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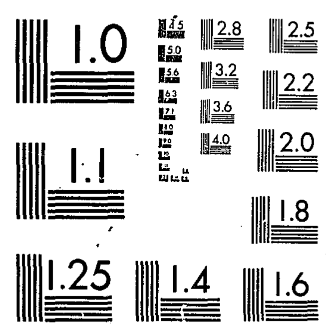

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ACCOUNTING AND AUDITING PRACTICES AND PROCEDURES

HEARINGS

BEFORE THE

SUBCOMMITTEE ON
REPORTS, ACCOUNTING AND MANAGEMENT

OF THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

NINETY-FIFTH CONGRESS

FIRST SESSION

APRIL 19, 21; MAY 10, 12, 24, 26; JUNE 9 AND 13, 1977

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FINANCIAL ACCOUNTING FOUNDATION
FINANCIAL ACCOUNTING STANDARDS BOARD

STATEMENT OF POSITION

ON

STUDY ENTITLED, "THE ACCOUNTING ESTABLISHMENT", DATED DECEMBER 1976, PREPARED BY THE STAFF OF THE SUBCOMMITTEE ON REPORTS, ACCOUNTING AND MANAGEMENT, COMMITTEE ON GOVERNMENT OPERATIONS (NOW COMMITTEE ON GOVERNMENTAL AFFAIRS) UNITED STATES SENATE

April 14, 1977

FINANCIAL ACCOUNTING FOUNDATION
FINANCIAL ACCOUNTING STANDARDS BOARD

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TABLE OF CONTENTS

94-081 O - 77 - 13

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AN OVERVIEW IN PERSPECTIVE

The Financial Accounting Foundation ("FAF" or the "Foundation") and the Financial Accounting Standards Board ("FASB" or the "Board") welcome the opportunity to cooperate with the Subcommittee on Reports, Accounting and Management in the exercise of its Congressional oversight responsibilities, and to submit this Statement of Position to state their views with respect to certain of the Study's recommendations and to correct and supplement the Study and to balance the record.

The FASB is the authoritative professional body designated by the American Institute of Certified Public Accountants ("AICPA") and recognized by the Securities and Exchange Commission (the "SEC" or the "Commission") to establish and improve financial accounting and reporting standards—i.e., those standards concerned with recording meaningful information about economic events and transactions in a useful manner in financial statements. The FASB does not set auditing standards or regulate auditing, which involves examining financial statements for the purpose of expressing an opinion as to whether they are presented fairly in conformity with generally accepted accounting standards. The formation of the FASB in 1972, as the independent, full-time accounting standard-setting body within the FAF, was widely endorsed by the accounting profession, the SEC, the financial and business community, accounting educators, and other commentators. As such, the FASB is primarily concerned with, and specially competent to comment on and take issue with, the Study's assertions with respect to the establishment of financial accounting standards and its recommendations for action by the Federal Government in that area. We understand that the AICPA, other professional and financial associations, individual accounting firms and others will be commenting on auditing and the other major areas of the Study.

In particular, the FAF and FASB strongly disagree with the recommendation of the Study that the Federal Government directly establish financial accounting standards for publicly-owned corporations.

The FAF and FASB strongly oppose this Study recommendation because in their opinion the present system of setting financial accounting standards, as it has evolved and is evolving, has successfully served the public interest, and affords the greatest promise of further developing accounting standards which are meaningful and useful to the investing public and other users of financial statements.

There is also no evidence in the Study or elsewhere, and indeed substantial doubt, that a Federal Government agency or agencies could do as well.

In the first place, a take-over by the Federal Government, or any action reducing the FASB from a standard-setting to a consulting or advisory body, would seriously disrupt the progress being made and would inevitably result in significant delays while an untried system is developed and launched. We believe, moreover, there would be a substantial reduction in the significant voluntary efforts which have characterized the commitment of the accounting profession, academicians, financial analysts and other users of financial statements, and others within the business and financial community in contributing generously of their time and effort to improve financial accounting standards.

Second, the Study fails to document its claim that standard-setting by the Federal Government—which has concentrated in special, limited areas such as regulated industries, or on a particular aspect of accounting, such as cost determination for government contracts—would be feasible or effective in the broader area of general purpose financial statements. We are clear that it would not be. Public investors, creditors and other users concerned with capital formation and deployment and the resources and operations of business enterprises rely on general purpose financial statements prepared in conformity with generally accepted accounting principles. These generally accepted principles provide an objective framework within which literally thousands upon thousands of transactions and events are evaluated, classified and reduced to meaningful numbers and then presented in financial statements useful for decision-making. The FASB's task of establishing and improving the accounting standards on which these financial statements are based is infinitely more pervasive and complex, the constituency significantly larger and more diverse, and the subject matter not limited to a specific function of Government. When understood in these terms, it is clear why the SEC, the accounting profession, users of financial statements, the business and financial community, accounting educators, and responsible public commentators alike have supported the FASB, operating within a framework of SEC review and participation. Congress has long been aware of and inquired before about this structure, but has not disturbed it. As documented in this Statement of Position, this structure has assured development of meaningful financial accounting standards in the public interest and financial statements useful for economic and investment decisions.

Third, the present system of setting accounting standards promotes the coming together of varying points of view in order to assist the FASB in determining what is most in the public interest. This is not to say that consensus satisfactory to all is necessarily desirable or can always be reached, or that progress is always as fast as some would have it. Some FASB accounting standards have been criticized by a number of those participating in the process, but this criticism is positive and constructive and assures general support and continuing participation. On the other hand, were the Government to take over, the process would in our judgment tend to become more adversary in nature, and constructive criticism and willingness to cooperate would diminish, and with it accounting standards most responsive to the needs of investors and the general public. We are concerned that Government accounting standard-setting would become legalistic and mechanical in both formulation and application, with problems frequently resolved in the courts.

Finally, we are concerned that displacement by Government of the present process of setting accounting standards could adversely affect the status of the United States as the world's largest and most open capital market. That status was achieved in part because the existing framework for establishing accounting standards provides financial information recognized and relied on throughout the world for its integrity and utility in reaching capital and investing decisions. If, on the other hand, accounting standards come to be formulated primarily to direct or implement specific, and changing, policy goals, this objective could seriously undermine confidence in financial statements and hamper the promising efforts in recent years towards developing the international capital markets.

We say this only after carefully considering the points advanced in the Study. We also say this as professionals who have given years of study, thought and effort to the most effective mechanism for setting accounting standards that best serve investors in particular and the public in general.

Our objective in submitting this Statement of Position is to provide a complete, accurate and balanced portrayal of the corporate financial accounting matters dealt with in the Study. We are confident that our presentation will demonstrate to the satisfaction of the Subcommittee that no fundamental change is required in the standard-setting process which, in cooperation with the SEC, has worked successfully to give the United States the most advanced accounting and corporate disclosure standards in the world.

In particular, we emphasize, and will document in this Statement of Position, that:

1. The accounting profession and the FASB, with the support, cooperation and participation of the private sector and the SEC, has been responsive to and acted in the public interest in establishing accounting standards. Contrary to the Study's assertions, the FASB's public due process procedures result in broad public participation in the standard-setting process. The analysis of the record demonstrates conclusively that the FASB meets its responsibilities with integrity, independence and objectivity and is not "dominated" (whether in terms of money, personnel or organizational support) by any of its sponsoring organizations, the large accounting firms or any "special interest group". There is a significant and steady record of progress in this cooperative effort with Government in establishing meaningful accounting standards, responsive both to newly emerging problems as well as the more intractable problems of the past. In its less than four years of operations, the FASB has issued 14 Statements of Financial Accounting Standards, 18 Interpretations, 20 Exposure Drafts, 13 Discussion Memoranda and held 15 public hearings on a range of significant accounting matters, and is currently engaged in a project to establish a comprehensive conceptual framework, including objectives of financial statements, to guide further improvements in financial accounting and reporting. (Parts I, II and III and Exhibits A, B, C and D)

2. The record is clear that the SEC has continuously exercised effective review of the FASB, its predecessor accounting standard-setting bodies and the accounting profession, and has not hesitated to exercise its authority promptly and in the public interest to supplement, supersede or to suggest standards, whenever it has perceived a need to do so. Contrary to the Study's assertions, the SEC has not "delegated" its authority or responsibility by its recognition of the FASB and its acceptance of accounting standards established by the FASB and its predecessors as presumptively binding and necessary for fair financial presentations. (Parts III, IV and V)

3. As discussed above, the Study presents no evidence that a Federal take-over of financial accounting standard-setting either could or would improve financial accounting standards, and there are substantial reasons for concluding it would not. The FASB and its predecessors have made significant progress in eliminating accounting alternatives and in some cases achieving that "uniformity" in accounting standards which the Study conceives, incorrectly, as the ultimate goal of the standard-setting process. The Government's Cost Accounting Standards Board, also a panel of extensively experienced experts, has recognized the impossibility of defining and attaining absolute uniformity, even in the comparatively limited area of cost accounting for government contracts. The FASB, like the CASB, has required a single accounting treatment when it has determined that circumstances are substantially the same for all those affected and this treatment will result in the most meaningful and useful financial presentation. (Parts III and V and Exhibits D and E)

4. Contrary to the Study's assertions, the record shows that neither preparers of financial statements nor accountants have an unrestricted ability to pick and choose, or to change, accounting standards to present matters in the most favorable light. Both the profession and the SEC have acted so that the FASB's and its predecessors' pronouncements are authoritative and presumptively binding to the exclusion of contrary principles. Changes in accounting standards are permitted if they improve financial accounting and reporting. The Study's assertions that there are too many accounting alternatives cannot be relied on, for the data the Study cites were developed in 1965 and have not been updated to reflect 12 years of progress, including steps by the FASB and its predecessor, the Accounting Principles Board, to reduce and in some cases eliminate alternatives. The Study, moreover, makes no effort to distinguish alternative practices which are necessary to reflect different circumstances or wholly different transactions. The Cost Accounting Standards Board has recognized the need for alternative accounting standards to meet differing circumstances and conditions in a number of its pronouncements. (Parts III and V and Exhibits D and E)

5. Contrary to the Study's assertions, the adequacy of accounting standards is not the issue in connection with the Study's cited instances of corporate accountability failures and financial difficulties, or public revelations of "questionable" or "improper" corporate payments. Virtually all of these cases involved fraud, dishonesty, falsification of books and records, inadequate or circumvented internal controls, estimates and judgments proved wrong by subsequent events, or simply poor or inadequate management—but not the inadequacy of accounting standards. We do not minimize the significance of these problems, or suggest they are not proper subjects for Congressional concern. We do believe it important, however, to place the factors contributing to these problems in proper perspective. (Part III)

6. The success and great value of the present cooperative effort between the FASB and the SEC with support and participation within the private and public sectors is apparent when one considers a complete, accurate and balanced record—and when one assesses the real and significant risks in switching to a new and untried system. There is no evidence in the Study or elsewhere that the FASB is not dedicated to the public interest or unequal to the task, or that Government could do better or even as well. Of equal importance, there is substantial evidence of continuing and willing support, both within Government and the private sector, for the FASB and the existing framework for establishing and improving financial accounting standards. (Parts I, II, III, IV, V and Exhibits A, B and D)

The principal question before the Subcommittee on this issue is:

Should financial accounting standards continue to be set by an experienced body responsive to the needs of public investors and others using financial information, and which draws on the substantial knowledge, experience and expertise of those who prepare, attest to and use financial statements, all as continuously reviewed and from time to time supplemented and revised by the SEC—Or should the Federal Government, directly or through an agency or agencies, replace this process with a new, untried system and assume full responsibility for, and set, accounting standards underlying general purpose financial statements?

