisions on the business combinations project that culminated in the issuance of Statement No. 141, *Business Combinations,* and Statement No. 142, *Goodwill and Other Intangible Assets*.

Mike Crooch: Fred and Ray, we all have been around the standard-setting process for a long time. We are well aware that accounting standards are set by boards or committees. Those boards and committees are made up of individuals who obviously will have, at times, differences of opinion about what a standard should say and how it should be applied. Speaking as a Board member, what happens in standard setting is that one may not agree with certain aspects of a standard but agree with others. In the final analysis, one must decide whether the standard, taken as a whole, represents a significant improvement over the current rules. This approach is critical to voting in favor of issuing the standard, even though it may not be 100 percent of what you might have wanted it to be.

In the case of business combinations, as the record will show, certain Board members disagreed with various aspects of the proposal, but when it came down to the final analysis, the Board voted unanimously to issue the standards. I would guess there are certain aspects of the standards with which you don't agree.

Q: What I would first like to focus on is the FASB's two new standards and hear your impressions of them. What is your overall reaction to the two new standards, and do you believe they provide a significant improvement over the current rules?

Fred Anderson: I believe the standards are a significant improvement. The Board undertook a deliberate process over the course of several years. I know the Board issued several documents for public comment and held numerous meetings and hearings. The Board also did some field testing and probably evaluated hundreds of comment letters. So, I think the deliberative process did result in important changes to the final statements on business combinations and intangible assets. Some of those changes probably were compromises to help build the consensus and support; but I believe eliminating pooling and having one consistent method of accounting for acquisitions—purchase accounting—will bring greater standardization, consistency and transparency from a financial statement user standpoint. So, overall I think it is positive.

Ray Krause: I believe the new standards will lead to an eventual improvement in financial reporting. I think that more intangible assets will be identified compared to what happens under the current rules. I think it will be helpful to have more definite criteria to consider in identifying those intangibles. As we noted in our comment letter on the revised Exposure Draft, we still do not agree with the decision not to amortize goodwill. We believe that goodwill is a wasting asset and not amortizing it is tantamount to effectively capitalizing newly generated goodwill—but that's our view. I know others had that same view but, on balance, the Board considered all of the comments, and I respect the decision of the Board. Certainly, the process was carried out the way it should be carried out.

We also felt that the comment period on the revised Exposure Draft was too short. Given the importance of the topic and the fact that the revised Exposure Draft was issued at the busiest time of the year, we couldn't respond as completely as we wanted to. However, I know that many other comment letters were very thorough and complete. I also respect the pressure the Board was under to complete the project by June 30, before the pending Board changeover.

Mike Crooch: We believe that most people were aware of part of the reason for the short exposure period and the desire to complete the project by June 30. We experienced a significant turnover in Board members, with three Board members leaving by the end of June. Clearly, the timeframe that we used was one that we considered very carefully.

Q: Do you think that the new standards will impact the level of merger activity now that the pooling method of accounting is being eliminated?

Fred Anderson: It is my belief that the elimination of pooling may have a negative impact on a very limited number of marginal deals. Overall, I think companies will continue to pursue mergers and acquisitions that are of strategic importance and that provide a good return on investment over the long term.

Ray Krause: In a conceptual world it really shouldn't matter whether an acquisition is accounted for as a "purchase" or a "pooling." If the economics make sense, the parties should do the deal. But, we also know that many mergers are predicated on the ability to use pooling accounting. And if the transaction does not qualify as a pooling, there often will be either a cessation of the merger negotiations or a repricing of the deal. It seems that if you have a company that is "poolable," it commands a premium, which really leads me to conclude that purchase accounting is appropriate for all of these transactions. I am absolutely in agreement with the Board that purchase accounting is the right answer. I had expected a flurry of merger activity within the last six months, when it became apparent that pooling would no longer be acceptable after June 30. But, I think that the general decline in stock prices has had a more chilling effect on companies proceeding with merger discussions.

Mike Crooch: One aspect that the Board has covered in the new rules is strengthening the criteria for separate recognition of intangible assets.

Q: Do you think we will see more intangible assets being recognized under the standards? Are we better off if we have these intangibles separately identified?

Fred Anderson: Yes, we will be better off if the information is disclosed in detail. In recognizing the intangible assets separately from goodwill, I think the new standards will provide more useful information with respect to the value and purpose of an acquisition because many times the real reason for the acquisition is related to the intangibles. Now, it is true that current accounting standards already require the recognition of many types of acquired intangible assets, and probably the amortization of many such assets will continue under the new standards, but I believe that there will be more intangibles separately identified under the new standards.

Ray Krause: I think a difficult aspect will be assessing whether identifiable intangibles—not constrained by a contractual life—have an indefinite life. I think it remains to be seen how much pressure there will be on allocating more amounts to identifiable intangibles with an indefinite life and, thus, not amortized versus to an intangible asset that would be amortized.

Mike Crooch:

Q: Don't you agree that there are some intangibles that are candidates for that category, such as trademarks, for example, that really don't have a discernible end to their useful lives?

Ray Krause: I think there are some, but I just don't know how big a population that represents. I guess an example would be an acquisition of Coca Cola and a Coke trademark. I think that fits the definition of an identifiable intangible asset with an indefinite life.

Fred Anderson: In my opinion, the approach for intangible assets with indefinite lives seems reasonable, particularly because it's consistent with the approach taken for goodwill. However, I would agree with Ray. I think that the number of such intangible assets that would be treated like goodwill and not amortized would be fairly limited in number.

Mike Crooch: During the course of the project, we heard that many people who use financial statements ignore goodwill amortization. In fact, one of the reasons that some Board members became comfortable with not amortizing goodwill was because many analysts told us that they don't actually take goodwill amortization into consideration as part of their analysis of a company. Some have wondered whether impairment losses also will be ignored.

Q: Do you believe impairment losses will be ignored by analysts?

Fred Anderson: Impairment losses will probably be factored out of short-term profitability analysis—much as goodwill amortization is today. However, I think impairment events will provide a clear indication to financial statement users as to the health of the acquired asset. I don't believe such information is always apparent under current accounting requirements. I would say that this additional information, if there is an impairment writedown, will often be extremely useful to the financial statement users.

Ray Krause: I suppose the question would be better answered by analysts, but I would hope that impairment losses would not be ignored. I say that because the recognition of an impairment of goodwill or other intangibles is an indication that things are not going well with that reporting unit. If a part of the business is not doing well, that could affect the entire business, and investors should be concerned about that.

Mike Crooch: The revised Exposure Draft included what some have referred to as a relatively narrow definition of a reporting unit. We received many comments that the level of the reporting unit was too low—that the Board was creating yet another level of measurement and analysis. Many people suggested that we move to the criteria and definitions on segments that are in Statement 131. The Board concluded that the reporting unit should be the operating segment or one level below.

Q: Does the reporting unit approach strike you as being operational and better than what the Board proposed in the revised Exposure Draft?

Fred Anderson: Identifying the reporting units consistent with Statement 131 is good. It means that identifying the reporting units will not be difficult because we are doing that today. I think the guidance offered by the Board will probably allow companies a degree of flexibility in identifying reporting units to the extent that they can modify their own internal reporting and assessment process, as is appropriate.

Ray Krause: Had the Board stopped at the operating segment and not gone any further, that might have made it easier to apply. You can pare down one level below that; and in a lot of situations, that is going to take you down to a divisional level which may not be a whole lot different than what the Board proposed in the original Exposure Draft. I don't know whether this distinction, in practice, will ultimately prove to be as significant as the Board may have thought. Didn't most of the respondents suggest that the Board stop at the operating segment?

Mike Crooch: Yes, but many others, in fact, indicated that companies would likely have to go one step lower in the measurement process. Some indicated that they would be able to go even lower than one level below the operating segment. However, the Board concluded that if certain conditions are met, the reporting unit is one step below the operating segment—otherwise the operating segment is the reporting unit.

Making the decision on the reporting unit level caused the Board to consider carefully what we thought would be an appropriate impairment test, and here we had to work very hard to balance the ability to isolate goodwill that is impaired with the cost that must be incurred in order to bring about that measure. What we finally decided on was a two-step impairment test. The first step is to compare the fair value of the reporting unit against its recorded net assets, including goodwill. If the fair value exceeds the recorded amount, you stop there and assume that goodwill is not impaired. However, if you fail that test, then you must use that fair value of the reporting unit as an assumed purchase price, and do a purchase price allocation to the reporting unit to determine the implied fair value of the goodwill. If the implied value of the goodwill is less than the carrying amount of goodwill, an impairment is recorded to account for the difference.

Q: Will that methodology isolate goodwill impairments soon enough, given the balance that we wanted to strike between the accuracy of the measurement and the cost that would be incurred?

Fred Anderson: Yes, I think the approach will allow companies to avoid the more costly detailed measurement steps if they can demonstrate that the overall value, as you said, of the reporting unit is greater than its carrying value. I think the approach is very reasonable. I also believe that acquisition accounting is well known to everyone and provides a reasonable and demonstrable process for testing the valuation of goodwill.

Ray Krause: I would say the Board's approach is an improvement over the original proposal. What I am somewhat troubled by is the determination of fair value for a business unit. I am much more comfortable with fair value of separate, identifiable assets and liabilities; but when it comes to the business unit, that embodies a premium that we call goodwill. After an exchange transaction, I am concerned that the ability to determine that amount of fair value will be a problem for auditors as well as preparers.

Mike Crooch:

Q: How much more trouble is determining fair value under the new rules than it was under the old rules?

Ray Krause: Good question. When there is a problem you look at the cash flows that the business unit is expected to generate either gross or on a discounted basis. I just don't think that under the old rules, one attempted to replicate an exchange transaction, as we are trying to do under the new rules. It was probably a cruder estimate, but I think equally as effective, and of course that was also offset by the continuous amortization of that intangible which begins to mitigate the big "blips" that may appear on the radar screen with the impairment approach. I am just very concerned that in practice, it is going to be a bit like what happened with restructuring accruals, despite the noble efforts of the EITF to try to curb that a bit and the SEC trying to help the process along as well in SAB 100. But, I think that when things aren't looking good, there is going to be every reason to be as aggressive in that impairment writedown as one could possibly be.