In considering this issue, it is important to bear in mind that virtually every aspect of industry and commerce, from heavy construction and housing starts to employment levels, consumer credit, and pension, welfare and other social programs—indeed all activity involving formation or deployment of capital—is based on financial information. The primary objective of the existing structure for setting accounting standards—to provide meaningful financial information useful to the public in making decisions—will eventually cease to be reflected in public financial information if the primary objective of accounting is changed, as the Study's recommendation entails, to support specific, and changing, policy goals.

If the Federal Government perceives a need for specialized financial data in the formulation of national policy, that data can be obtained without altering or replacing the existing accounting standard-setting framework. A recent example is Public Law 94-163, "Energy Policy and Conservation Act", in which Congress directed the SEC, with the assistance of the FASB, to develop accounting practices sufficient to generate a special energy data base for oil and natural gas producers to assist Congress in formulating energy policy. The FASB is currently working on accounting standards for the extractive industries pursuant to this Congressional mandate. The FASB's development of a comprehensive Discussion Memorandum in cooperation with a task force of knowledgeable and experienced members, and observed by representatives of the SEC, the General Accounting Office, the Cost Accounting Standards Board, the Federal Power Commission, the Federal Energy Administration, and a Congressional committee, is testimony to the feasibility and advantages of maintaining financial accounting and reporting where it now is, rather than having the Federal Government assume direct control, and the corresponding sole responsibility for the work and the result.

In considering this issue, it is also important to bear in mind that the Study's principal recommendation regarding accounting standard-setting is based on fundamental and pervasive misconceptions of the purpose and goal of financial accounting and reporting, the

process for establishing financial accounting standards, the nature and basis for selecting and applying these standards, and the financial presentations to which they apply. This Statement of Position will correct these misconceptions and balance the record with respect to

1. The independence and objectivity of the FASB in performing its standard-setting responsibilities in the public interest (Part I and Exhibits A, B, C and D);

2. The broad public participation in this process (Part II and Exhibits A, B and D);

3. The responsiveness and success of the FASB and the private sector, with SEC review and participation, in establishing meaningful financial accounting standards in the public interest (Parts II and III and Exhibits A, B, D and E);

4. The nature, selection and application of financial accounting standards, the financial presentations to which they apply, and their binding and authoritative character (Part III and Exhibit D);

5. SEC review and participation in the accounting standard-setting process (Parts IV and V); and

6. Federal standard-setting, and the support and recognition Government agencies are according the FASB and its accounting standards (Part V).

The FAF and FASB do not claim that the existing structure for establishing accounting standards is perfect, for they recognize that the present system, like accounting itself, is a dynamic and evolving process of continuing improvement. An essential characteristic of a vital organization or profession is its willingness and ability to challenge itself, with thoroughness and objectivity, and promptly to implement improvements where desirable. The FASB and the accounting profession are not exceptions.

The profession's recent history has been marked by a number of significant efforts to improve financial accounting. In 1972, the AICPA commissioned a seven-man study group, the majority of whom were outside the accounting profession, under the chairmanship of Francis M. Wheat, a lawyer and former SEC Commissioner, to conduct a comprehensive review of the FASB's predecessor, the Accounting Principles Board. The result was the "Wheat Report", "Establishing Financial Accounting Standards", which, following wide acceptance within the profession, the interested public and endorsement by the SEC, led to the formation of the FASB. In October 1973, another AICPA-commissioned study group, under the leadership of the late Robert M. Trueblood, issued a comprehensive report entitled "Objectives of Financial Statements", which became a basis for the FASB's current major project on "A Conceptual Framework for Financial Accounting and Reporting". In another area, the AICPA commissioned former SEC Chairman Manuel F. Cohen and a group of other experts in 1974 to study and to report on the role and responsibilities of independent auditors. The Cohen Commission's tentative conclusions and recommendations for improvement have recently been announced, and a further report is expected later this spring.

The FAF and the FASB have similarly been active with regard to the structure for establishing accounting standards. The FAF's By-Laws expressly require its Trustees to "review periodically . . . the basic structure of establishing and improving standards of financial accounting and reporting." Since the FASB's formation, the FAF's Trustees have designated a Structure Committee from among their number, and charged that Committee with the responsibility of "making recommendations to the Board of Trustees regarding any changes in the basic structure of the Financial Accounting Standards Board and Financial Accounting Standards Advisory Council. . . ."

The FAF's and FASB's internal evaluations have resulted in improvements. In early 1975, the FASB established a technical division to deal specifically with an increasing volume of emerging problems involving narrow but significant accounting questions of some urgency, and appointed a continuing 15-member Screening Committee on Emerging Problems to assist it. In mid-1976, the FAF's Structure Committee recommended that the Securities Industry Association, representing investment bankers charged by Federal statute with significant duties to the public, be added as a sponsoring organization to broaden still further public support and involvement in establishing accounting standards. The Securities Industry Association became a sponsor effective October 1, 1976.

In December 1976, the third anniversary of the FASB's first accounting pronouncement, the FAF's Trustees directed the Structure Committee to conduct a comprehensive oversight study of all aspects of the FASB's organization and operations. After an extensive process of interviewing over 100 persons of various disciplines, including persons in the Federal Government, and a two-week field review in Stamford, Connecticut of all aspects of the FASB's technical and administrative operations and procedures, the Structure Committee has recommended and recently made public specific proposals designed to increase still further public participation in the FASB's processes and to improve its effectiveness and efficiency in meeting its responsibilities. The FAF's Trustees have agreed in principle with this report and intend to consider expeditiously the Committee's recommendations. As discussed below, and perhaps of particular interest, the Structure Committee has recommended that the Trustees consider further representation of financial statement users on the FAF's Board of Trustees, and that the AICPA's Board of Directors be replaced as sole elector of FAF Trustees by representatives of the Foundation's six sponsoring organizations with each having an equal voice in the Trustee selection process.

In a similar vein, and in anticipation of the expiration of the FAF's five-year start-up financing plan in December 1977, the FAF Finance Committee is currently proceeding with a new plan for 1978 and subsequent years predicated on further increasing the breadth and depth of public support. This plan is based on the principle that no one person, firm or corporation will be solicited to contribute, or will contribute, annually more than the lesser of $50,000 or 1% of the FASB's annual operating expenses. This plan will have the practical effect of reducing the annual contributions of the eight major accounting firms from the $200,000 contributed annually by each since 1972—a practical necessity when the FASB was launched—to no more than $50,000 per firm each year, and reducing other contributions as well through the AICPA's Accounting Research Association.

The FAF's Trustees are also reviewing another aspect of the FASB's process. The Trustees have directed its Committee on Personnel Policies to review the FASB's existing conflict of interest policies, and to make such recommendations as the Committee may deem appropriate. In particular, the Trustees have charged the Committee to consider reporting of all investments, even immaterial ones, by FASB members and staff directors; specific limitations on certain securities transactions and on receipt of gifts from non-family members; and adoption of a more general rule with respect to potential conflicts of interest. The Committee is expected to make its recommendations at a meeting of the FAF Trustees later this spring. While the FAF and FASB disagree with the Study's assertions as to the

effectiveness of existing personnel policies and emphasize there has been no instance of detrimental conduct since the Board's formation, they accept the principle articulated in existing policies that perceptions of potential conflict, however unfounded, can be as troublesome as conflict in fact, and should be investigated, not ignored.

The FAF and FASB are consistently on record as welcoming a fair and objective study of the structure and the public procedures for establishing and improving financial accounting and reporting standards. We are confident that when an objective analysis, based on a complete, accurate and balanced record, is made, the conclusion will be that the existing structure with the FASB is most effective in establishing financial accounting standards in the public interest. This structure has evolved and is evolving in response to Congress' recognition in the first Federal Securities Laws of the unique responsibilities of the accounting profession and the significance of financial statements to public investors.

As the balance of this Statement of Position demonstrates from varying perspectives, this structure has worked and is working effectively in the public interest through the FASB, as the designated standard-setting body, with support within the private and public sectors and review and participation by the SEC.

I. INDEPENDENCE AND OBJECTIVITY OF THE FASB IN THE STANDARD-SETTING PROCESS

A. Formation of the FAF and FASB

The FAF and FASB were created in 1972, the result of the recommendations of a seven-man study group appointed by the AICPA's Board of Directors to study the process of establishing accounting principles and to make recommendations for improving the process.

Chaired by Francis M. Wheat, a lawyer and a former SEC Commissioner, the Wheat Study Group,* after public hearings, numerous interviews and review of position papers, concluded that a "continuing dynamic relationship between a private standard-setting board and the SEC offers the greatest potential for future progress in financial accounting". The Wheat Study Group also concluded that "continuation of the framework and the process of developing accounting standards originating in the 1930's would result in acceptance of a private body's accounting standards by the accounting profession, government and the public at large", if

1. the standard-setting body were independent and objective in fact and appearance;
2. there were significant participation by the financial reporting community in the standard-setting process;
3. standards were issued only after public procedures insuring that all who wished to be heard would be heard and their views considered;
4. the quality of the body's pronouncements were high in terms of logic and supporting reasoning, consistent with objectives, amenable to the exercise of professional judgment where appropriate, and useful to investors and the public at large; and
5. the accounting profession supported these standards in attesting to the fair presentation of financial information.

To accomplish these goals, the Wheat Study Group recommended that

1. A Financial Accounting Foundation be established separate from all existing professional bodies, with a Board of Trustees nominated by organizations** having

* Other members of the Wheat Study Group and their affiliations at the time were John C. Biegler (senior partner of Price Waterhouse & Co.), Arnold I. Levine (national executive partner-management of J. K. Lasser & Company), Wallace E. Olson (executive partner of Alexander Grant & Company), Thomas C. Pryor (Senior Vice President of White, Weld & Co.), Roger B. Smith (Vice President-Finance of General Motors Corporation), and David Solomons (Professor and Chairman of the Accounting Department, Wharton School of the University of Pennsylvania).

**American Accounting Association (AAA) (12,000 accounting educators, academicians and practicing accountants), American Institute of Certified Public Accountants (130,000 certified public accountants), Financial Analysts Federation (Analysts Federation) (14,000 analysts, investment advisers and portfolio managers), Financial Executives Institute (FEI) (9,250 financial and accounting executives representing 5,000 companies), and National Association of Accountants (NAA) (70,000 financial and accounting executives and accountants). In September 1976 the Foundation's Certificate of Incorporation was amended to add the Securities Industry Association (SIA) (600 investment banking and other securities firms) as a sponsoring organization and to expand the Board of Trustees to include an additional financial executive and an investment banker. The current Trustees and their principal occupations are listed in Exhibit A hereto.

special expertise and continuing interest in financial accounting and reporting matters and consisting of five certified public accountants in public practice (including, *ex officio,* the Chairman of the AICPA), two financial executives, one accounting educator and one financial analyst. The principal duties of the Trustees would be to appoint members to the Financial Accounting Standards Board and to a public advisory body, the Financial Accounting Standards Advisory Council; to raise funds to support these organizations; and to review periodically the basic structure of the standard-setting organization;

2. The FASB be given all authority, functions and power of the AICPA and Foundation's Trustees for establishing and improving standards of financial accounting and reporting and the conduct of all activities relating thereto. The FASB would have seven full-time, salaried members independent of all other professional and business affiliations, four of whom would be certified public accountants drawn from, or principally experienced in, public practice, while the remaining three, who might but need not be certified public accountants, would be well versed in problems of financial accounting and reporting*; and

3. A Financial Accounting Standards Advisory Council be appointed from the public to work closely with the FASB in an advisory capacity as to accounting and reporting matters, with its members drawn from a variety of disciplines with no particular occupation predominating.**

These recommendations were widely endorsed at public hearings and in interviews and comment letters by the accounting profession, the SEC, the financial and business community, accounting educators, and the interested public. The Internal Revenue Service ruled in 1972 (and reaffirmed in 1976) that the Foundation was an educational charitable institution exempt from taxation under Section 501(c)(3) of the Internal Revenue Code. Of special significance, the accounting profession and the SEC each took prompt steps in 1973 to endorse the FASB as the official accounting standard-setting body and to designate its pronouncements as authoritative and presumptively binding for financial statements.

The AICPA designated the FASB, effective July 1, 1973, as the successor to the Accounting Principles Board (the "APB") in establishing accounting principles for purposes of Rule 203 of the AICPA's Code of Professional Ethics. Rule 203 provides that no accountant who is a member of the AICPA may opine that financial statements are fairly presented in conformity with generally accepted accounting principles if such statements depart from an FASB pronouncement or an effective pronouncement of its predecessor standard-setting bodies, the Accounting Principles Board and the Committee on Accounting Procedures, unless the accountant can demonstrate that due to unusual circumstances the financial statements would otherwise be misleading.

In December 1973, the SEC reaffirmed its administrative practice and policy of looking to the accounting profession's authoritative standard-setting body for initiative in establishing and improving accounting principles and standards, and stated that principles, standards and practices issued by the FASB and its predecessors were presumptively required to be applied in financial statements filed with the SEC and that financial

* Currently these three include a former accounting educator, the former Chief, Office of Accounting and Finance of the Federal Power Commission, and a former corporate financial executive. See Exhibit A hereto for a listing of the seven current FASB members and their former affiliations.

**The current members and their affiliations are listed in Exhibit A hereto.

statements applying contrary accounting principles would be unacceptable in the absence of an SEC determination to the contrary.

B. Independence Through Corporate Structure

The corporate structure of the FAF and the FASB, recommended by the Wheat Study Group and adopted only after review and public hearings called specifically for the purpose, is designed to assure the integrity, independence and objectivity of the FASB as the official accounting standard-setting body.

Under the Foundation's Certificate of Incorporation, the electors of the Foundation (i.e., its members, or stockholders if the FAF were a business corporation, and currently the AICPA's Board of Directors) have no powers, authority or functions other than electing and, in limited specific circumstances, removing the FAF's Trustees*. Similarly, the FAF's Certificate of Incorporation provides that all powers, authority and functions of the Foundation and the Trustees in respect of financial accounting and reporting standards, including all activities relating thereto, are delegated to the FASB. In furtherance of this delegation, the Foundation's By-Laws provide that the Trustees may not, directly or in connection with their approval of annual budgets, cause the FASB to undertake or to omit to undertake any particular technical project or activity, or otherwise affect the FASB in the exercise of its powers and responsibilities over financial accounting and reporting. Apart from their authority to appoint and, in limited specific circumstances, to remove members of the FASB** and the Advisory Council, the Trustees' only remaining authority is limited to periodic review of the basic structure for establishing financial accounting standards. Structural changes affecting the FASB and the Advisory Council can be made only with the affirmative vote of nine of the eleven Trustees.

Similarly, there can be no personal participation by the Foundation's Trustees in the technical work of the FASB or any of its other activities. The Trustees are prohibited from serving simultaneously as FASB members or staff members, or from serving on the Advisory Council, the FASB's Screening Committee on Emerging Problems, or any FASB task forces. Correspondingly, no appointed member of the Advisory Council may serve as a Trustee or as an FASB member or staff member, and no member of the Board of Directors of the AICPA (the Foundation's present elector) may serve as an FASB member or staff member.

The effect of these prohibitions, and the personnel policies discussed below applicable to FASB members and staff members, ensures at all times that the FASB will be free from pressures and influences which might be perceived as affecting the integrity, independence or objectivity of the FASB as a standard-setting body. This structural independence has proven as effective in practice as it was when first recommended by the Wheat Study Group and endorsed by the SEC and the accounting profession, and there has been no instance

* These circumstances are the same as for removal of FASB members, as discussed below. No Trustee has been removed or considered for removal.

** An FASB member can be removed only on the vote of eight of the FAF's eleven Trustees and only then in limited specific circumstances for reasons of disability, malfeasance or alleged malfeasance, or conduct otherwise detrimental to the Foundation or the FASB. No FASB member has been removed or considered for removal for any reason, and, contrary to the Study's assertion, these standards do not permit removal except in extreme and necessary cases. The power of removal is not a means of assuring that the FASB acts in a manner responsive to the desires of the Trustees, and certainly cannot be invoked "for anything that might offend the sensitivities of the FAF Trustees".

where anyone has sought to impose improper pressure or influence on the FASB or its activities, or where the FASB has acted other than with integrity, complete independence and objectivity.

As mentioned in the introductory overview to this Statement of Position, the FAF's Trustees directed its Structure Committee in December 1976 to conduct a comprehensive oversight study of this structure and all aspects of the FASB's organization and operations. The Structure Committee has finished its review and very recently published its report proposing recommendations designed to improve the structure of the Foundation, the FASB, and the Advisory Council to encourage still broader public participation in the standard-setting process and to improve the operating efficiency and effectiveness of the FASB and the Advisory Council.

Very briefly, the Committee's report concludes that the FASB is firmly established beyond reproach as an independent body and has added significantly to the quality and depth of accounting knowledge. The Committee also concluded that certain changes could be made to further improve the standard-setting process. Among the Committee's recommendations are that the Trustees consider further representation of users of financial statements on the FAF's Board of Trustees and that the AICPA's Board of Directors be replaced as sole elector of the FAF's Trustees by representatives of all six sponsoring organizations, each having an equal voice in the Trustee selection process. In view of its conclusion that the FASB had firmly established itself as an effective and independent standard-setting body, the Committee has also recommended that the Foundation's Certificate of Incorporation and By-Laws be amended to eliminate the requirement that four of the FASB's seven members be practicing public accountants or primarily experienced as accounting practitioners, and that FASB members be selected from the best available people solely on the basis of ability, experience and knowledge and their understanding of the needs of financial statement users. The FAF's Trustees have agreed in principle with the Committee's report and intend to consider expeditiously the Committee's recommendations.

C. Diversity of Responses to FASB Proposals

Notwithstanding, however, the careful structuring of the FAF and FASB to assure the integrity, independence and objectivity of the FASB, the Study asserts that the AICPA, the major accounting firms and the FAF's other sponsoring organizations "dominate" the FAF and through it the FASB, in order to serve the "special interests" of the major accounting firms' large corporate clients. The record proves the contrary, and clearly reflects the FASB's independence and objectivity and the breadth and depth of public participation in its processes.

Dramatic evidence of this independence and objectivity and public participation is provided by an analysis of the comments received from those alleged by the Study to dominate the FASB in response to the Exposure Drafts for FASB Statements No. 2, 5, 7, 8, 9, 12, 13 and 14, eight of the Board's most significant Statements to date.

This analysis, set forth in Exhibit B, was undertaken by the FASB's technical staff, who selected the accounting proposals, and the major issues within each proposal, before commencing the analysis and without regard to possible outcome. The staff reviewed responses on these proposals and issues from public respondents in the following categories: the FAF's six sponsoring organizations, the 15 largest accounting firms, all academicians, and *Fortune's* 1975 listing of the 500 largest industrial companies and each of the 50 largest commercial banking, life insurance, diversified financial, retailing, transportation, and utilities enterprises. These responses are contained in the FASB's public record and are available for public inspection at its offices in Stamford, Connecticut.

This analysis shows in detail how incorrect it is to speculate, as the Study does, that professional organizations, accounting firms and business enterprises act in concert when commenting to the FASB on accounting proposals.

As Exhibit B shows, sponsoring organizations frequently disagree among themselves; major accounting firms disagree with each other, their clients and the AICPA; and the FASB's most consistent support in terms of positions taken seems to come from users of financial statements. If one were to generalize, or "keep score", the following could be viewed as representative of the entire analysis.

Taking the 19 issues* analyzed in Exhibit B on which it is possible to say that a given response on the Exposure Draft was equivalent to a given attitude on the Board's final position in the Statement, one sees that the least supportive of FASB decisions were business enterprises. Views expressed by a majority of business enterprises were rejected by the Board on 12 of 19 issues. Those sponsoring organizations representing the views of corporate financial and accounting executives also had little apparent influence on the FASB, for the FEI disagreed with the Board on 6 of the 10 issues it addressed and the NAA disagreed on all 5 on which it took a position.

The record of rejection of the views of business enterprises and corporate financial and accounting executives, conveniently classified as preparers of financial information, stands in sharp contrast to the record of users of financial information, to the extent represented by the Analysts Federation. The Analysts Federation supported the Board on all 15 issues on which it took a position.** The major accounting firms and the AICPA were somewhere between preparers and users on these proposals; the AICPA supported the FASB on 8 issues and disagreed on 4, while major accounting firms were in accord on 9 and in disagreement on 6.

The analysis also contradicts the Study's unsupported charge that accounting firms are "dominated" or "controlled" by their clients: the number of issues on which major accounting firms were consistent with a majority of their responding clients was roughly equivalent to the number of issues on which they disagreed (43 to 42).

* The questions used in these aggregate figures are Statement No. 2, issue 1; Statement No. 5, issues 1, 2 and 3; Statement No. 7, issues 1, 2 and 3; Statement No. 8, issues 1, 2 and 3; Statement No. 9, issues 1 and 2 (Exposure Draft and Public Hearing); Statement No. 12, issue 1; and Statement No. 14, issues 1-5. On Statement No. 8, issue 1, qualified agreement was classified as disagreement.

** The Study states: "Of the five private groups sponsoring the FASB, only the Financial Analysts Federation and its members have an apparent interest in developing accounting standards, which clearly convey the results of corporate activities to the public. . . . The Financial Analysts Federation appears to have the least influence as a sponsor of the FASB, and the FASB has yet to establish the type of meaningful accounting standards which would be most beneficial to investors and other users of financial statements."

In analyzing the public record of responses on specific issues, Exhibit B also demonstrates, in sharp contrast to the Study's speculation, the full range of diverse views on major FASB positions. The following examples illustrate such diversity.

In Statement No. 5, the FASB established financial accounting and reporting for loss contingencies. Support for the provisions subsequently adopted in the Statement was expressed by the Analysts Federation and the AICPA, while the FEI and the NAA opposed them. Six major accounting firms generally agreed with those provisions; five generally disagreed. The seven academicians who took positions unanimously were in support.