Mike Crooch: You've led us into the next obvious question with that comment. That is, we have noted concern that companies will do a lot of "cleaning house" with the adoption of the new set of standards.

Q: Do you envision that there will be a significant amount of goodwill being written off upon adoption of the new standards?

Fred Anderson: I don't expect that the adoption of the standards will necessarily result in a significant number of impairment loss writedowns. The standards do alter how such impairment losses are going to be determined, and it does require a thorough, transitional impairment test; but because most companies do not currently review the value of their intangible assets as rigorously as will now be required, there is certainly the possibility that there will be transitional impairment losses. But, I don't think they are going to be significant in number.

Ray Krause: Given where we are at now with the new set of standards, it would be less than what it would have been under the revised Exposure Draft approach. But, then I realized that you have also provided an opportunity for companies that didn't exist in the revised Exposure Draft. That is to take the transition adjustment as a cumulative effective change in accounting policy, below the operating income line, which gives every incentive for companies to carefully consider whether there is the need for an impairment writedown, and have that writedown escape being reported as part of operating income. So, I think that you may have helped to bait the trap in how you have allowed the transition to proceed in this area.

Mike Crooch: One of the other controversial decisions we made was to require that the standards—with the exception of the elimination of pooling—be adopted as of the beginning of a company's fiscal year. We did make an effort to give companies the ability to adopt it earlier if they were willing to satisfy the criteria—that is, if a company has not yet issued its first quarter financial statement. We received a lot of comments that it would be better to have the non-amortization criteria for goodwill start at the beginning of the fiscal year. Some companies were not very happy with that decision.

Q: What do you think about the approach of starting at the beginning of the fiscal year?

Fred Anderson: I believe it is a good decision. It should make the fiscal year data more comparable and allow companies more time to prepare for the adoption. I think most companies also will disclose in the interim filings—prior to the adoption of the Statement—the estimated impact of adoption, which will allow the financial statement users to make valid comparisons between companies that already adopted and those that have not.

Ray Krause: I also concur with the decision that the Board made on the effective date of the standard.

Mike Crooch: My own sense is that the process works. We received a lot of input from our field visits. In fact, I gained a lot of insight about how management views goodwill and how often internal management is held accountable for the amount invested in an acquisition, which includes goodwill without amortization. So, we learned a lot through this process. Frankly—from my perspective—the process worked even though not everybody is happy with all aspects of both standards.

Q: Ray, you commented earlier on the short exposure period for the revised Exposure Draft, and we appreciate your views. Do you or Fred have any other general thoughts about the Board's deliberations on this project or any suggestions for ways to improve the process?

Fred Anderson: I think this issue—the elimination of pooling as an acceptable method of accounting for a business combination—had the potential to be very explosive. The Board showed incredibly good judgment in having a very deliberative process in trying to build a consensus behind it. Through this process the Board averted the potential for a situation similar to what happened several years ago with accounting for stock options. I think this is a significant improvement over both APB 16 and 17. It is a credit to the Board that they took the time and effort to build consensus.

Ray Krause: Which standards have the Board issued that everybody agrees with entirely? There is always some piece of most every statement that somebody finds to dislike.

Mike Crooch: I agree with that, as I mentioned in my opening comment. That is why at the end of the process you have to decide whether the improvement provided by the new standard is enough to compensate for the parts that you don't like.

Ray Krause: I think the process once again has proven to work. There is every reason to believe that all views of constituents were considered. I believe there will be Monday-morning quarterbacking on the decision not to amortize goodwill. There are going to be those who view that decision as a political compromise. But, it is a decision that the Board made and we respect it.

Mike Crooch: Fred and Ray, we appreciate your taking the time to talk with us.

Testimony of Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
Before the Subcommittee on Commerce, Trade, and Consumer Protection
of the Committee on Energy and Commerce
July 31, 2001

Attachment 12

Articles about the FASB and the Project on Business Combinations

Articles about the FASB and the Project on Business Combinations

1. Michael Rapoport and Phyllis Plitch, "FASB Move on Goodwill May Have Far-Reaching Effects," *Dow Jones News Service*, December 7, 2000

2. Floyd Norris, "Can Regulators Keep Accountants From Writing Fiction," *New York Times*, September 10, 1999

3. Editorial, "Firms Avoid Revealing Costs," *USA TODAY*, July 3, 2000

4. Amy Kover, "Big Banks Debunked," *Fortune,* February 21, 2000

5. Shawn Tully, "It's Time for Merger Mania II," *Fortune,* May 21, 1999

6. Michael Davis, "Why the Case for Pooling-of-Interests Accounting Is All Wet," *Barron's*, October 21, 2000

7. Floyd Norris, "Merger Accounting: Fiction on Wall Street," *New York Times*, April 26, 1999

8. Shawn Tully, "The Earnings Illusion," *Fortune,* April 6, 1999

9. Mike McNamee, "What Could Burst The Net's Merger Bubble," *Business Week*, March 1, 1999

10. Matthew Goldstein, "The Pool Is Drying Up," *Smart Money.com,* August 23, 2000

Testimony of Edmund L. Jenkins
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July 31, 2001

Attachment 13

Members of the FASB's Business Combinations Task Force

Business Combinations Task Force Roster

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Vice President and Comptroller
General Electric Company

Mr. Peter R. Bible
Assistant Comptroller & Chief Accounting Officer
General Motors

Mr. Larry R. Carter
Senior Vice President, CFO
Cisco Systems, Inc.

Mr. Errol Cook
Managing Director
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Mr. Jeff Priest
Amajac Capital Corporation

Mr. Hal Rogero
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Business Combinations Task Force Observers

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Mr. Ron Salole
Canadian Institute of Chartered Accountants

Testimony of Edmund L. Jenkins
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Financial Accounting Standards Board
Before the Subcommittee on Commerce, Trade, and Consumer Protection
of the Committee on Energy and Commerce
July 31, 2001

Attachment 14

Report of the FASB, *International Accounting Standard Setting: A Vision for the Future*

INTERNATIONAL ACCOUNTING STANDARD SETTING:

A Vision for the Future

Report of the FASB

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INTERNATIONAL ACCOUNTING STANDARD SETTING: A VISION FOR THE FUTURE

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ACKNOWLEDGMENTS

The principal author of this report is Carrie Bloomer, assistant project manager. E. Raymond Simpson, senior project manager, developed the text of Appendix B. The ideas and conclusions expressed in this report result from extensive consultation with members of the FASB and members of the Board of Trustees of the Financial Accounting Foundation and from their agreement on the final content of this report.

FASB staff member Alison Miller provided valuable editorial and administrative assistance in the preparation of this report.

INTRODUCTION

The evolution of a global society brings many implications for what, in the past, have been considered areas of strictly national authority or responsibility. It is increasingly difficult to think of an aspect of business that remains untouched by some level of international influence. As technology and the desire to tap the demands of nondomestic markets bring us closer together, formal and informal international groups are springing up to deal with demands for effective cooperation, for forums for national representation and input on international matters, for efficiency of global activities, for exchanging ideas internationally, and for conflict resolution. Existing organizations, whether national or international, are challenged to continually assess the relevance of their objectives, structures, and processes in the context of the international system of the future. Those that do not do so risk obsolescence in a global society.

Financial reporting and accounting standard setting are not immune to the changing times. We are beginning to see the emergence of a truly international accounting system—the emergence of international-level organizations and cooperative ventures among national organizations in the areas of accounting standard setting and financial statement preparation, auditing, regulation, and analysis—to deal effectively with the merging of national and international financial reporting issues. Today's U.S. accounting standard-setting structure and process reflects the increasingly international dimensions of the FASB's role as a global leader in accounting standard setting.

This report discusses how the FASB's role may continue to evolve and how its structure and process may change over time in the context of the FASB's objective and goals for participating in the international accounting system of the future. It includes a discussion of that objective and related goals, a vision of the international accounting system of the future, a discussion of the characteristics of high-quality accounting standards, and a discussion of the minimum functions and characteristics of a quality international accounting standard setter. It was developed with a view to the future as it pertains to the FASB's role in national and international accounting standard setting.

Recognizing its need to be actively involved as the international accounting system evolves and its potential to provide leadership in meeting market demands for high-quality international accounting standards, the FASB and its oversight body, the Financial Accounting Foundation (FAF), have expressed joint support for the content of this report. During many months of discussions on international strategic policy, the FASB and the FAF reached general agreement on a number of key points that underlie much of what is expressed in this report, including the following:

- The FASB has a leadership role to play in the evolution of the international accounting system and is guided by the belief that, ideally, the ultimate outcome would be the worldwide use of a single set of high-quality accounting standards for both domestic and cross-border financial reporting.
- Until that ideal outcome is achieved, the FASB's objective for participating in the international accounting standard-setting process is to increase international comparability while maintaining high-quality accounting standards in the United States. To achieve that objective, the FASB is willing to commit the required resources to the related goals of (1) ensuring that international accounting standards are of high quality and (2) increasing the convergence and quality of the accounting standards used in different nations.
- The FASB believes that the establishment of a quality international accounting standard-setting structure and process is key to the long-term success and development of international accounting standards. The FASB will participate in establishing that structure and process. The FASB accepts that an increasing and substantial level of resources might be required to support and influence the establishment of that organization.
- The FASB acknowledges that, if a quality international accounting standard-setting structure and process emerges, the FASB's commitment and desire to participate in a meaningful way in the operations of that standard setter may ultimately lead to

structural and procedural changes to the FASB as well as potential changes in its national role.

The vision of the international accounting system of the future set forth in Appendix A is intended to provide a context for the discussion of the FASB's objective and goals. It is one of many possibilities for the future and may be a useful tool with which to envision the FASB's future role as a result of pursuing the objectives. The FASB recognizes that it is not possible to predict the future. Others may or may not agree on whether the vision is an accurate one or whether different scenarios are more likely. In any scenario, however, the FASB believes that for an international accounting system to be successful, establishment of a quality international accounting standard setter is imperative.

Appendix B discusses the attributes of high-quality accounting standards, and Appendix C of this report includes a description of the functions and characteristics that the FASB believes are necessary to a quality international accounting standard setter in the future, including an independent decision-making structure, adequate due process, and sufficient technical capabilities to develop high-quality international standards. Some of the functions and characteristics described in Appendix C differ from the functions and characteristics of the existing structure of the International Accounting Standards Committee (IASC). Nevertheless, the FASB believes that the objectives and vision in this report and the objectives for structure reform of the IASC recently published in an IASC Discussion Paper, *Shaping IASC for the Future,* are consistent. However, the FASB cannot predict whether an international accounting standard-setting structure and process that meet those objectives will emerge from the proposals to reorganize the IASC. Thus, the objectives and vision presented are also consistent with other possible alternatives, including the possibility that the FASB might reorganize itself to become an international standard setter or that an alternative international structure and process could be established that meets the FASB's fundamental objectives.

U.S. capital markets are the envy of the world. They are the deepest, broadest, and most liquid anywhere. That is in no small part because of the confidence provided by the credibility and thoroughness of our financial accounting and reporting. Financial reporting is credible in the United States in part because of the independence of the FASB's accounting standard-setting process from any special interests and the thoroughness of its due process, which works to balance the interests of all the FASB's constituents. 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. In carrying out that mission, the FASB creates accounting standards that promote transparency with the goal of providing the consumers of financial statements—principally investors and creditors—with the best possible financial information for making economic decisions. The FASB believes that the substance of that mission is equally valid—even essential—in the international arena.

This report has been published to convey the FASB's intention to maintain its leadership role in standard setting and to ensure that the standards used in U.S. capital markets, whether developed by the FASB or an international standard-setting organization, are of the highest possible quality. That can only be accomplished by a strong commitment to an active role in the establishment of both international accounting standards and national accounting standards.

OBJECTIVE AND GOALS FOR THE FASB'S PARTICIPATION IN THE INTERNATIONAL ACCOUNTING SYSTEM OF THE FUTURE

Introduction

Changes are taking place in the international accounting standard-setting environment at a rapid pace. The FASB believes that it is important to ensure that those changes move accounting standard setting at the national and international levels in a positive direction. To do so, changes must be aligned with a set of shared objectives and guided by some vision of the desired outcome of this evolution to more global capital markets.

The FASB has examined the issues in the current environment in great detail and developed a vision of the future international accounting system and the objective and goals for the FASB's participation in that system. That vision is provided as Appendix A to this report and represents only one of the possible scenarios for the future. However, the FASB believes that using such a vision as a guide will tend to move the FASB toward a positive and mutually beneficial outcome for all of the key participants in the international accounting system of the future.

The objective and goals developed by the FASB are compatible with that vision as well as with the following key considerations:

- The FASB should retain a worldwide leadership role in standard setting.
- The FASB should do as much as it can to participate in the development of internationally recognized standards to ensure that they are of the highest possible quality.
- Worldwide acceptance of internationally recognized standards and a global standard-setting process is impossible without U.S. acceptance and participation. As the largest capital market, the United States is the primary target in the drive for internationally recognized standards. U.S. support is necessary to the legitimacy of any set of

international standards, and the United States has much to contribute to ensuring those standards are of high quality.

The objective and goals for the FASB's participation in the international accounting system of the future are described below.

Objective

The FASB's commitment to the development of international accounting standards is guided by the belief that, ideally, that process ultimately will lead to the worldwide use of a single set of high-quality accounting standards for both domestic and cross-border financial reporting. The demand for those standards is driven by the desire for high-quality, internationally comparable financial information that capital providers find useful for decision making in global public capital markets. The FASB believes that progress toward the ideal outcome will result from pursuing the overall objective of increasing international comparability while maintaining the highest quality accounting standards in the United States.

Two Related Goals: High-Quality International Standards and Increased Convergence

As the world moves toward that overall objective, the FASB is a leader, sharing influence with other standard setters, in determining the international standard-setting structure and process of the future. In fulfilling that role, the FASB has two related goals: (1) to ensure that international accounting standards are of the highest quality and (2) to accelerate convergence of the accounting standards used in different nations. Those goals are pursued within the context of the FASB's ongoing commitment to establish and improve standards of financial accounting and reporting in the United States. The FASB believes that developing accounting standards that increase international comparability is a key element of that commitment.

The FASB has reached consensus that a set of high-quality international standards is desirable because their use would improve international comparability; reduce costs to financial statement users, preparers, auditors, and others; and, ultimately, optimize the efficiency of capital markets. In the long run, the FASB believes that the global costs to implement and maintain standards also will be lower. Further, a set of high-quality international standards is increasingly demanded by existing market forces. The FASB describes *international standards* as a set of accounting standards that are internationally recognized as acceptable through, for example, endorsement by the relevant capital market authorities of individual nations[1] and through acceptance by financial statement users.

Convergence is both a goal and a process. The FASB describes the *goal of convergence* as different standard setters arriving at high-quality national or international standards on the same topic that are as similar as possible. The *process of convergence* includes using all reasonable efforts to arrive at consensus, recognizing that it may be beneficial to arrive at very similar higher quality national standards when consensus on a single international standard is not possible. Convergence would result simultaneously in a reduction of differences between existing standards and an increase in their quality. Further, in some cases and among some standard setters, the process of convergence may

[1]The relevant national authority is that organization (or those organizations) that has the authority to make decisions about accounting requirements for capital markets and to enforce those requirements. The relevant national authority in a given nation may differ; for example, in the United States it would be the Securities and Exchange Commission (SEC), whereas in other countries it may be a stock exchange, a government body, or some other organization.

lead to identical new standards. In other cases, resulting standards may differ in some aspects. In all cases, participating in a process to achieve convergence should result in higher quality standards that are more similar than they otherwise would be were each of the standard setters to develop a standard in isolation. That is, the expected result of pursuing the goal of convergence is to minimize differences while improving the quality of accounting standards worldwide and, thus, maximize the potential for international comparability.[2]

Need for Both Goals

Convergence and development of high-quality international standards are interrelated goals. Convergence that leads to agreement on a single solution among standard setters in different countries can result in an international standard. Conversely, participating in the development of international standards is one way to facilitate the convergence process and to achieve the goal of convergence among nations.[3] The FASB considered stating either the goal of increased convergence or the goal of ensuring that international standards are of high quality as the singular goal for its international activities. In arriving at its consensus to pursue convergence and high-quality international standards simultaneously, the FASB considered a number of factors, such as

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[2]It should be noted that the International Accounting Standards Committee (IASC) recently has begun using the term *convergence*. However, the IASC uses convergence to mean national standards moving toward higher quality IASC standards. As described above, the FASB uses the term convergence to mean national accounting standards moving toward each other with the objective of increasing quality.

[3]Perhaps the best example of the contrast between achieving convergence and agreeing on an identical standard is the FASB's project on segment reporting. The FASB and the Canadian Institute of Chartered Accountants (CICA) worked jointly to develop a standard on that topic while the IASC worked concurrently on its own standard. Every effort was made to reach the same conclusions in both projects. As a result of those efforts, convergence was achieved with the IASC while the FASB and the CICA issued virtually identical standards. The IASC standard, while much more similar to the CICA-FASB standard than it otherwise would have been, is different in some important respects.

the extent to which international standards would be used in the future and the feasibility of uniformity in accounting requirements among all nations.

Many questions remain as to what ultimate function a set of high-quality international accounting standards will serve. On one end of the spectrum, they might be acceptable only for cross-border filers in some or all countries. At the other end of the spectrum, international standards might eventually replace all national standards, resulting in a single set of standards for all countries.[4] The FASB has concluded that whatever the ultimate function of international standards, their use will affect financial reporting in the United States, and, therefore, the FASB must participate in the process that leads to their development. The FASB believes that its meaningful participation in the development of international standards is necessary in order to ensure that future international standards are of sufficient quality to be acceptable in the United States.

However, the FASB believes that it is fruitful in the near term to pursue both high-quality international standards and increased convergence, rather than pursuing the singular goal of ensuring high-quality international standards. Based on the FASB's experience working with other standard setters, it is clear that, in some circumstances, standard setters will be unable to agree that a single solution is appropriate for all national environments. Because achieving *either* increased convergence *or* high-quality

[4]The IASC, for example, has recently completed a set of core standards, which, at the moment, are intended to be used as a basis for financial reporting by cross-border filers in any and all capital markets. However, it is not clear that financial statements based on those standards will be acceptable for cross-border filings in the United States. While the FASB recognizes that use of IASC standards results in an improvement in financial reporting in some countries, the FASB is not convinced that their use in their present form would improve financial reporting in the United States relative to what U.S. investors presently receive. At least within the FASB's current planning horizon, it seems unlikely that the IASC's core standards (or any other international standards, for that matter) will be accepted in the United States without requiring reconciliation of some of those standards expected to be presented by the IASC. Those factors were important considerations in the development of the FASB's objective and goals described in this report.

international standards would result in higher quality standards and increased comparability of financial reporting worldwide, the FASB supports both goals.

Establishment of a Quality International Accounting Standard Setter Is Key

A great deal of progress has been and continues to be made in the areas of convergence and development of high-quality international accounting standards through the commitments and cooperative efforts of national standard setters and others acting independently. However, the FASB believes that, for the long term, if the future international accounting system is to succeed and, ultimately, result in the use of a single set of high-quality accounting standards worldwide for both domestic and cross-border financial reporting, the establishment of a quality international accounting standard setter to coordinate and direct the process is key.

The FASB's Commitment

The FASB believes it has a leadership role to play in the evolution of the international accounting system. That will require that a high and increasing level of resources be devoted to positioning the FASB as a strong influence on the establishment of a quality international accounting standard-setting organization. If a quality international accounting standard-setting structure and process emerges, the FASB's commitment and desire to participate in a meaningful way in the operations of that standard-setting organization may ultimately lead to structural and procedural changes to the FASB, a shift in the FASB's national role, and a substantial contribution of resources to the international standard-setting process. At the same time, the FASB believes it is important to maintain its program of improving U.S. national standards in order to meet the objective of high-quality accounting standards (whether national or international standards) in the United States.

Two notions fundamental to the FASB's objective and goals require elaboration. The first is what is meant by "high quality" accounting standards, and the second is what are the functions and characteristics of a quality international standard setter.