This pattern was generally followed on the specific issues. The FASB decided that accrual would not be permitted for self-insured risks. Business firms overwhelmingly opposed this view; fifty firms disagreed with the FASB position and only two supported it. Again, the FEI and the NAA opposed, and again the AICPA and the Analysts Federation supported the FASB position. Five accounting firms supported the FASB; only one disagreed. Four of the five firms agreeing took a view opposed by the overwhelming majority (20 to 2) of their clients. Again, the academicians unanimously supported the FASB.

Similarly, the FASB proposed and subsequently concluded in Statement No. 5 that accrual not be permitted for catastrophe loss contingencies for casualty insurers. Nineteen business firms disagreed with the FASB position; six supported it. The FEI disagreed again; the Analysts Federation and the AICPA supported the FASB. The three accounting firms disagreeing with the FASB took positions consistent with those of the majority of their clients. Once again the academic commentators responded unanimously in support of the FASB position.

In Statement No. 12, the FASB determined how certain equity marketable securities would be carried on the balance sheet and how declines in market value below cost would be treated. The Exposure Draft's proposal that those securities be carried at the lower of cost or market value was followed in the Statement. But the Exposure Draft's proposal that declines be charged to net income was modified to apply only to securities classified as current assets, with declines in other securities being charged to stockholders' equity.

The Analysts Federation, the AICPA, and the AAA committee members all supported the Exposure Draft's overall approach; the FEI disagreed. Five accounting firms disagreed; four agreed, and three had no clear overall position. Academicians split evenly. Business firms generally disagreed (38 to 13). Four of the five accounting firms disagreeing with the position of the Statement took positions consistent with those of their clients; the four accounting firms agreeing with the position of the Statement all were in disagreement with a majority of their clients.

On the issue of how securities would be carried on the balance sheet, the final FASB position was supported by the Analysts Federation, the AICPA, and the AAA committee members; the FEI disagreed. The major accounting firms were evenly divided on this issue (5 to 5). Business firms again strongly opposed the FASB approach (38 to 2). Two academicians supported the FASB position, and one opposed it. Of the five accounting firms supporting the Board's position, all took positions inconsistent with those of the majority of their clients.

On the second issue in the Exposure Draft, which the FASB modified in its final Statement, the Analysts Federation, the AICPA and the AAA committee members again supported the FASB's Exposure Draft, while the FEI disagreed. The major accounting firms opposed the position in the Exposure Draft by a narrow margin (5 to 4). The two academicians who took a position agreed with the Exposure Draft. Business firms again strongly opposed the Exposure Draft by a margin of 29 to 2.

Reaction to the Exposure Draft's proposal subsequently adopted in Statement No. 8, "Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements", to include in determining income foreign currency exchange gains or losses was divergent between users and preparers of financial statements. The Analysts Federation supported the proposal; the NAA disagreed. Three major accounting firms supported the proposal and three disagreed. Business firms overwhelmingly opposed the proposal (54-5).

An interesting picture also emerges from the comments on the Exposure Draft preceding Statement No. 7, "Accounting and Reporting by Development Stage Enterprises", a Statement which the Study characterizes as benefiting "big business." The FASB decided that development stage enterprises should be subject to the same accounting standards as established enterprises, and the Analysts Federation, the FEI and the AICPA supported this view. The major accounting firms split (4 to 4), and nearly half (15 of 34) of *Fortune's* responding corporations disagreed with the FASB.

As mentioned above, Exhibit B contains further analyses of responses on several additional issues in these and other significant accounting standards. While comments analysis is not a precise science and, as Exhibit B points out, necessarily involves judgments in analyzing and classifying responses, the FAF and FASB believe that the results of this analysis demonstrate conclusively that no one "dominates" or "controls" the FASB, and that FASB determinations are made independently and objectively and only after receiving and considering a myriad of conflicting points of view.

D. Funding

The Study asserts that funding of the FASB through the Foundation, and the salaries paid to FASB members and staff, is one means "to insure that financial accounting standards remain compatible with the interests of the 'Big Eight' and their clients." The Study offers nothing beyond speculation in support of this assertion, and indeed nothing else exists.

In addition to revenues from the sale of FASB publications, reprint royalties and interest income (nearly one-third of total revenues in 1976), the FAF is funded by contributions from a wide range of sources, principally from the accounting profession and business, commercial and financial enterprises, including dues through its program of associate membership. Associate members receive automatically copies of Discussion Memoranda, Exposure Drafts, Statements and Interpretations and the FASB's newsletter "Status Report." For 1976, approximately 45% of the FAF's budget was funded by contributions from the financial and business communities, with the average contribution being $1,300, and the largest being $40,000 or less than 1% of the FASB's operating expenses of $4,199,000. Another $1,766,000 was attributable to dues paid to the Accounting Research Association of the AICPA, with the 15 largest accounting firms accounting for approximately 87% of this total. Additionally, the AICPA, AAA, Analyst Federation and NAA contributed $208,000, $7,000, $7,000 and $75,000, respectively.

While this breadth of financial support is significant, the Trustees' announced and continuing goal is to expand the base of support further and to rely to a lesser degree on large contributions.

Funding of the FAF has been an evolving process. When the FAF and FASB were created in 1972, the most obvious problem confronting the FAF's Trustees was to insure

adequate financing. The Wheat Study Group had estimated an annual budget of up to $3 million per year and had recognized that voluntary contributions would necessarily constitute the bulk of financial support, at least during the start-up phase. The Wheat Study Group mentioned several possible approaches to the contribution question, but concluded that the matter was best left to the Foundation's Trustees.

It was clear to the FAF's first Board of Trustees that, as a matter of practical necessity, the success of the FASB depended upon significant financial commitments from within the accounting profession. Accordingly, the Trustees initially concentrated on establishing this necessary base and, as a result of their efforts, the Accounting Research Association of the AICPA committed to use its best efforts to raise sufficient funds from within the accounting profession to insure that the Foundation would receive at least $2,000,000 in each of its first five years through 1977. As a part of this commitment, the eight largest accounting firms pledged $200,000 in each year of the five-year start-up period and the ARA's suggested contributions for other accounting firms were set proportionately based on their size. As a result of the ARA's efforts, the Foundation has received approximately $2,000,000 each year from the accounting profession, and at December 31, 1976 the ARA held approximately $1,780,000 in excess of its commitment. Membership dues received by the ARA are its source of funds.

The Trustees also sought contributions in the FASB's start-up period from whatever other sources they could find. Contribution campaigns were undertaken by other sponsoring organizations, particularly the Financial Executives Institute. Beginning in 1974 the FAF also commenced direct annual solicitations to further broaden support. Last year the Foundation mailed nearly 9,000 requests for contributions and commenced and implemented a plan of associate membership by which those contributing a specified amount would be assured of receiving automatically the FASB's technical and other publications. This plan has been successful and there are now more than 2,500 associate members.

The FAF Board of Trustees has authorized its Finance Committee to proceed with a new financing plan for 1978 and subsequent years based on further increasing the breadth and depth of public support. Specifically, this plan is based on the principle that no one person, firm or corporation will be solicited to contribute, or will contribute, annually more than the lesser of $50,000 or 1% of the FASB's annual operating expenses. As a part of this plan, the Finance Committee has suggested to the AICPA that the original five-year commitment on the part of the accounting profession through the ARA be reduced from $2,000,000 to $1,000,000 annually by means of contributions through the ARA, with this amount being supplemented by up to an additional $500,000 annually from the $1,780,000 currently held by the ARA in excess of its five-year commitment in 1972. This plan will have the practical effect of reducing the annual contributions of the eight largest accounting firms from $200,000 annually to no more than $50,000 annually, with other contributions through the ARA being reduced as well. The Trustees and the Finance Committee believe that additional public support, including support within the membership of the Securities Industries Association, and increasing publication revenues and royalties from reprint rights will prove sufficient to support the Board's operations at levels commensurate with its increasing technical activities.

The Study speculates that the seven members of the FASB may compromise their professional integrity and issue standards satisfactory to the FAF's major contributors so as not to jeopardize funding, particularly of their salaries. As demonstrated in the next section, all Board members are men with outstanding qualifications and records of service who have

94-081 O - 77 - 14

made financial, career or personal sacrifices to serve on the Board. The FAF's By-Laws specifically disallow the use of the Trustees' budget authority to interfere with or influence the work of the FASB. The Study does not, and cannot, offer evidence of any attempt to influence FASB action through financial means.

E. Personnel

1. *Training, Experience and Professional Associations.*

The Study decries the extensive participation in the FASB's processes of persons within the professional, business and financial community—defined by the Study to include all persons associated with the AICPA, "big business", members of the sponsoring organizations, lawyers, investment and commercial bankers and others.

The Study's stated concern is that participation of those belonging to the AICPA and other sponsoring organizations mutes potential criticism of the FASB and assures compatibility of the FASB's accounting standards with the views of the major accounting firms and their large corporate clients. This is without basis in fact, as the Summary and Exhibit B's analysis of responses to FASB technical proposals prove. In practical terms, it is principally from among the membership of these organizations that persons best qualified to set accounting standards are to be found. If there is one essential characteristic of accounting, it is its technical complexity and the need to rely on the judgment and willingness of knowledgeable, experienced and dedicated people from a range of disciplines and with varying points of view. No one is excluded from the FASB's processes, however, for the fundamental qualification is only the capacity and willingness to contribute to the work of the Board.

Each FASB member meets this standard, and has brought a certain dimension and an individual point of view to the FASB's standard-setting process.

Marshall S. Armstrong, the FASB's first and only Chairman, was never associated with a "Big Eight" firm, having formerly been managing partner of a regional accounting firm headquartered in Indianapolis with several smaller offices elsewhere in Indiana. Prior to his appointment, Mr. Armstrong had been a member of the Accounting Principles Board and the AICPA's Committee on Auditing Procedure, and was the President of the AICPA when the Wheat and Trueblood Study Groups were commissioned to study and report on establishing accounting standards and the objectives of financial statements.

Arthur L. Litke, former Chief of the Federal Power Commission's Office of Accounting and Finance, joined the FASB in 1973 after many years of Government service, including service as Associate Director, Civil Accounting and Auditing Division, of the General Accounting Office. Mr. Litke also served as President of the Association of Government Accountants and as a member of the Committee on Auditing Procedure.

Robert T. Sprouse joined the Board in 1973 after eight years as Professor of Accounting at the Stanford University Graduate School of Business. Prior to joining Stanford, Mr. Sprouse had taught for 13 years at the Schools of Business Administration of the University of Minnesota, the University of California at Berkeley and Harvard University. Though not a member of the AICPA, Mr. Sprouse is a past President of the American Accounting Association, and is the author of several books and many articles on accounting.

Oscar S. Gellein was a retired former partner of Haskins & Sells when he joined the Board in 1974. During his years in practice, Mr. Gellein was National Director of

Accounting and Auditing and Director of Research Activities for his firm. Prior to joining Haskins & Sells, Mr. Gellein had been a Professor of Accounting at Kansas State University and the University of Denver. Mr. Gellein was also a member of the Accounting Principles Board and the Committee on Auditing Procedure, and served on the Trueblood Study Group.

Robert E. Mays joined the Board in 1973 following his retirement as Controller of Exxon Corporation. Prior to his association with Exxon, Mr. Mays had served in various financial and accounting positions in the petroleum and retailing industries.

The remaining two FASB members, Donald J. Kirk and Ralph E. Walters, severed their respective partnerships in Price Waterhouse & Co. and Touche Ross & Co. before joining the FASB. Both men brought extensive experience as audit and practice partners to the FASB, and Mr. Walters was a member of the Committee on Auditing Procedure for four years.