High-Quality Accounting Standards

The fundamental underpinning of the FASB's objective and goals for participation in the international accounting system of the future (a vision of that system is described in Appendix A) is a belief that the ongoing evolution of accounting standards should result in continual improvements to the quality of those standards and, as a result, the quality of financial reporting worldwide. That belief has guided the FASB's standard-setting efforts in the United States and is carried forward with the extension of the FASB's standard-setting role to the international environment.

High-quality financial reporting is financial reporting that provides decision-useful information for outside investors, creditors, and others who make similar decisions about allocation of resources in the economy.[5] The FASB believes that sacrificing quality for convergence or focusing on arriving at consensus rather than the best possible solution in the circumstances does a disservice to the consumers of financial reporting—that is, financial statement users—and undermines the credibility and efficiency of global capital markets. While it is difficult to define "high quality," the FASB believes that there are a

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[5]There are many other valid purposes for financial reporting, including uses for internal management, for rate regulation, or pursuant to covenants in a loan agreement. Purposes for financial reporting other than providing information useful to investor-creditor decision making are outside the scope of this discussion.

number of attributes of high-quality accounting standards that can be identified. Those attributes are summarized here and discussed in more detail in Appendix B.

A reasonably complete set of unbiased accounting standards that require relevant, reliable information that is decision-useful for outside investors, creditors, and others who make similar decisions would constitute a high-quality set of accounting standards. Each of those accounting standards should:

- Be consistent with the guidance provided by an underlying conceptual framework.
- Avoid or minimize alternative accounting procedures, explicit or implicit, because comparability and consistency enhance the usefulness of information.
- Be unambiguous and comprehensible so that the standard is understandable by preparers and auditors who must apply the standard, by authorities who must enforce the standard, and by users who must deal with the information produced by the standard.
- Be capable of rigorous interpretation and application so that similar events and transactions are accounted for similarly across time periods and among companies.

Overall, financial reporting under those standards should result in transparent information. Transparent information is sufficient in its content and readily comprehensible so as to provide a meaningful basis for economic decision making by financial statement users. Transparent information does not obscure information relevant to economic decision making. In that context, a set of high-quality accounting standards should result in accounting information that is:

- *Relevant*—Relevant information is capable of making a difference in a decision by helping users to form judgments about the outcomes of past, present, and future events or to confirm or correct prior expectations.
- *Reliable*—Reliable information faithfully represents what it purports to represent, and that quality of representational faithfulness is verifiable using independent measures.
- *Neutral*—Neutral information is not biased toward a predetermined result.
- *Comparable*—Comparable information can be meaningfully compared with similar information about other enterprises. Information is comparable if similar transactions and events are accounted for similarly, and different transactions and events are accounted for differently.

- *Consistent*—Consistent information can be meaningfully compared with similar information about the same enterprise for some other period or some other point in time.

A Quality International Accounting Standard Setter

Establishing a quality international accounting standard setter is an indispensable part of the means by which the FASB's goal of high-quality accounting standards and increased international convergence will be realized. Although a great deal of progress toward increasing international comparability and the quality of accounting standards can be made through the independent cooperative efforts of standard setters, for the international accounting system of the future to be successful and efficient, a quality international standard setter will be needed. Establishment of such an organization may occur in any number of ways. For example, a structurally changed International Accounting Standards Committee (IASC) might succeed; a successor international organization might emerge and build on what the IASC has done, perhaps based on the G4+1;[6] or the FASB might be modified to become more acceptable internationally.

Because the world is still in transition to a fully international accounting system, there is a unique opportunity to influence the establishment of an international accounting standard-setting organization. As such, it is important to have some guidelines for moving toward that goal. The FASB believes that there are some functions and characteristics that are essential to any future international accounting standard setter if it is to attain the goal of developing high-quality international accounting standards. The FASB has identified a set of eight essential functions that should be embodied by a quality international accounting standard setter—leadership, innovation, relevance, responsiveness, objectivity,

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[6]The G4+1 is a working group of Board members and senior staff of the standard-setting bodies in Australia, Canada, New Zealand, the United Kingdom, and the United States, as well as staff of the IASC.

acceptability and credibility, understandability, and accountability. (Appendix C describes those functions in more detail.) It is important to note that the ideal standard setter likely will not exhibit all of those functions equally and at the same time. The challenge is in finding an appropriate balance within a structure and process that provides the opportunity for each function to be reasonably present. That is, the structure and process must be conducive to fostering an environment in which each of those interrelated functions is *adequately* exhibited at any given point in time.

Those functions provide the context for the minimum characteristics of an international standard-setting structure and process that must exist in order to achieve those functions. The characteristics the FASB has identified are (1) an independent decision-making body, (2) adequate due process, (3) adequate staff, (4) independent fundraising, and (5) independent oversight. (Appendix C describes those characteristics in more detail.) There are a number of possible ways to incorporate those characteristics within an organization. The FASB believes that however the international accounting standard setter is organized, its structure should facilitate the eight essential functions and incorporate the five characteristics of structure and process to be capable of success in developing high-quality international accounting standards.

Appendix A

VISION OF THE INTERNATIONAL ACCOUNTING SYSTEM OF THE FUTURE

Introduction

This vision was developed as a statement of aspiration to assist the FASB in developing strategies for its participation in international accounting standard setting. For that reason, only the FASB's role as a national standard setter has been included; other national standard-setting authorities may define their roles differently. The vision contemplates the establishment of the following types of organizations that would participate in the international accounting system of the future:

- *International Standard Setter (ISS):* The decision-making body that develops and promulgates international accounting standards. As an international organization, the ISS is independent of national standard setters of the major developed countries and other national standard setters, although national standard setters participate in the ISS process. The ISS embodies the functions and characteristics described in Appendix C.
- *International Interpretations Committee (IIC):* An organization designed to address issues arising from application of international accounting standards. To achieve consistent interpretation and implementation, the IIC responds to implementation issues in circumstances in which, for example, the intent of a standard is unclear; assists those who apply and ensure application of the standards in understanding the language of the standards; and, when a large number of questions arise on the same issue, supplements the standards with additional guidance. This function permits questions and responses to be monitored and common problem areas to be detected and dealt with as early as possible.
- *International Professional Group (IPG):* An international organization of accounting professionals comprising national professional organizations. The IPG is primarily concerned with facilitating the assurance function for the application of international standards by helping to ensure compliance with the standards, adequate dissemination of the standards to the national level, and education of assurers about the appropriate application of the accounting standards as they are set.

The Vision

The FASB envisions the following possible scenario:

Acceptance and Enforcement of International Standards

A set of standards issued by the International Standard Setter (ISS) has been recognized and endorsed by each national standard setter, national regulatory body, or other relevant national authority[7] for cross-border capital-raising purposes. They have agreed that the objective of financial reporting based on international accounting standards is to produce internationally comparable general purpose financial statements that provide information useful to capital providers' (including investors' and creditors') decision making in public capital markets. Accepting ISS-based financial statements in individual national markets contributes to the efficiency of market transactions through increased international comparability. Those financial statements are a primary source of information to capital providers who may have access only to publicly available information. The ultimate objective of the international accounting system is simultaneously optimizing capital market efficiency and ensuring investor protection.

In order to ensure realization of the benefits of international comparability, systems assuring enforcement of ISS standards are established in each market by relevant national authorities. Those authorities have agreed to a set of guidelines that can be used as a benchmark for enforcement of ISS standards in national markets.[8] It is expected that the

[7]The term *national authority* is used throughout the following discussion to refer to the national organization (or organizations) in a given country that has the authority (1) to decide what accounting principles and practices are acceptable and required and (2) to enforce those requirements. A national authority may be a government agency, a stock exchange, a national standard setter, or other organization.

[8]A number of securities regulators have already agreed to such a set of guidelines. In 1994, the Council of Securities Regulators of the Americas agreed to "Fundamental Elements of a Sound Disclosure System," which includes a set of goals and principles for financial reporting in capital markets.

guidelines will evolve over time to deal with unforeseen issues. It is also expected that the national authorities' shared commitment to the system's objectives will help to ensure that each country behaves within the guidelines.

The role and the level of autonomy of the national authorities are unchanged from the present. National authorities have enforcement responsibility within their respective markets, although the organization designed to fulfill that role may differ from country to country. Thus, decisions about the use of ISS standards in domestic markets are left to be made at the national level.

For example, each national authority either accepts or requires that cross-border filers use ISS standards in their individual national markets. Some also permit domestic filers to use ISS standards. Those that do may or may not require reconciliation of financial statements prepared under ISS standards to domestic generally accepted accounting principles; however, national authorities and the ISS are working toward the elimination of reconciliations in those areas covered by both domestic and international standards. The goal is that such reconciliations ultimately will be eliminated. (National authorities may continue to require financial information in addition to that provided by ISS-based financial statements, for example, additional disclosures or specialized industry information.)

Assurance

National authorities further require that qualified professionals audit financial statements prepared under ISS standards. The responsibility of those professionals is to provide assurance that ISS standards are appropriately applied to the preparer's financial data. Guidelines have been developed by the International Professional Group (IPG) that identify the minimum educational and professional qualifications necessary to be recognized as a qualified assurer and that define the minimum requirements for the assurance function. In the United States, those professionals are the certified public accountants (CPAs), and similar professionals carry out that responsibility in other markets. While professional auditing standards are issued at the national level, analogous to the benchmark guidelines agreed to by national authorities, national professional member organizations have mutually committed to the IPG's international guidelines. Similarly, it is expected that the shared commitments of IPG representatives will help to ensure that each participant country will act in the spirit of cooperation. The IPG is responsible for monitoring problems related to the assurance function at the national level and making recommendations for improvement.

Interdependence of Enforcement and Assurance

Although the roles and responsibilities of the groups that provide enforcement and assurance are separately defined, national authorities, the ISS, and the IPG recognize the interdependence of the enforcement and assurance functions. That interdependence is part of a system of checks and balances in the international accounting environment. The enforcement function is facilitated when the enforcers have confidence that the assurance function is independent of preparers and is carried out effectively; for example, effective assurance makes it less likely that conflicts will arise that lead to enforcement action. Conversely, the existence of a separate enforcement function reinforces the assurers' ability to enforce application of the international accounting standards and assists in ensuring a high-quality assurance function. Thus, the ISS, national authorities, and the IPG share an open and cooperative relationship, with representatives monitoring the activities of each other's organizations and providing input on matters that have an impact on both the assurance and enforcement functions.

Translation

In order to be readily understood by and available to the largest possible number of constituents within resource constraints, ISS standards are published simultaneously in the languages whose use is most geographically widespread. The ISS has a translation department on site, and the translation department also reviews translations of ISS standards into other languages to ensure that the requirements and objectives of the standards are preserved.

Education

Once an ISS standard is issued, responsibility for initial education about the application of a given standard is undertaken primarily at the national level. Assurers are educated about the appropriate application of ISS standards either through independent study or through seminars and conferences sponsored by their firms, state or national professional organizations, the ISS, or the IPG. The ISS publishes educational materials or sponsors conferences in conjunction with other groups (for example, the IPG) on special topics when it becomes apparent that a large number of assurers are encountering similar problems. If questions arise in which assurers need assistance in the form of interpretations, assurers and their representative organizations have access to the ISS, the staff of which responds consistently to various inquiries, or to the ISS's International Interpretations Committee (IIC). The IPG has a standing committee that deals specifically with education issues and that provides a close liaison between the ISS and the profession on those topics.

Similarly, financial statement preparers and users become educated about ISS standards through independent study or through seminars and conferences sponsored by their firms or state or national professional organizations. That education process is further assisted by the assurers as they deal with their preparer clients.

Preparer Responsibility

Preparers are responsible for maintaining awareness and understanding of the requirements of ISS standards so that they are in compliance with them. Preparers have access to information about ISS standards and their application through accounting and other professional organizations and through the ISS. To assist in ensuring that similar events and transactions are accounted for similarly around the world, national market authorities require that preparers that apply ISS standards adhere rigorously to those standards and apply them comprehensively.

Role of National Standard Setters

The role of national standard setters in the future international accounting system differs from nation to nation because the need for accounting standards generally differs from nation to nation. Because the ISS cannot proclaim itself to be the standard setter of any single country, each nation decides the extent to which it looks to the ISS to satisfy its need for accounting standards.

For example, countries that have relatively few resources to devote to standard setting, that have a relatively simple accounting infrastructure, or that have a relatively undeveloped capital market may depend entirely on the ISS for their standard-setting needs. That is the case for a number of countries today that look to the IASC. In those cases, procedures may be set up to coordinate the acceptance and dissemination of ISS standards within that country or there may be a liaison organization between national and international professional and regulatory organizations. There may or may not be a desire in each country to participate directly in the ISS process via, for example, representation on the decision-making body of the ISS.

Other countries may have resources to devote to standard setting, have a complex accounting infrastructure, or have large, highly developed capital markets. Those countries have greater demands for accounting standards and place greater reliance on them as a mechanism for regulating behavior. They also may have special demands for accounting standards or have experiences with specialized, complex, or unique transactions that may be most efficiently met by a national-level response. The desire to participate in the ISS process is likely to be greater in those countries.

Implementation Issues

Even with appropriate dissemination, adequate education, and consistent interpretation at the front end, implementation issues may arise over time as an ISS standard is applied. Sometimes diverse practices develop. Other times practices evolve that are unacceptable to national authorities. The IIC is responsible for issuing timely guidance on emerging issues. Each enforcement jurisdiction has access to the IIC, and any group or individual may suggest issues to be resolved.

Existing ISS standards cover most of the key areas of accounting that are commonly encountered by the vast majority of nations, for example, accounting for property, plant, and equipment, accounting for intangibles, recognition and measurement of financial instruments, and accounting for leases. Many national authorities permit or require that national standards be used to account for events or transactions not covered by ISS standards. However, the ISS continues to develop new standards in those areas when the topic is a pervasive issue at the international level. Topics that are unique to a single nation or that raise issues for only a small number of enterprises are dealt with by individual nations working together when possible.

Standard Setting in the United States

At the national level, transition to the international accounting system has brought changes to the way in which the FASB conducts its standard-setting activities. At least one FASB representative serves as a voting member on the ISS decision-making body. Although that representative votes as an individual, he or she receives input from the FASB members and staff on the various issues that come before the ISS. That input is maximized by the changes to the FASB's agenda and operations at the national level. The FASB's agenda contains three different types of projects: (1) projects that are also on the agenda of the ISS, (2) projects to converge preexisting U.S. GAAP with standards issued by the ISS and other standard setters, (3) projects that meet the specific demands of U.S. markets.

Sufficient FASB staff resources are assigned to monitor and keep the FASB up-to-date with the progress of each ISS project. That staff also serves as liaison between the FASB and the ISS project team, providing the ISS with the FASB's input and rationale for potential solutions to the issues in question on the project. The FASB itself is the lead on some ISS projects. Those projects are staffed much as FASB major agenda projects were before the FASB participated fully in the standard-setting activities of the ISS. Sufficient FASB Board meeting time is set aside to discuss and deliberate issues related to ISS projects. The FASB has agreed to use its distribution channels to distribute ISS discussion documents and standards.

The FASB also has a number of convergence projects on its agenda. The objective of convergence projects is to bring existing U.S. GAAP and ISS or other national standards as close together as possible while maintaining the highest possible quality. Often the outcome of those projects results in a joint standard. In all cases, the outcome is one or more standards that are closer than they otherwise would be if the standard setters involved had developed them independently. Teams for convergence projects are staffed jointly by the standard setters involved, much the same way that the FASB's first joint standard-setting project with Canada on segment disclosures was organized.

There continue to be a number of accounting issues that are unique to the U.S. environment, that arise from existing U.S. standards on topics not covered by the ISS, or for which timely guidance is necessary that cannot be provided immediately through the ISS. Because of the FASB's ongoing commitment to international convergence and high-quality standards, it continues to work toward resolving those types of issues, and staff resources are devoted to those kinds of projects as well.

The FASB also monitors and provides input for the issues dealt with by the IIC. Standard setting in the United States, at least in the near term, continues to provide a role for the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants and the FASB’s Emerging Issues Task Force; however, the agendas of both groups must be coordinated with those of the FASB and the ISS.

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The interaction of the various national and international entities that share responsibility for implementation of ISS standards creates a system of checks and balances that augments the opportunity for success. International comparability is promoted through a sufficient and common understanding of the letter and spirit of the standards on behalf of those who apply them. ISS standards are applied comprehensively and appropriately to the facts and circumstances of any given entity and are applied consistently by all entities that apply them. The assurers are independent of the preparers and have no self-interest in the financial information that results. Assurers and others have access to the ISS and the IIC to resolve pervasive issues.

National authorities ensure that preparers are applying ISS standards, that assurers are doing their job adequately, and that the resulting application of ISS standards produces reliable, high-quality financial information in conformity with the ultimate objective of investor protection. Financial statement users understand the nature, extent, and limitations of the financial information prepared under ISS standards and, thus, have confidence in the information generated as a result of their application. Comparability is also promoted through the cooperative efforts and shared objectives of national authorities.

Appendix B

QUALITY OF ACCOUNTING STANDARDS

Introduction

This appendix describes the attributes of high-quality accounting standards that contribute to high-quality financial reporting.[9] The discussion is based on the premise that high-quality financial reporting is financial reporting that provides decision-useful information for outside investors, creditors, and others who make similar decisions about allocation of resources in the economy.[10]

A reasonably complete set of unbiased accounting standards that require relevant, reliable information that is decision useful for outside investors, creditors, and others who make similar decisions would constitute a high-quality set of accounting standards. Each of those accounting standards should:

a. Be consistent with the guidance provided by an underlying conceptual framework.
b. Avoid or minimize alternative accounting procedures, explicit or implicit, because comparability and consistency enhance the usefulness of information.
c. Be unambiguous and comprehensible so that the standard is understandable by preparers and auditors who must apply the standard, by authorities who must enforce the standard, and by users who must deal with the information produced by the standard.

Overall, financial reporting under those standards should result in transparent information. Transparent information is sufficient in its content and readily comprehensible so as to provide a meaningful basis for economic decision making by

[9]High-quality accounting standards are just one of the ingredients necessary to achieve high-quality financial reporting. Other ingredients include proper implementation of the standards in preparing financial information, auditing, regulation such as by the SEC, and so forth. The discussion in this appendix focuses on high-quality accounting standards and does not address those other ingredients.

[10]There are many other valid purposes for financial reporting, including uses for internal management, for rate regulation, or pursuant to covenants in a loan agreement. Purposes for financial reporting other than providing information useful to investor-creditor decision making are outside the scope of this discussion.

financial statement users. Transparent information does not obscure information relevant to economic decision making.

This appendix begins with a discussion of the reasons for a conceptual framework (item (a) above) and addresses the objectives of financial reporting and the qualitative characteristics of accounting information that make it useful including:

- *Relevance.* Relevant information is capable of making a difference in a decision by helping users to form judgments about the outcomes of past, present, and future events or to confirm or correct prior expectations.
- *Reliability.* Reliable information faithfully represents what it purports to represent, coupled with verifiability by consensus of independent measures that it does have that representational quality.
- *Neutrality.* Neutral information is not biased toward a predetermined result.
- *Comparability.* Comparable information can be compared with similar information about other enterprises.
- *Consistency.* Consistent information can be compared with similar information about the same enterprise for some other period or some other point in time.

It then discusses accounting alternatives (item (b) above) and the need for unambiguous accounting standards (item (c) above). Finally, this appendix discusses the standard-setting process and the need for a body of accounting standards to be reasonably complete.

Reasons for a Conceptual Framework

In the United States, FASB Concepts Statements provide a framework that guides decisions about recognition, measurement, and display of economic events in financial statements. A conceptual framework should guide a standard setter in developing sound accounting standards and provide the standard setter and its constituents with an understanding of the appropriate content and inherent limitations of financial reporting. That framework provides the guidance for developing accounting standards that require decision-useful financial information that, together with information from other sources, facilitates the efficient allocation of scarce resources in the economy.

As stated earlier, high-quality accounting standards should be consistent with the guidance provided by an underlying conceptual framework. For example, in terms of the FASB's conceptual framework, high-quality accounting standards are standards that require information that meets (a) the objectives of financial reporting and (b) the qualitative characteristics that make accounting information useful. Other standard setters obviously do not have to adopt the FASB's conceptual framework. However, the success of their accounting standards directed to external financial reporting will necessarily be determined to a great extent by how well their standards measure up against the substance of the objectives and qualitative characteristics that are relevant to financial reporting that provides decision-useful information. Those objectives and characteristics are discussed in the FASB's conceptual framework.