The Study criticizes membership in the AICPA and other sponsoring organizations, but the FAF and the FASB are aware of no requirement that restricts or prohibits federal judges, for example, from belonging to bar associations or professional organizations advancing the development of the law. Members of Congress belong to professional and other associations, yet no one has suggested that their memberships raise conflicts of interest. We are also unaware of any suggestion that judges or members of Congress reflect the views of their professional or other associations at the expense of their public responsibilities.

If sound accounting standards are to be developed, those persons best equipped by knowledge, experience and expertise will have to bear the brunt of the responsibility for researching, considering alternatives, deliberating the issues, and deciding on the standards to be adopted. The public will not be well served by turning the ultimate responsibility over to individuals with no interest or capacity to contribute to the effort. This is certainly not to suggest the public does not have a significant interest or role in the standard-setting process; as listed in Exhibit A, the breadth of disciplines, points of view and experience represented on the FASB's Advisory Council, its task forces and its Screening Committee on Emerging Problems speaks for itself. While technicians and others with extensive knowledge or experience may do most of the actual defining of issues and deliberating and accepting some proposed solutions while rejecting others, the process is open to all for their review and comment and the FASB considers the views of all. Nor is the lay public unrepresented by its own expert; continuing review and participation of the SEC, charged by Congress with responsibility to assure full and fair disclosure, assures a most qualified spokesman in a position of authority and responsibility.

The FASB is currently developing accounting standards for the extractive industries pursuant to Public Law 94-163, "Energy Policy and Conservation Act", in which Congress directed the SEC, with the assistance of the FASB, to develop accounting practices sufficient to generate a special energy data base for oil and gas producing companies to assist Congress in formulating energy policy. The Study's criticism that 17 of the 19 members of the FASB's task force have actual or potential financial interests in the outcome seems to imply that the public interest is not being protected or served. This criticism lacks any substance, for the FASB's Discussion Memorandum in December 1976 was developed as a neutral document in cooperation with the task force under the observation of representatives of the SEC, the Federal Power Commission, the Federal Energy Administration, the General Accounting Office, the Cost Accounting Standards Board, and a Congressional committee.

2. *Personnel Policies.*

In recognition that the appearance of independence is as important as its fact, the Board of Trustees has adopted personnel policies to govern the activities of FASB members, and FASB staff directors and deputy directors. The Chairman of the Board has adopted similar policies governing the activities of the remaining FASB staff. These policies are strict, and with respect to outside earned income, receipt of honoraria, obligations owing to or payable from former employers, and understandings and arrangements for future employment, are stricter than standards applicable to members of Congress and compare favorably with standards applicable to Government agencies. Each FASB member, director and deputy director is required to sign an annual acknowledgment that he has not violated these policies.*

Pursuant to these policies, FASB members, directors and deputy directors

(a) may not be owed any financial or other obligation, directly or indirectly, by any former employer or client, other than fixed and vested pension, retirement or separation benefits and other than may arise in normal banking relations, ownership of governmental securities or publicly traded securities, and certain other limited investments;

(b) prior to advising the Trustees of intent to resign or not to stand for reappointment, may not have any formal or informal arrangement or understanding with any person to the effect that he can or will return to, or become affiliated with, an employer or business partnership, or resume or enter into consulting or other similar arrangements after termination of his relationship with the FASB or the Foundation.**

* See Exhibit C for a comparison of these policies to those applicable to members of Congress, the SEC, CASB and GAO and the Federal Judiciary.

** An exception is made for academic leaves of absence for staff (but not FASB) members.

The Study suggests that Walter Schuetze's resignation and his rejoining Peat, Marwick, Mitchell & Co. violated personnel policies applicable to FASB members. This is speculation and incorrect.

The FASB understands that Mr. Schuetze first brought up the possibility of returning to his former firm, Peat, Marwick, Mitchell & Co., with that firm's senior partner shortly before April 9, 1976. On that date, Peat, Marwick's senior partner advised Mr. Schuetze that his readmission to the firm would be recommended to Peat, Marwick's partners and principals, but that there were no assurances that Mr. Schuetze could or would be readmitted since readmission was conditioned, in accordance with Peat, Marwick's established practice, on the unanimous affirmative vote of all of the firm's more than 850 partners and principals. That same day, April 9, Mr. Schuetze notified the FAF's President and the FASB's Chairman of this and that he would resign from the FASB, effective June 30, 1976, which Mr. Schuetze confirmed by letter on April 12, 1976. It was not until May 13, 1976 that Mr. Schuetze was notified by Peat, Marwick that the vote on his readmission was favorable and that he could return as a partner, effective July 1, 1976.

During the period from April 9, 1976 through June 30, 1976, the Board took no votes on the issuance of any Exposure Drafts, final Statements or final Interpretations, and Mr. Schuetze disqualified himself from voting on the four Interpretations proposed for submission to the Advisory Council for comments. During this period, the Board also considered a Discussion Memorandum as the basis for a public hearing, and requests that it reconsider Statement Nos. 5, 8 and 12 issued in 1975. Mr. Schuetze participated in these matters, since none involved the issuance of a new accounting pronouncement or issuance of an amendment or proposed amendment of an existing pronouncement. Under the personnel policies, the question of disqualification on a vote is left to each FASB member.

(c) may not have or owe any financial or other obligation to any former employer, business relationship or client, other than normal banking relationships, covenants not to compete and obligations of a comparable character;

(d) must devote their full business time to the activities of the FASB and not engage in any outside activity which interferes with the performance of their duties, and may not be affiliated as a partner, director, trustee, officer, employee, agent or consultant with respect to any organization, other than a non-profit organization (with limited exceptions involving essentially family matters), and no affiliations with non-profit organizations or family matters may exist which interfere to any material degree with devoting their full business time to the performance of their duties, or which affect their independence or objectivity;

(e) may not, directly or indirectly, use or otherwise place themselves in a position to benefit personally from, or to disclose or make available to others, any information which might be regarded as material relating to the functions or activities of the FAF or the FASB which has not been made available publicly;

(f) must pay any fees, honoraria or other like payments over to the FAF;

(g) must report by written questionnaire all material investments*; and

(h) must take great care to conduct themselves and all their activities in such a manner that investments and personal activities will not affect their independence or objectivity or be detrimental to the interests or repute of the FAF or the FASB.

The staff personnel policies, issued by the Chairman of the FASB, are similar to the personnel policies applicable to FASB members, directors and deputy directors. Certain differences in terms of permissible activities and investments are largely practical and recognize the lesser degree of involvement and sensitivity of staff positions in the standard-setting process—in particular, the fact that only FASB members decide technical issues and vote on the issuance of FASB pronouncements.

Both personnel policies provide that violations of these policies and rules of conduct may be deemed conduct detrimental to the purposes and repute of the FASB and constitute grounds for removal or involuntary termination. The Study cites no example, nor do the Chairman of the FASB nor the FAF's Trustees know of any instance, where independence

* The Study cites as an example of self-interest that immaterial investments do not have to be reported by Board members and senior staff directors and deputy directors.

At the time of the creation of the FAF and the FASB, the question of investments was considered thoroughly before the existing policies were adopted. Unlike the SEC, which has limitations in respect of the securities of particular companies which are or recently were in registration, a comparable restriction on securityholdings by Board members and directors would involve restricting investments in every possible vehicle because of the scope of the Board's mandate to establish any and all financial accounting and reporting standards affecting all companies. It was concluded that if no investments were permitted, it would be virtually impossible to find people willing to liquidate their securityholdings and possibly incur extreme tax penalties as a condition to service. Disclosure was the alternative, and it was decided, for purely practical reasons, that little could be gained by requiring a person to list every investment if immaterial in amount or immaterial in relation to his net worth. The question of a blind trust was also considered, but as the Study concedes, its usefulness is questionable in practical terms.

As discussed above, the question of scheduling investments is currently under review by the Trustees' Committee on Personnel Policies.

or objectivity, in fact or appearance, has been or might be compromised by anyone. While the FAF and the FASB believe that existing personnel policies have proven effective, the FAF's Trustees are mindful of the Study's criticisms and, as discussed above, have directed its Committee on Personnel Policies to conduct a review and to make such recommendations for improvement as may be appropriate.

3. *Employment After Leaving FASB.*

The record provides no support for the Study's speculation, based on one FASB member's rejoining his former accounting firm, that a "revolving door" arrangement between the FASB and the "big accounting firms" has begun.

In the FASB's nearly four years of operations, four FASB members have resigned or announced their intention to resign or to retire at the expiration of their terms. Of these four, only one, Walter Schuetze, rejoined his former accounting firm. Of the others, John W. Queenan went into retirement on his resignation in 1974; Marshall S. Armstrong will step down at the end of 1977 after five years as the FASB's first Chairman to devote his full time to the Foundation for approximately two more years as Chairman Emeritus; and Robert E. Mays, who retired as Controller of Exxon Corporation prior to joining the Board, has advised the Foundation's Trustees that he does not wish reappointment upon expiration of his term at year-end. Similarly, and looking ahead, the careers of the five other present FASB members do not suggest any foreseeable possibility of a "revolving door arrangement". Oscar S. Gellein came out of retirement to join the Board in 1974, and Robert T. Sprouse and Arthur L. Litke spent their entire professional careers as, respectively, an accounting educator and an official in the Federal Government before becoming FASB members. Donald J. Kirk was reappointed in 1976 to a five-year FASB term expiring in 1981 and Ralph E. Walters just joined the Board effective April 1, 1977.

The same pattern also emerges when the FASB's technical staff is considered.* Of the sixteen technical staff members who have left to date, only three are known to have rejoined their former accounting firms and of the four others who went into public practice, three had joined the FASB directly upon leaving school. Of the other nine former technical staff members, six went to academic institutions (of whom two did not return to accounting practice), one went with a Federal Government agency, one joined an investment banking firm, and the position of one is unknown.

II. PUBLIC PARTICIPATION IN THE STANDARD-SETTING PROCESS

A. Standard-Setting

Notwithstanding the extensive procedures for encouraging public participation and obtaining public comment specified in the FAF's Certificate of Incorporation and By-Laws and the FASB's Rules of Procedure, the Study concludes "these forms of public participation, however, do not alter the fact that the actual decisions on accounting standards are made behind closed doors by private parties with a vested interest in the outcome." In effect, the Study seems to assert that the FASB's public procedures are useless. The fact is, however, that the FASB's public participation procedures were modeled on the Adminis-

* The Board supplements its permanent technical staff through its FASB Fellow Program. These technical staff members are hired on the understanding that it is expected they will return to their former employers after an approximate two-year period of concentrated technical training on the FASB's staff. The FASB Fellow Program is comparable to the SEC's Accounting Fellow Program.

trative Procedure Act and in several respects are more demanding, and were adopted only after considerable study, public exposure for comment, public hearings and widespread support within the private and public sectors.

As described in detail in Exhibit A, no Statement of Financial Accounting Standards can be issued without public exposure for at least 30 days, and Statements more frequently are exposed for at least 60 days. No Interpretation may be issued without prior general exposure, or exposure to members of the Advisory Council for comment for at least 15 days. Public hearings on projects are required for all Statements, except those where the Board specifically finds that, on the basis of existing data, it can make an informed decision without a public hearing. Fifteen public hearings, preceded by the circulation of Discussion Memoranda or Exposure Drafts, have been held to date.* Anyone may request to appear and be heard at FASB hearings, and everyone requesting to do so has been granted time to appear and to be heard on the record. In fact, the FASB has even extended hearing dates in order to permit everyone wishing to appear to do so.

The FASB presently distributes over 27,000 copies of each Discussion Memorandum, over 37,000 copies of each Exposure Draft, over 100,000 copies of each Statement, and over 90,000 copies of each Interpretation. Anyone can get on the Board's mailing list, and, depending upon the size of the document, at least one and frequently more copies of each Discussion Memorandum and Exposure Draft are free to anyone (including non-contributors) for the asking. There are no limitations on who can ask for and receive free copies, or who can subscribe to the FASB's publications or become an FAF associate member, nor is there any restriction on ordering specific publications directly from the Board. Each FASB member considers comments and position papers submitted by anyone who is willing to take the trouble to write. In addition, all comments and position papers are analyzed by the FASB's staff and copies of analyses are given to each FASB member in connection with his review.

The evolution of Statement of Financial Accounting Standards No. 8, "The Translation of Foreign Currency Transactions and Foreign Currency Financial Statements", is illustrative of the degree of public exposure and public participation in the FASB's standard-setting process. The FASB commenced the development of Statement No. 8 by appointing a task force of 14 knowledgeable and interested persons in 1973. A Discussion Memorandum was published on February 21, 1974, and 21,000 copies were distributed. Fifteen presentations were made during two days of public hearings held in New York City in June 1974. After considering the 90 comment letters and position papers received, the FASB issued an Exposure Draft on December 31, 1974, of which 39,000 copies were distributed. The FASB received an additional 191 comment letters on the Exposure Draft. The FASB issued Statement No. 8 in October 1975.

The public's participation in the development of Statement No. 8 is not unique. Since the FASB's formation, 2,200 comment letters and position papers have been received on 13 Discussion Memoranda; 322 oral presentations have been made at 15 public hearings; 3,160

* Hearings were not held for Statements No. 1, "Disclosure of Foreign Currency Translation"; No. 3, "Reporting Accounting Changes in Interim Financial Statements"; No. 4, "Reporting Gains and Losses from Extinguishment of Debt"; No. 6, "Classification of Short-Term Obligations Expected to be Refinanced"; and No. 10, "Extensions of 'Grandfather' Provisions for Business Combinations." In each case, the FASB concluded it had sufficient data upon which to reach an informed decision, and judged public exposure of the proposed statement to be all that was necessary.

comment letters and position papers have been received on 20 Exposure Drafts; and 179 different individuals have served on 14 task forces.

The Board's Statements are not dictated as unsupported decrees. In addition to stating the accounting standard, each Statement sets forth, among other things, (i) those FASB members dissenting and their comments in support of their dissent, (ii) the various alternative solutions considered by the Board and the reasons leading to their rejection or acceptance, (iii) a summary of the more significant views expressed in comment letters and position papers received by the Board, and (iv) relevant background information, including results of research undertaken on the project. The FASB's Interpretations must also contain the comments of dissenting FASB members. There is no provision in the FASB's Rules of Procedure for private or informal ex parte "interpretations" and, as a matter of policy, the FASB does not issue them. Arbitrary or self-interested standard-setting could not stand up under these requirements of self-analysis and the FASB's procedures for public comment and participation.

The Study criticizes the FASB for reaching substantive technical determinations on standards in meetings not open to the public. In so doing, however, the Study notes that the Government's Cost Accounting Standards Board is exempt under the "Government in the Sunshine Act" when reaching its decisions. The Sunshine Act's exemptions also permit the SEC to hold private meetings if it determines that premature disclosure is likely to result in significant speculation in securities or currency. The FASB considers its technical actions equally sensitive and subject to abuse if disclosed piecemeal or prematurely. In these circumstances, and because the FASB's processes are open to the public at every stage up to decision and the public is provided ample opportunity to consider and comment on the issues and alternatives and the FASB's Exposure Drafts, the FASB has felt it preferable for everyone to become informed of the same information at the same time.

B. Public Notice and Public Record

In order to maximize public participation and to keep the public informed promptly of significant developments, the FASB's Rules of Procedure require it to make prompt public announcements of projects added to its agenda; assignment of priorities to agenda projects; completion of each significant phase of a project; the availability of Discussion Memoranda and background and other materials; notices of public hearings; the issuance and availability of Exposure Drafts; the availability of transcripts of public hearings; and the issuance and availability of Statements and Interpretations. In addition to press releases, matters of significance are also reported in the Board's newsletter "Status Report", of which over 38,000 copies are regularly distributed. The Board's present regular mailing list includes 23,000 names.

Further, the FASB's Rules of Procedure require that the Board maintain a complete public record available for public inspection at its offices in Stamford, Connecticut. Among the materials required to be maintained in this public record are all written research data and background and other material for public hearings; all written comments and position papers submitted at all stages of the FASB's procedures (other than statistical data of a confidential character and related explanatory text); written comments of Advisory Council members on proposed Statements and Interpretations; the minutes of all meetings of the FAF, FASB and the Advisory Council; transcripts of public hearings; and the votes of FASB members, including dissents, on the issuance of Statements and Interpretations.

C. Meetings and Public Communications

The FASB meets with interested parties on its own motion or at the request of others as a means of obtaining information as to the impact of implementation of proposed standards and as a means of learning of the concerns of the public. While the Board necessarily has to budget its time and is unable, as a practical matter, to accede to every meeting request, it or its staff regularly participates in meetings when the subject is likely to result in new or additional relevant information which otherwise may not be obtainable. Although the Study has criticized these informal meetings, the FAF's Structure Committee has recommended in its recent report that the FASB and its staff hold more informal meetings as a means of further encouraging and increasing public participation in the standard-setting process.

It is interesting to note that the Government's Cost Accounting Standards Board also views meetings as an important means of getting additional information. At every stage of the CASB's deliberations, its staff consults informally with industry representatives and other affected groups in order to discuss and evaluate the need for a cost accounting standard, possible alternatives, the expected costs and benefits, and foreseeable practical difficulties in implementation.

On occasion the Board has issued public invitations requesting information relevant to its work. For example, promptly upon commencing operations in 1973, the FASB issued an "open letter" to accounting firms, the financial and business community, analysts, and all interested persons requesting information on the experiences of preparers, auditors and users of financial statements "which would indicate that existing pronouncements need interpretation, amendment or replacement." The Board received over 100 replies, some more than 30 pages, advising as to these matters for consideration by the Board. More recently, the Board issued an open invitation to all interested persons to submit research papers on the economic effects of accounting standards, with particular reference to existing standards and to projects on the FASB's agenda. In issuing this invitation, the FASB stated that all papers submitted would be reviewed and some selected for presentation at its planned conference on economic consequences of accounting standards in early 1978.

III. PROGRESS AND SUCCESS OF THE FASB AND ITS PREDECESSORS

Review of a complete and balanced record shows that the FASB and its accounting standard-setting predecessors have been successful in establishing meaningful financial accounting standards, responsive both to pervasive and persistent problems of the past and to newly emerging problems in need of prompt solution.

A. Significant Accounting Pronouncements

In its less than four years of operations, the FASB has issued 14 Statements of Financial Accounting Standards, 18 Interpretations, 20 Exposure Drafts and 13 Discussion Memoranda and has held 15 public hearings, as enumerated in Exhibit D. The FASB's pronouncements, the more significant of which are also summarized in Exhibit D, demonstrate the dedication and attention of the FASB to its objective of establishing and improving financial accounting standards. When considered in conjunction with Exhibit B's analysis of responses on FASB proposals, Exhibit D also demonstrates that the FASB is not "dominated" or "controlled" by "special interest groups", and is willing and able to reduce or eliminate accounting alternatives when reasonable to do so.

By way of brief summary, certain of the FASB's Statements have dealt with broad, pervasive accounting questions long in need of resolution, such as:

- Accounting for Research and Development Costs. (FASB Statement No. 2)
- Accounting for Contingencies. (FASB Statement No. 5)
- Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements. (FASB Statement No. 8)
- Accounting for Leases. (FASB Statement No. 13)

Other Statements have also addressed and resolved long-standing issues, including:

- Accounting and Reporting by Development Stage Enterprises. (FASB Statement No. 7)
- Financial Reporting for Segments of a Business Enterprise. (FASB Statement No. 14)

Still other FASB Statements have been issued in response to emerging problems perceived as urgently in need of solution:

- Reporting Accounting Changes in Interim Financial Statements. (FASB Statement No. 3)
- Reporting Gains and Losses from Extinguishment of Debt. (FASB Statement No. 4)
- Classification of Short-Term Obligations Expected to be Refinanced. (FASB Statement No. 6)
- Accounting for Income Taxes—Oil and Gas Producing Companies. (FASB Statement No. 9)
- Accounting for Certain Marketable Securities. (FASB Statement No. 12)

Two examples will suffice to illustrate the FASB's willingness to act where it is reasonable to reduce or eliminate accounting alternatives. In its Statement No. 2, "Accounting for Research and Development Costs", the FASB eliminated three alternative accepted practices by requiring that all research and development costs be charged to expense when incurred unless related to an item with an alternative future use. Another example is FASB Statement No. 8, "Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements". Prior to that Statement, there were a variety of generally accepted methods of translating foreign currency, including current—non-current, monetary—non-monetary, and variations. Additionally, a variety of methods were applied to defer recognition of exchange gains until they could be utilized to offset exchange losses. The FASB provided for translation of asset and liability accounts at specified rates, thereby eliminating all other alternatives, and eliminated deferral techniques by requiring exchange gains and losses to be included in determining net income for the period in which the rate changed.

The FASB also has a number of significant matters on its current technical agenda. Among these are: "Financial Accounting and Reporting in the Extractive Industries", which relates to Public Law 94-163; "Accounting by Debtors and Creditors in Troubled Debt Restructurings"; "Accounting for Employee Benefit Plans"; and "Conceptual Framework for Financial Accounting and Reporting".

As for the FASB's predecessors, the Committee on Accounting Procedure issued a total of 51 Accounting Research Bulletins between 1939 and 1959, and its successor, the

Accounting Principles Board, issued 31 Opinions and 4 Statements on a variety of accounting matters through 1973, some of the more significant of which are summarized in Exhibit D.

It is interesting to note that for all of its 1,760 pages of text and reproduced information and data, the Study devotes less than two pages to the FASB's accounting standard-setting activities and mentions only four of the FASB's Statements—Nos. 2, 7, 9 and 12. Again, the Study's criticisms are wide of the mark, and neither stand analysis nor support its assertions.

For example, FASB Statement No. 2, discussed above, prescribed a uniform standard and eliminated the very practices which are cited in the Study as having contributed to the financial difficulties of Lockheed, R. Hoe and Talley Industries. In criticizing Statement No. 2 as causing small developing companies to report reduced earnings, the Study also ignores the conclusions of a study conducted by the United States Department of Commerce on the potential economic impact of Statement No. 2 on small developing firms; following interviews with 40 lenders and investors, 11 small, high-technology firms, 11 accountants and selected Government agencies, the Commerce Department's study concluded that the "FASB's Statement Two should not have a significant impact on those firms who have heretofore capitalized R&D."