Objectives of Financial Reporting

Financial reporting is not an end in itself but is intended to provide information that is useful in making business and economic decisions—for making reasoned choices among alternative uses of scarce resources in the conduct of business and economic activities. High-quality accounting standards are essential to the efficient functioning of the economy because decisions about the allocation of resources rely heavily on credible and understandable financial information.

In the United States, objectives of financial reporting stem primarily from the information needs of external users (investors and creditors and their advisors) who lack the authority to prescribe the financial information they want from an enterprise and therefore must use the information that management communicates to them.

The objectives of financial reporting are:

- To provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions.
- To provide information to help present and potential investors and creditors and other users assess the amounts, timing, and uncertainty of prospective net cash inflows to an enterprise and, based in part thereon, ultimately, cash flows to themselves.
- To provide information about the economic resources of an enterprise, the claims to those resources, and the effects of transactions, events, and circumstances that change its resources and claims to those resources.

Qualitative Characteristics of Accounting Information That Make It Useful

The objectives of financial reporting focus on the use of accounting information in making investment, credit, and similar decisions. Thus, the quality of accounting standards must be judged based on whether their application produces information that is useful in economic decision making.

Relevance and *reliability* are the two primary qualities that make accounting information useful for decision making. To be relevant, information must be timely, and it must have predictive value, feedback value, or both. To be reliable, information must have representational faithfulness, and it must be verifiable and neutral. Increased relevance and increased reliability are the characteristics that make information a more desirable commodity—that is, one useful in making decisions. If either of those qualities is missing, the information will not be useful. Comparability, which includes consistency, is a secondary quality that interacts with relevance and reliability to contribute to the usefulness of information.

Relevance

A high-quality accounting standard requires relevant accounting information, that is, information that is capable of making a difference in a decision by helping investors, creditors, or other users to form judgments about the outcomes of past, present, and future events or to confirm or correct prior expectations. The past often is prologue for the future. Knowledge about the outcomes of past actions generally will improve decision makers' abilities to predict the results of similar future actions.

Reliability

To be useful, information must be reliable as well as relevant. The reliability of the information required by an accounting standard rests on the faithfulness with which it represents what it purports to represent, coupled with an assurance for the users, which comes through verification, that it has that representational quality. Thus, reliability rests upon the extent to which an accounting description or measurement is verifiable and representationally faithful. Neutrality of information also interacts with those two components of reliability to affect the usefulness of the information required by an accounting standard.

Verifiability means that several measurers are likely to obtain the same measure of events and transactions given the same circumstances. Representational faithfulness, on the other hand, refers to the correspondence or agreement between the accounting numbers and the resources or events those numbers purport to represent.

Neutrality

A standard setter should strive to be objective in its decision making and to ensure, insofar as possible, the neutrality of information resulting from its standards. To be neutral, an accounting standard must require information that reports economic activity as faithfully as possible without coloring the image it communicates for the purpose of influencing behavior in any particular direction. In formulating standards, the primary concern is the relevance and reliability of the information required by the standard, not the effect the new rule may have on a particular interest. The requirements of an accounting standard must be free from bias toward a predetermined result. The objectives of financial reporting serve many different information users who have diverse interests, and no predetermined result is likely to suit the needs of all interests.

Comparability and Consistency

A primary reason for having accounting standards is to promote comparability and consistency. Information about a particular enterprise gains greatly in usefulness if it can be compared with similar information about other enterprises and with similar information about the same enterprise for some other period or some other point in time.

The purpose of comparison is to detect and explain both similarities and differences. Comparability should not be confused with sameness—sometimes more can be learned from differences than from similarities. Greater comparability of accounting information is not to be attained by making unlike things look similar any more than by making like things look different. A high-quality accounting standard requires accounting for similar transactions and circumstances similarly and accounting for different transactions and circumstances differently.

Accounting Alternatives

Accounting standards that specifically allow alternatives are counterproductive in meeting the goal of enhancing comparability. Nevertheless, accounting alternatives now exist in the accounting standards of all regimes. For example, the IASC-U.S. comparison project[11] found 27 instances in which explicit alternative methods of accounting are permitted. The breakdown is as follows:

- In 19 cases, only the IASC standard permits alternative approaches.
- In 4 cases, only the U.S. standard permits alternative approaches.
- In 4 cases, both U.S. GAAP and the IASC standard permit similar alternative approaches.

Explicit accounting alternatives create noncomparability. Financial statement users who try to adjust for noncomparability have varying degrees of success. Implicit accounting alternatives that result from accounting standards that have imprecise or ambiguous requirements or that provide inadequate guidance are even more troublesome. Financial statement users cannot even attempt to adjust for noncomparability of which they are unaware.

Unambiguous Accounting Standards

Accounting standards cannot help to meet the objectives of financial reporting if those standards are not understandable. Preparers need to know what is expected of them.

[11] In 1996, the FASB issued the first edition of *The IASC-U.S. Comparison Project: A Report on the Similarities and Differences between IASC Standards and U.S. GAAP.* That report discusses areas of similarity and difference between IASC standards and U.S. GAAP, including guidance that explicitly allows alternative accounting methods for the same transactions or events.

Auditors need to know what is required before they can decide whether financial reporting is in accordance with generally accepted accounting principles. Securities regulators need standards that are sufficiently unambiguous to facilitate enforcement. Unambiguous accounting standards increase the likelihood that preparers, auditors, and regulators reach similar conclusions about what is required.

An accounting standard should not be subject to multiple interpretations or to avoidance through misunderstanding or misinterpretation. The amount of specificity that is needed in order to have an unambiguous accounting standard requires judgment. A so-called "cookbook" full of "bright line" rules may in some instances be counterproductive. But silence about how to perform important procedures that are required by a standard or a one-sentence, vague description of a necessary procedure followed by "or other method that achieves a more appropriate result in the circumstances" is obviously insufficient. Imprecise language of this type inevitably produces implicit accounting alternatives and therefore noncomparability of information that users will be unaware of.

Users need to be confident that application of an accounting standard is comparable between enterprises and consistent by each enterprise. Clarity of language is crucial for internationally accepted standards because an accounting standard that is applied by enterprises in different countries must be sufficiently clear and unambiguous to overcome cultural differences between, for example, preparers in France and Australia, or auditors in Japan and the United Kingdom. An ambiguous standard will not be consistently interpreted and applied by enterprises in different countries and is unlikely to be applied consistently even within the boundaries of a single country.

Standard-Setting Process

The development of accounting standards based on a conceptual framework cannot be done in isolation. Accounting standards have an impact on many organizations within a standard setter's large and diverse constituency. Accounting standards in their formative stage must be subjected to rigorous procedures that encourage all interest groups to communicate their views to the standard setter. Similarly, the deliberative process of the standard setter should be open to observation by all interests groups so that the public is informed on a timely basis about important developments pertaining to the standard setter's project. A standard setter's consideration of the diverse views and concerns of its constituents enhances the overall quality of a final accounting standard by improving the standard setter's judgment about matters such as, to cite just two examples, why certain information is or is not relevant in particular circumstances and why certain information is or is not reliable if provided by a particular method or procedure.

Body of Accounting Standards

Individual accounting standards cannot be judged in isolation because each individual standard should be part of an integrated, consistent set of standards. That set of accounting standards must be sufficiently complete to cover the full range of transactions and events that need to be included in financial reporting. If the set of accounting standards is incomplete or inconsistent, the financial information produced by it will not meet the objectives of financial reporting.

Summary

A sound underlying conceptual framework will guide a standard setter in developing high-quality accounting standards. Evidence that an accounting standard will produce decision-useful information that meets the objectives of financial reporting is provided if the information required by the standard is relevant, reliable, neutral, comparable, and consistent.

Accounting standards that permit explicit accounting alternatives create noncomparability and should be avoided. Users are ill-equipped to make adjustments for that lack of comparability. Implicit accounting alternatives that result from standards that have imprecise or ambiguous requirements or that provide inadequate guidance create noncomparability that users are not even aware of. A high-quality accounting standard requires accounting for similar transactions and circumstances similarly and accounting for different transactions and circumstances differently.

Accounting standards need to be unambiguous so that preparers, auditors, securities regulators, and users reach similar conclusions about what is required by the standards. Vague, imprecise, or cursory language inevitably produces the implicit accounting alternatives discussed above. Clarity is particularly critical for international accounting standards, which must overcome language and cultural barriers to be applied in many different countries.

Finally, a standard setter's accounting standards taken as a whole should represent an integrated, consistent, and reasonably complete body of accounting standards. Otherwise, the financial information produced by that body of standards will not meet the objectives of financial reporting.

Appendix C

FUNCTIONS AND CHARACTERISTICS OF A QUALITY INTERNATIONAL ACCOUNTING STANDARD SETTER

This appendix elaborates on the eight essential functions and five essential characteristics that the FASB has identified as necessary to a quality international accounting standard setter of the future.

Eight Essential Functions

Leadership. The standard setter should be able to lead in the development and improvement of standards, not just follow in the wake of other standard setters or codify the status quo. That leadership function should include working jointly with others to develop accounting standards.

Innovation. The standard setter should be at the forefront of advanced thinking and research on accounting issues. It should encourage solutions to accounting issues of worldwide importance that make the best use of the latest ideas and technology.

Relevance. The standard setter and the standards it produces should meet the identified needs in the capital markets they serve. That is, the standard setter's process and structure should be designed to be proactive in understanding and meeting capital market demands. Its product should be effective in achieving the desired objective or objectives, that is, standards should result in improvements in financial reporting.

Responsiveness. The standard setter should be able to respond to capital market developments and demands in a timely manner and to move expeditiously to deal with urgent problems.

Objectivity. The standard setter should be seen as serving the public interest, with minimal susceptibility to the self-serving objectives of private-interest groups.

Acceptability and Credibility. The quality of the standard setter should be recognized and respected by others, and its structure and process should be endorsed through a broad base of support from constituents and others.

Understandability. The standards developed by the standard setter should be broadly understood by constituents (and should provide guidance that results in reported information that is generally understood) to facilitate consistent interpretation and application.