The Study also points to Statement No. 7, "Accounting and Reporting by Development Stage Enterprises", as showing that the FASB sided with established operating companies against their developing potential competitors. Here again, the FASB eliminated a variety of previously acceptable alternatives for development stage companies and required them to apply accounting standards applicable to established operating companies. The Study again fails to note that the FASB did not issue Statement No. 7 until it had considered the potential economic impact on development stage enterprises; as indicated in paragraph 49 of Statement No. 7, the FASB held discussions with 15 venture capital enterprises, whose consensus was that the FASB standard would have little effect on the availability or terms of their future capital.

Similarly, with regard to Statement No. 9, the Study fails to credit the FASB with acting promptly to resolve an accounting issue which arose as a direct result of enactment of the Tax Reform Act of 1975. That Act substantially reduced or eliminated percentage depletion as a federal income tax deduction for many oil and gas producing companies, and accounting literature at the time did not address certain questions because before the Act tax deductions generally exceeded capitalized costs. In Statement No. 9, the FASB required, commencing January 1, 1975, all enterprises to record deferred income taxes for intangible development costs and other costs of exploration and development of reserves entering into determination of financial accounting income and taxable income in different periods, unless they had excess statutory depletion. This and other accounting issues applicable to oil and gas producing companies are currently being considered in the FASB's Extractive Industries project.

The Study's last venture into accounting analysis relates to Statement No. 12, "Accounting for Certain Marketable Securities". Here the FASB required marketable equity securities to be reflected on balance sheets at the lower of cost or market, and required that any difference from cost be recognized currently in income for securities classified as current assets and in stockholders' equity for securities held for long-term investment. Contrary to the Study's assertions, the FASB reduced accounting alternatives as to like asset classifications of marketable equity securities, and did not discriminate when it exempted specialized industries (insurance companies, broker-dealers and investment companies) because those enterprises already were carrying their marketable securities at current market. Statement No. 12 more properly should be regarded as having improved consistency in accounting for marketable equity securities.

B. Conceptual Framework and Objectives

A particular aspect of the Study's criticism of accounting standard-setting requires special mention. The Study asserts that the accounting profession and more recently the FASB have failed to prescribe a comprehensive set of objectives for financial statements and a conceptual framework within which further improvements in financial accounting and reporting can develop consistently.

The accounting profession has been engaged in several major efforts since the mid-1960's to define objectives and to provide an underlying conceptual framework. APB Statement No. 4, "Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises", was issued by the Accounting Principles Board in 1970 with a stated purpose of providing an enhanced understanding of the broad fundamentals of accounting and guiding the future development of financial accounting. In 1971 the AICPA commissioned the Trueblood Study Group to hold hearings and to investigate the objectives of financial statements; the Trueblood Study Group's "Objectives of Financial Statements" was issued in October 1973.

From its formation, the FASB has continued these efforts and devoted substantial resources to establishing a comprehensive conceptual framework for financial accounting and reporting, including objectives of financial statements. On April 1, 1973 the Board placed this project on its first technical agenda and in June 1974 issued a Discussion Memorandum on objectives and held public hearings in September of that year. In December 1976 the Board published its tentative conclusions on the objectives of financial statements and issued a second Discussion Memorandum entitled, "Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement". As discussed more fully in Exhibit D, this project is expected to lead to FASB pronouncements involving objectives, qualitative characteristics, basic elements of financial statements, bases of measurement and units of measure. These issues are extremely complex and require logical, objective and thorough analysis by knowledgeable, experienced experts. The second public hearing on this project is scheduled for this summer.

C. The Soundness of the Structure for Selecting and Applying Accounting Standards

The Study asserts, incorrectly, that the structure for selecting and applying accounting standards in the preparation of financial statements does not provide the public with meaningful or accurate financial information, and that the existence of accounting alternatives results in financial information serving the interests of large accounting firms and their clients, to the detriment of the public.

A brief review of scope and purpose of financial accounting and reporting will demonstrate the soundness of the existing structure for selecting and applying financial accounting standards and how it assures meaningful and useful information for the public.

Financial accounting and reporting is the process of recording, classifying, summarizing and interpreting transactions and events, and presenting that information in a meaningful and useful manner in financial statements. Accounting standards delineate the scope and method of financial communication, namely, what and how to communicate to the reader.

General purpose financial statements constitute the principal source of financial information to the investing public, creditors and others concerned with the operations and formation and deployment of resources of a business enterprise. These financial statements are to be contrasted with limited purpose or supplementary financial statements intended to serve a limited or specific need of particular users. Managerial accounting, for example, is specifically tailored to the particular needs of management in monitoring day-to-day operations. Similarly, tax accounting and systems of accounts for regulated industries serve particular regulatory purposes. The Government's Cost Accounting Standards Board is also an example of a body charged with a specific function—setting cost accounting standards for government contracts, particularly in connection with defense procurement. Governmental authorities, such as tax and ratemaking bodies, typically have statutory authority to prescribe the form and content of such financial reports as they deem necessary to fulfill their functions.

Financial accounting and reporting is to be distinguished from auditing. Auditing standards establish the procedures by which information that has been recorded, classified, summarized and interpreted in books and records and presented in financial statements is reviewed to determine whether the financial statements are presented fairly in conformity with generally accepted accounting standards. An example, using revenue recognition, may be helpful. Accounting standards set forth criteria for determining the timing of revenue recognition which management should apply. Auditing standards set forth procedures to be followed by independent auditors when expressing an opinion on financial statements as to whether, based on the circumstances and underlying data, (i) the appropriate accounting method has been applied in relation to the accounting criteria, and (ii) the amounts are supported by that data.

The FASB is responsible for establishing and improving financial accounting and reporting standards. It does not have any responsibility for setting auditing standards or regulating auditing. This distinction is significant, especially with respect to the Study's assertions that cases of corporate failures and financial difficulties and "questionable" or "improper" payments are evidence of failure of financial accounting standards. As discussed below, these and other of the Study's related criticisms are not justified, for they are based on lack of understanding of the FASB's responsibilities and the nature, scope and purpose of financial accounting standards and financial statements.

1. *Generally Accepted Accounting Principles.*

Any body of accounting standards must be responsive to the myriad of variables, circumstances and transactions bearing upon the sources of financial information and the presentation and ultimate use of that information through the medium of financial statements. In this context, the accounting profession and the SEC long ago developed the related concepts of "generally accepted accounting principles" and "substantial authoritative support" as a means of providing a realistic, but structured, framework within which accounting standards could be evaluated for acceptability and appropriateness.

"Generally accepted accounting principles" (frequently referred to as GAAP) is an accounting term encompassing conventions, rules and procedures necessary to define accepted accounting practice. The term includes not only guidelines of general application, but also practices and procedures.

Only those accounting principles for which there is "substantial authoritative support" are regarded as being "generally accepted" by the SEC for purposes of financial statements filed with it under the Federal Securities Laws. Forty years ago, in 1938, the SEC stated that, as a matter of administrative policy, financial statements applying accounting principles for which there was no substantial authoritative support would be viewed as misleading and would not be accepted in filings and reports with it. In the absence of unusual circumstances which must be demonstrated and disclosed, an auditor cannot render an unqualified opinion, and financial statements will not be acceptable under the Federal Securities Laws, unless the independent auditor can conclude that the financial statements are presented fairly in conformity with generally accepted accounting principles.

2. *Selecting Generally Accepted Accounting Principles.*

Professional accounting literature, developed largely through the efforts of the accounting profession and its designated standard-setting bodies (the FASB and its predecessors*) with SEC encouragement and participation, has long contained enumerations of the sources of generally accepted accounting principles—that is, those principles for which there is substantial authoritative support.

Contrary to the Study's assertion, there is not unrestrained "picking and choosing" among accounting principles when more than one acceptable principle exists. First, the profession's Code of Professional Ethics and SEC policy require that the accounting principles applied be not only generally accepted but also *appropriate* in the circumstances. Second, the accounting profession and the SEC both recognize certain generally accepted accounting principles as presumptively binding, and, in the absence of unusual circumstances, require that these generally accepted principles be applied in the preparation of financial statements.

Under Rule 203 of the AICPA's Code of Professional Ethics, a member of the AICPA may not express an opinion that financial statements are presented fairly in conformity with generally accepted accounting principles if the statements depart from an FASB Statement or Interpretation or an APB Opinion or Accounting Research Bulletin, unless the accountant can demonstrate that, due to unusual circumstances, the financial statements would otherwise be misleading. In its Accounting Series Release No. 150 in December 1973, the SEC reaffirmed its long-standing administrative policy and endorsed the FASB for purposes of financial statements filed with it under the Federal Securities Laws, stating that any accounting principle contrary to an FASB Statement or Interpretation or an APB Opinion or an ARB would be presumed to have *no* substantial authoritative support and thus be unacceptable, unless the Commission determined otherwise either generally or in specific cases.**

Rule 203 and the SEC's long-standing policy have proven successful in narrowing the selection of accounting principles and have contributed significantly to consistency and certainty in the preparation of financial statements. The FAF and FASB understand there have been almost no instances since 1973 where the SEC has accepted financial statements departing from an FASB or APB pronouncement or an ARB.

* The Accounting Principles Board (1959-1973) and the Committee on Accounting Procedure (1939-1959).

** Accounting Series Release 150 is currently the subject of litigation in *Arthur Andersen & Co. v. Securities and Exchange Commission,* Civil Action No. 76 C 2832 (N.D. Ill., filed July 29, 1976). In August 1976 the Court refused to issue a temporary restraining order, and on September 3, 1976 the Court denied motions to enjoin the application of ASR 150. Motions for summary judgment and an SEC motion to dismiss are currently pending before the Court.

Rule 203 and the SEC also recognize that, in unusual circumstances, literal compliance with presumptively binding generally accepted principles issued by the FASB and its predecessors may not always insure that financial statements will be presented fairly. In those cases, as well as cases not covered by an FASB or APB pronouncement or an ARB, authoritative literature provides direction for the selection of generally accepted accounting principles. The AICPA's Statement on Auditing Standards No. 5 enumerates these sources as including pronouncements of the SEC or other regulatory bodies, AICPA Industry Audit Guides and Accounting Guides, industry accounting practices, APB Statements, and AICPA Accounting Interpretations and Statements of Position.

In recognizing the requirement of fair presentation of financial statements in relation to the selection and application of generally accepted accounting principles, authoritative literature requires the auditor, when expressing an opinion, to judge the fairness of overall presentation of the financial statements within the framework of generally accepted accounting principles as the standard for the exercise of this judgment. After referring to the necessity of appropriate generally accepted accounting principles being applied, Statement on Auditing Standards No. 5, paragraph 4, enumerates the auditor's judgmental determinations as follows:

> "(c) the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation . . . ; (d) the information presented in the financial statements is classified and summarized in a reasonable manner, that is, neither too detailed nor too condensed . . . ; and (e) the financial statements reflect the underlying events and transactions in a manner that presents the financial position, results of operations, and changes in financial position stated within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements."

Statement on Auditing Standards No. 5 also states that generally accepted accounting principles recognize the importance of recording transactions in accordance with their substance, and directs the auditor to consider whether the substance of transactions differs materially from their form.