Accountability. The standard setter should be accountable to the public interest. That is, interested parties should have the ability to be heard, to provide feedback to the decision-making body on the impact of its decisions, and to challenge the standard setter on important issues. There should be some form of oversight to provide both a mechanism and a catalyst to enact necessary changes. Further, there should be adequate checks and balances in the structure and process to prevent breakdowns in the system and to provide for appeal in the rare circumstances in which that may be necessary to serve the public interest.

Five Essential Characteristics

The following are essential characteristics of a standard setter that are conducive to the functions described above.

1. Independent Decision-Making Body

An independent decision-making body primarily supports the function of objectivity in standard setting: serving the public interest rather than serving the objectives of private-interest groups. However, it also should assist in securing an ability to innovate, ensuring that standards are relevant to the needs of capital markets, and achieving acceptability and credibility of the standard setter and resulting standards. To meet those objectives, independence of the standard-setting decision-making body might be characterized in the following way:

a. There is a balanced representation of interests with decision-making authority such that no particular interest has the power to overrule that of another.
b. The foremost role and responsibility of representatives on the decision-making body is that of a standard setter serving the public interest.
c. Members of the decision-making body vote as individuals rather than as spokespersons elected to express the views of the interest groups they represent.[12]
d. The decision-making body has full authority to set standards. That is, it is independent from other decision-making bodies, it has the power to innovate, and its decisions are not subject to the approval of another body that could veto decisions based on self-interested objectives.
e. The decision-making body should not be involved in fundraising for the standard-setting organization. That is, it should be removed from the possibility or perception that votes or membership can be bought.

The details of how those five criteria are achieved are subject to debate.[13] For example, some might say that to meet those criteria, some or all of the members of the decision-making body would have to be full-time employees of the standard-setting body

[12]It is, of course, likely that there will be some overlap between the views of a representative as an individual and the views of the interest group that he or she represents. That is a natural phenomenon resulting from perspectives acquired as a result of individual experience.

[13]Independence can be achieved to different degrees and in a number of ways. For example, some believe that the same group should not both set accounting standards and be charged with applying them because that will lead to standards that serve the specific objectives of a particular interest group (for example, the accounting profession). That situation might lead to standards that conflict with the general public interest. Separation of those duties could be achieved in different ways. For example, many believe that the current standard-setting structure in the United States achieves both independence of the FASB and adequate representation of the public interest.

with no existing or prospective outside affiliations, reducing the possibility of pursuing self-interested objectives. However, others might say that balanced representation and the process by which members are selected can overcome the need for such complete independence or that if the representatives are national standard setters, they represent the public interest and need not sever ties to the national standard-setting organization. Individual perspectives on those kinds of details, therefore, are likely to vary, depending upon the checks and balances perceived within the standard-setting structure and process as a whole. That, however, does not preclude agreement that the decision-making body of an international standard-setting structure must, at a minimum, meet the five criteria listed above through some combination of characteristics in order to be considered a quality standard setter.

2. Adequate Due Process

The nature and extent of due process is perhaps the most efficient device for providing the opportunity to achieve the functions of innovation, relevance, responsiveness, objectivity, acceptability and credibility, understandability, and accountability. Due process is the means by which the decision-making body interrelates with parties external to it in whose interests it serves. That is, it is a way to ensure that standards are not set in a vacuum by decision makers that are insulated from the public interest. Combining adequate due process with an independent decision-making body results in a powerful synergy and creates a system of checks and balances that lends credibility to the entire system.

The following characteristics of any due process would help to ensure that there is opportunity for the standard setter to achieve the functions of innovation, relevance, responsiveness, objectivity, acceptability and credibility, understandability, and accountability:

a. The standard setter communicates with external experts on the various topics on its agenda so that the issues are clearly understood and all viable potential alternatives are identified or developed.
b. The standard setter communicates with external parties about current issues and problems so that capital market needs are well understood and addressed in a timely manner.
c. All interested parties are provided the opportunity to express their views as individuals at various stages of the process so that the standard setter is able to discern what potential alternatives best serve the public interest.
d. Key constituent groups are identified whose representative views are sought by the standard setter prior to finalizing decisions. Those key groups are provided equal opportunity to be heard so that the standard setter is able to weigh those views equally.
e. The process permits opportunities for the standard setter to educate external parties about its activities and tentative conclusions in order to foster acceptability and understanding of its views.
f. The process provides a mechanism for feedback on how successful the standard setter is in achieving its objectives.
g. The standard setter's decisions are made in meetings that are open to the public.

There are different ways by which the above criteria can be met in a due process system. In the United States, they are met by project task forces, liaison meetings, comment letter solicitation and public hearings, field testing, the existence of the Financial Accounting Standards Advisory Council, open Board meetings and public announcement and availability of documents, as well as other aspects of due process. As with the creation of an independent decision-making body described in the previous section, there may be alternative procedures that are part of an international due process that would achieve the desired functions. For example, there may be no need for a formal advisory group if key constituents feel that they have adequate representation through other means, such as membership on the decision-making body, frequent liaison meetings, and specific solicitation of their comments.

3. Adequate Staff

As all independent national standard setters have found, it is necessary to have a core group of qualified individuals whose time is devoted fully to the standard-setting process and to supporting the needs of the decision-making body. The necessary size of that core group will vary depending upon the number of topics on the agenda, the nature of the decision-making process (for example, deciding issue-by-issue as at the FASB versus voting on a fairly comprehensive package of tentative conclusions as at many other standard-setting organizations), the amount of research needed, and the complexity of the topics addressed, among other things.

To exhibit leadership, innovation, and responsiveness (essential functions identified above), the size of the staff would need to be sufficient to undertake the following responsibilities:

a. Conduct research essential to full understanding of the issues involved and sufficient to identifying potential alternative solutions for resolving those issues in a timely manner.
b. Develop potential alternative solutions and make recommendations to the decision-making body.
c. Explore additional specific areas on an ad hoc basis as requested by the decision-making body.
d. Be available to interact with constituents to receive and understand their input, help them understand the positions taken, and respond to inquiries about the progress of projects and the implementation of existing standards.
e. Interact and communicate on an ongoing basis with the decision-making body to ensure that body is fully informed about the issues and on matters needing attention.
f. Administer and coordinate due process procedures, such as meetings, hearings, solicitation of comments, drafting of documents, and so forth.

Staffing of the international standard setter may be supported, at least partly, by national standard setters. The role of members of the decision-making body could include some of the items above if they also undertook some of the activities related to research and development of standards. In any case, the number of full-time staff people should be sufficient that each of those responsibilities is carried out for each standard-setting or research topic on the decision-making body's agenda.

4. Independent Fundraising

Separation of fundraising from recommendations and voting responsibilities helps to preserve the independence and objectivity of the decision-making body. The following characteristic would be part of a quality international standard-setting structure:

a. Fundraising activities should be undertaken by individuals or a group of individuals independent of those directly involved in standard setting (namely, members of the decision-making body and its staff).
b. Funds should be solicited from a wide variety of sources that include all interest groups.

In the United States, the FASB does not participate in the fundraising activities of the Financial Accounting Foundation (FAF).

5. Independent Oversight

Oversight helps to ensure that the standard setter maintains its credibility, responsiveness, objectivity, and efficiency in the formulation of accounting standards. That responsibility should fall to an independent group of individuals that has the ability to ensure, as far as possible, that changes are made as necessary, even when they may upset the status quo or vested interests.

a. The decision-making body, its activities, policies, and procedures, but not its standard-setting conclusions, should be subject to ongoing oversight and periodic evaluation by a group independent of the decision-making body itself.
b. Oversight should be broadly representative of constituent groups and the public interest to balance interests.

The Trustees of the FAF continue to provide independent oversight of the FASB in the United States.

Testimony of Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
Before the Subcommittee on Commerce, Trade, and Consumer Protection
of the Committee on Energy and Commerce
July 31, 2001

Attachment 15

FASB Status Report, *Perspectives on the IASB*

STATUS REPORT
No. 218 / March 30, 2001
No. 334

Perspectives on the IASB

Interviews with Tony Cope and Jim Leisenring

Long-time FASB associates Tony Cope and Jim Leisenring assume their new positions as members of the International Accounting Standards Board (IASB), effective April 1. (See previous announcement in the February edition of *Status Report*.) Prior to leaving the FASB, Tony and Jim interviewed with *Status Report* to detail highlights of the process that led to the creation of the new IASB and what might be expected in the formative stages of the new organization whose mission is to achieve convergence in international financial reporting. Highlights of those interviews follow.

While the FASB will miss the services of both Tony and Jim, we wish them well in their new challenges and endeavors. We also look forward to future interaction with them and, in particular, with Jim who will serve as the IASB's liaison to the U.S. since that part of his work will require frequent contact and involvement with the FASB.

Interview with Tony Cope

SR: How did the Strategic Working Party come into being?

TC: The Executive Committee of the IASC appointed members of the SWP in early 1997. The SWP was made up of a variety of international accounting professionals, including several IASC Board members as well as two former IASC Chairmen and the then current Chairman. The SWP had its first meeting in the spring of 1997. The group, initially comprising 14 members, met seven times beginning that year and concluded its work in December of 1999.

SR: When was the first SWP document produced and what was its focus?

TC: Following its first set of meetings in 1997, the SWP issued its initial document for public comment which proposed a bicameral organization that would include a technical committee and a Board of Trustees. The technical committee was to have responsibility for developing accounting rules while the Board would have the power to issue standards. In addition, the Board would carry authority to veto decisions made by the technical committee. That provision roiled those who viewed the technical committee as being paramount. Critics from this camp thought it disturbing to have the work of the technical staff "shelved" over what many believed would be political and geographic conflicts. Others thought that the technical committee, which involved the direct representation of the major national standard setters, would be dominated by the "G4" standard setters.

Therefore, the proposal was not well received. Depending on which side you were sitting, it was believed that one group had more power than the other.

After receiving comments on the Exposure Draft, the SWP went back to the drawing board and developed a revised proposal that ultimately was approved by the IASC Board and the International Federation of Accountants (IFAC).

SR: What were the most challenging issues for the SWP?

TC: There were many conflicts to resolve and probably the most contentious focused on two different philosophies involving the structure of the IASC. Some believed that the most important aspect of the organization would be the technical quality of the standards, while others thought that balanced political representation of the Board and Trustees—specifically geographical representation—was of primary concern.

The SWP resolved this conflict by striking a compromise. In an effort to achieve a balance in its composition, the selection of Trustees would be based on geographical representation. To address concerns about high technical standards, Board members would be appointed based on technical merit.

Other issues the SWP confronted that presented challenges and required considerable negotiation included the size of the Board, voting procedures and the geographical breakdown of Trustee composition.

SR: Where were meetings held and how often did you meet?

TC: We held seven formal meetings that took place in various cities—London, Toronto, Paris, Warsaw, and Venice. Each of those meetings lasted a couple of days and involved intensive discussion and debate over multiple issues involving the structure and goals of the IASC. During the final drafting phase, the SWP met several times by telephone, as well.

SR: What factors were considered in determining the size of the Board?

TC: Initially, there were two distinctly different viewpoints on how large the IASC Board should be. Those who were more concerned about having ample geographic representation favored a Board with many seats. In contrast, those who were more focused on an efficiently run Board, preferred a smaller number. Given the two opposing viewpoints, preferences ranged from 8 to 25 members. In concluding these negotiations and reaching a compromise, the SWP leaned toward formation of a smaller Board, recommending 14 seats—12 full-time and 2 part-time members—which, ultimately, was adopted.

SR: What points of view were represented on voting procedures?

TC: Once again, the SWP was faced with two camps on the Board's voting procedures. One group preferred a super majority vote and the other proposed a simple majority. The simple majority won out because of the SWP's earlier decision to have 14 members—an even-numbered Board. Thus a majority, or at least 8 votes, would allow for a simpler and more manageable process in issuing a standard.

SR: How were the number and composition of the IASC Trustees determined?

TC: Because the Europeans wanted equal geographical representation with the North Americans, it was decided that of the 19 IASC Trustees, six trustees would represent North America, six would be from Europe, four would represent Asia and the balance could be drawn from anywhere in the world. A provision was set forth in the IASC's constitution stating that this particular geographical balance must be maintained.

Similar to FASB practice, the IASC's terms for Board members and Trustees would be five and three years, respectively. The maximum number of terms for either post would be two.

SR: As a member of the SWP, what issues did you believe to be the most important?

TC: While there were a number of issues that I believed were important, Financial Accounting Foundation Trustee David Ruder and I argued in favor of the overriding importance of technical merit as the key criterion for Board appointments. Likewise, David and I supported a smaller Board. We believed that if the IASC were to operate efficiently and achieve its goals, the organization's productivity would be hampered by a large Board.

SR: How do you feel about the composition of the new IASC Board and Trustees?

TC: First of all, I am very pleased with the strong group of Trustees that have been assembled. The Trustees have done an excellent job of fund-raising and they have appointed some terrific people to the new Board. I already knew 12 of the 13 other Board members—six of whom I had worked with in the past. I am very excited about the opportunity to work with such a top-notch group of professionals from various countries.

SR: What are your expectations of the new IASB in the next few years?

TC: I believe the most important objective of this effort is bringing everyone—all nations—together to demonstrate cooperation and progress toward the development of higher accounting standards that can be agreed upon and shared by all. Given the size of the job, it is going to take considerable time and effort on everyone's part. In the short term, I believe it will be important to start on a few key projects in which advances are already underway. For example, many countries—including the U.S.—are already focusing on the elimination of the pooling-of-interests method of accounting for business combinations. Given Chairman David Tweedie's objectives for the IASB over the next three years, this type of project might be achievable given the relatively short time frame versus others—such as fair value or leasing that are much more complex. Others that come to mind might include standardization of measurement issues in pension accounting and another possibility could be standardization of practice in the reevaluation of fixed assets.

SR: What made you decide to join the IASB?

TC: Having joined the FASB from Wellington Management, for many years I have been involved in cross-border accounting issues and international investing. Having recently served on the SWP, that experience underscored my interest in this area and emphasized its importance to the investment community. I have had an intellectual attachment to the idea of international standard setting for some time and am committed to making progress on convergence issues. While I have found my tenure with the FASB to be a very rewarding experience, the opportunity to address international accounting standards was very appealing to me. I viewed the invitation as a unique opportunity to build on the invaluable experience I had drawn from the past eight years at the FASB and saw this as an extension of that very positive experience.

SR: What will be your primary focus as an IASB member?

TC: Because my expertise is on the investment side, I will serve as the IASB's principal liaison to the investment community. Accounting issues play a critical role in the decision-making process. One of my objectives is to create greater awareness of and interest in accounting standards among investors—an important constituency. Analysts and investors must become more involved in the standard-setting process so that they can contribute to the development and availability of better, more comparable information in the global marketplace.

SR: What do you see as the biggest challenge for the IASC?

TC: Given the broad scope of IASB activities, gaining acceptance by the various nations will be a major challenge. Having seven Board members with specific national liaison responsibilities should help in this process. In addition, because the IASB is newly developed, there is no detailed blueprint outlining the specifics of the organization and its logistics. As a group, we will need to anticipate, accept and build on change as the organization evolves.

Interview with Jim Leisenring

SR: How would you describe the partnership between the IASB and the FASB?

JL: The partnership between the IASB and the FASB will involve joint venture-type projects. This applies not only to the FASB but also to all standard setters that are part of the international effort. No one organization can tackle the task of creating a single set of accounting standards for worldwide use. Therefore, cooperation among all standard setters is essential. Given the breadth and depth of the FASB's work, I expect the FASB to be a major contributor to the development of international accounting standards.

SR: What will the IASB draw from these partnerships?

JL: Given the magnitude of the effort to develop global accounting standards, staff resources—together with identified areas of expertise—are major considerations. Because the IASB will have limited staff, as does any standard setter, the IASB will collaborate with the staffs of the FASB and others. So, the IASB's staffing needs will be complemented by the resources of the national standard setters.

SR: As a long-time FASB associate, what, in your opinion, is the FASB's interest in contributing to global accounting standards when its focus has been on U.S. accounting?

JL: The FASB has always supported convergence in accounting standards—that is nothing new. In fact, the FASB's support of global standards was at the core of the FASB's *International Accounting Standard Setting: A Vision for the Future* that was published in 1999. The FASB has always sought a single set of international accounting standards. However, the only way that this will be achieved is by having the FASB and others work toward that goal. The IASC has provided the operating structure to achieve convergence. The FASB has excellent staff resources and years of experience in developing standards. I expect that all of this will contribute to the establishment of global standards.

SR: What will be your primary responsibilities as IASB liaison to the U.S.?

JL: My principal role will be that of communicator. I will need to understand and explain what the FASB is doing and why to the IASB and vice versa. This is a not a small task if you consider, for example, the amount of work the FASB does week after week.

I don't see myself arguing in favor of the FASB view to the IASB or, alternatively, fighting for the IASB view at the FASB. My concern is that the two Boards understand one another. The Boards will make whatever decisions they wish to make. I do not see myself dramatically impacting those decisions other than through my individual vote and role as an IASB member.

I also see my role as helping the IASB and FASB agree on agenda decisions. Both Boards will be seeking guidance on what they can do to bring about convergence in the most efficient manner.

SR: What day-to-day involvement will you have with the FASB?

JL: While I will travel at least monthly to London for meetings with the IASB, I will retain an office at the FASB. This will allow me to stay in close contact with its staff and Board members to keep up-to-date on domestic projects—particularly those with potential international applications.

Because my new employer will be the IASC, my voting rights will be with the IASB—not the FASB, which remains a seven member Board. I will participate in some of the discussions at the FASB—including at FASB Board meetings, when there are joint projects under discussion, or projects with particular international applications.

SR: How will the IASB's agenda be established?

JL: While the specifics on how agenda items will be determined are not set at this time, the work that we have done on the G4+1 has provided some initial information for the IASB. More recently, FASB Project Manager Carrie Bloomer and I have prepared a memorandum that proposes certain projects based on our involvement in G4+1 that will be used as a basis for the IASB's April discussion. The final decision by the IASB will be made after consultation with domestic standard setters and the IASB Advisory Council.

SR: What sorts of projects do you expect the IASB to put initially on its agenda?

JL: In developing agenda items, we will target those that are the most consequential to the global marketplace. Ideally, the agenda should be a mix of short- and long-term projects. Critical to this effort will be balancing our collective resources.

Based on early discussions, the IASB plans to focus on precedential projects. Understanding display implications for performance reporting would be one example. By resolving issues relating to performance reporting, progress on other future projects would be facilitated, such as those involving fair value of financial instruments. As part of performance reporting, certain elements, including the statement of comprehensive income and the statement of cash flows, would be the areas of focus.

The IASB also is considering a fundamental improvements project to take a hard look at all of its standards that are in effect. As part of that effort, the Board will examine various alternatives, ambiguities, as well as possibilities for convergence, to see what should be addressed.

Consideration also may be given to projects that are broader in scope than the improvement projects that would bring about convergence. Examples in this area might be differences in pension and income tax accounting.

Last, but not least, the IASB inherits the IASC projects on which work has already been done. This includes efforts by the Joint Working Group on Financial Instruments, the insurance accounting project and work on accounting for extractive industries, such as oil and gas. In sum, there is no shortage of potential projects for the IASB's early agenda.

SR: What do you see as the IASB's greatest challenge?

JL: The real challenge will be in balancing resources—particularly staffing resources—and managing time. Meetings will be held once a month and a great deal must be accomplished during the days that we meet.

SR: In your opinion, what is the importance of convergence and is it achievable?

JL: Clearly, the marketplace wants convergence of global accounting standards and it is attainable. The benefits would be immense for the same reasons that comparability is important in the U. S. Convergence is all about finding the superior answer and having international accounting standard setters converge around that best solution. Cooperation is essential to that process.

The IASB seeks the support and cooperation of domestic standard setters. It needs key resources that domestic standard setters can provide to help advance projects that meet the objective of convergence of accounting standards. Given this goal, it will make sense for the IASB to identify projects of common interest to multiple standard setters so that a project can be worked on simultaneously to help "pull" the project through the process, thereby speeding the time it takes to deliver a standard. The notion of convergence should never mean that the IASB is simply going to adopt a FASB standard or vice versa. This must be a collaborative process in order to ensure success.