3. *Limitations on Accounting Changes.*

In addition to establishing parameters for the *selection* of accounting principles (looking first to the official pronouncements of the FASB and its predecessors), the accounting profession and the SEC have also limited the circumstances in which a generally accepted principle, once adopted by an enterprise, can thereafter be changed for events and transactions of a similar type in favor of another generally accepted principle. Contrary to the Study's assertions, neither preparers nor auditors of financial statements have a free choice, or the right to change accounting principles once applied, to present matters in the most favorable light. There is no merit to assuming that accounting changes are bad *per se.*

APB Opinion No. 20 states there is a presumption that an accounting principle once adopted should not be changed in accounting for events and transactions of a similar type. This presumption may be overcome only if the enterprise justifies the use of an alternative acceptable accounting principle on the basis that it is preferable or if an official pronouncement of an authoritative standard-setting body requires or expresses preference for another principle or rejects the principle then being applied. Opinion No. 20 requires that the change and its effect on income be disclosed in the financial statements, together with justification clearly explaining why the newly adopted principle is preferable. The SEC additionally requires a publicly-owned company to report the date and reasons for the change, and requires the company's independent accountant to advise in writing whether, in his opinion, the change is to a generally accepted principle preferable in the circumstances.* Thus, both management and the independent accountant must be prepared to justify in filings under the Federal Securities Laws, as to which liability for false or misleading statements attaches, that the accounting change will constitute an improvement in financial reporting.

While the FASB has not addressed accounting changes generally, in its first Interpretation, "Accounting Changes Related to the Cost of Inventory", it clarified the application of APB Opinion No. 20 to changes in the composition of elements in inventory cost that might result from changes in determining inventory cost for Federal income tax purposes. The FASB concluded in this instance that an accounting change could not be justified as preferable solely on the basis of tax savings, but had to constitute an improvement in financial reporting.

A change to another acceptable accounting standard frequently may also tend towards greater comparability. For example, a change from accelerated to straight-line depreciation is a change to a more prevalent depreciation practice. Similarly, the Study criticizes Texaco for changing from "full cost" to "successful efforts" accounting for its exploration and drilling costs. What is not mentioned, however, is that Texaco was the only major oil company using "full cost" accounting and, in changing, comparability of financial statements of major oil companies improved.

4. *Accounting Alternatives.*

Financial accounting encompasses all operations, of all companies, in all industries, and in all environments. In common experience there are significant operational differences between companies within a particular industry or even within a single company. It is therefore frequently appropriate to apply different accounting principles in order to reflect the realities of different circumstances and different transactions. Nevertheless, the Study criticizes the FASB and the SEC for not achieving uniform accounting principles and for permitting alternatives to exist. The Study makes no attempt to determine the reasons underlying the existence of accounting alternatives and overlooks the substantial and continuing progress being made in eliminating alternatives not justified by different circumstances or wholly different transactions.

(a) *The Study's Outdated Analysis.* The Study supports its criticism of accounting alternatives by reproducing (page 134) a table which is represented as showing a variety of alternative accounting methods available to account for the same business transaction.

The Study's reliance on that table is misplaced, for the data presented are based on a 1965 research study which was not updated in the Study to reflect 12 years of progress, including that by the FASB and the Accounting Principles Board. The Study also makes no effort to distinguish among those alternatives necessary to reflect different circumstances or wholly different transactions, even though the 1965 research study took care to do so when originally published.

* This SEC requirement is currently the subject of litigation in *Arthur Andersen & Co. v. Securities and Exchange Commission,* Civil Action No. 76 C 2832 (N.D. Ill., filed July 29, 1976). In August 1976 the Court denied a motion by Arthur Andersen for a temporary restraining order, and on September 3, 1976 the Court denied a motion to enjoin the application of this rule. Motions for summary judgment and an SEC motion to dismiss are currently pending before the Court.

Of the 42 "alternatives" listed in the Study's table, 30 are not alternatives or are of such minor import as to be immaterial in effect on financial statements, as shown in the following tabulation updating and correcting the Study:

14	apply to circumstances which clearly differ and for which there are recognized criteria for determining the appropriate practice, or apply to wholly different transactions.
4	have been eliminated.
1	is now the sole practice.
1	is not an accounting method.
10	relate to items having no material effect on financial statements.
2	are rare and disappearing.
10	are practices which may be alternatives.
42	

Of the 10 practices which may be alternatives, 2 are currently under study by the FASB in its Extractive Industries project.

Exhibit E contains a detailed discussion of the Study's outdated analysis, "alternative" by "alternative", and includes a reconciliation supporting the 1977 tabulation shown above.

(b) *Alternatives Necessitated by Different Circumstances or Transactions.* In the attempt to narrow the number of acceptable accounting alternatives, the essential problem usually is to determine which transactions and their surrounding circumstances are sufficiently similar that one accounting method will reasonably provide meaningful and useful information, and which ones are sufficiently different that no one method will do so. For the latter situations, a futher question is whether criteria can be developed that will give guidance as to which method should be used for a particular set of circumstances or for particular transactions.

That differing circumstances or wholly different transactions can require a different accounting method can be illustrated by the different methods for revenue recognition. Generally accepted accounting principles base the recognition of revenue upon the principle of realization in most circumstances. Where the collection of receivables can be estimated with reasonable accuracy at the time a transaction is complete, revenue is *realized* at the time of sale and its *recognition* for financial accounting purposes is ordinarily appropriate at that time. Thus, for example, many companies selling merchandise on the instalment plan have extensive credit experience, and can estimate within a close range the ultimate collections at the time of sale. With appropriate provision for bad debts, they *should* recognize revenue at that time for they have then taken all substantive steps necessary to earn the profit.

Other instalment or deferred payment sales may be made by companies having little credit experience, however, with down payments so small as not to lend assurance that the total contract price will be collected. In those circumstances, the principle of realization is *not* satisfied, and it would not be appropriate to recognize the entire revenue and profit at the time of sale.

From the above example, it can be seen that, though there is more than one method for recognizing revenue, there are criteria to determine the use of one over another in particular circumstances. Indeed, having more than one method is necessary to provide meaningful and useful information.

94-081 O - 77 - 15

(c) *Other Alternatives.* As indicated in the above tabulation, some areas remain for which more than one generally accepted accounting method exist and for which generally accepted accounting principles do not prescribe criteria for applying a particular method based on particular circumstances.

An example is inventory, where the three principal methods are first-in, first-out (FIFO), last-in, first-out (LIFO) and average cost. Despite the lack of stated criteria, however, business enterprises apply inventory methods with reference to their particular circumstances, operations and prospects, and not in a vacuum. These considerations might include levels and necessity of cash flow (including tax considerations), current and predicted rates of inflation, nature of inventory components and frequency of inventory turnover, practicalities such as recordkeeping, and regulatory requirements and considerations. APB Opinion No. 22 requires disclosure of whatever inventory method is used, and APB Opinion No. 20 restricts change to another method unless management can justify that the new method is preferable in the circumstances. As mentioned above, the FASB decided in its first Interpretation that tax savings alone were not adequate justification for a change in inventory method.*

The Government's Cost Accounting Standards Board, which is charged, among other things, with achieving whenever possible uniformity and consistency in costing governmental contracts, has considered the question of alternative inventory methods. After lengthy study, publication of a proposed standard, and analysis of letters of comment, the CASB issued a cost accounting standard in 1975 permitting all three of the above generally accepted financial accounting methods of valuing inventory for government contract cost purposes, and requiring each contractor to adopt and adhere to a written policy of inventory valuation for each category of inventory.

5. *Materiality.*

In view of the literally thousands upon thousands of transactions and events reflected in financial statements, it would be impossible to communicate financial information in meaningful and useful terms without some basis for judging fairness and significance when portraying a business' operations and financial position to a user of financial statements. Yet the Study implies that the convention of "materiality" may not be in the public interest because it permits large corporations to avoid disclosures smaller companies must make, and thus their financial statements may result in "misleading" conclusions when compared with those of smaller companies.

Materiality, as it applies to accounting, is inherent in the exercise of judgment and is the standard adopted by Congress in the 1930's as the basis for all disclosure, both in financial statements and in reports and filings with the SEC, and for determining liability. The Federal Securities Laws require only the disclosure of material information, and predicate liability of management, accountants, underwriters and others on whether there has been a misstatement of, or an omission to state, a material fact.

* A conspicuous area in which uniform accounting standards might have been prescribed by the Federal Government, but have not been, is in the determination of taxable income. Essentially, the Treasury Department is determining periodic business income for Federal income tax purposes, just as financial accounting determines periodic business income for financial reporting purposes. Yet, both the Internal Revenue Code and IRS regulations provide corporate taxpayers with an enormous number of options and elections. This is illustrative of the difficulties in attempting to provide uniform standards covering a broad and diverse constituency.

The SEC has defined materiality, without objective criteria, in these terms:

> "The term 'materiality' when used to qualify a requirement for the submission of information as to any subject, limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before purchasing the security registered." (Rule 405 under the Securities Act of 1933.)

Similarly, the Government's Cost Accounting Standards Board has regarded materiality in subjective rather than solely quantitative terms. A subjective concept of materiality has also been adopted by the courts as a means of guiding preparers and auditors of financial statements as to the inclusion of information which will be perceived useful by investors. The problems with a subjective definition are recognized, but as the number of court cases has increased and standards of liability have become more stringent, there has been a tendency to disclose more and more information. Concerned with the "unreadable prospectus", the SEC has urged periodically in public releases that care be taken to include only material information, on the theory that an over-abundance of information obscures disclosures essential to investment decisions.

The FASB, too, is concerned with the concept, and currently has "Criteria for Determining Materiality" on its technical agenda. In 1975, the FASB issued a 246-page Discussion Memorandum on this topic and held hearings in mid-1976. The Board intends to progress further on its Conceptual Framework project before completing this project, inasmuch as a number of the more significant issues in assessing materiality are also involved in its Conceptual Framework project.

D. Corporate Accountability Problems.

1. *Corporate Failures and Financial Difficulties.*

By its failure to distinguish between the functions of financial accounting and reporting and those of internal controls and auditing, the Study creates the inaccurate impression that shortcomings in financial accounting are somehow largely responsible for the cases it cites of corporate failures and financial difficulties.

Analysis of the Study's 20 cases* of corporate failure and financial difficulties indicates that virtually all involved fraud, dishonesty, falsification of books and records, inadequate or circumvented internal controls, errors in judgment proved wrong by subsequent events, or simply poor or inadequate management—but not inadequacy of accounting standards. This is not to minimize the significance of these problems or suggest they are not proper subjects for Congressional concern. On the other hand, we believe it important to place the factors contributing to these problems in proper perspective.

In a few of the cases cited it was asserted that use of accounting principles acceptable at the time may have been among the contributing factors. In these cases, however, the accounting issue arose from *applying* an accepted principle in circumstances where there were insufficient, inaccurate or misrepresented facts required to satisfy accepted criteria for the *use* of the principle, rather than acceptability of the accounting principle itself.

* Continental Vending; Four Brokerage Firms (Orvis Brothers, Francis I. du Pont, Dempsey-Tegeler, and Hayden Stone); Equity Funding; Four Seasons Nursing Centers; International Controls; Lockheed; Mill Factors; National Student Marketing; Penn Central; Republic National Life Insurance; R. Hoe; Stirling Homex; Talley Industries; U.S. Financial; Whittaker Corporation; Giant Stores; and Ampex.

In the four cases cited where there was any suggestion that an accounting principle may have been inadequate, the alleged inadequacies have been eliminated in subsequent authoritative pronouncements or guidelines. In three of those cases, Lockheed Aircraft Corporation, R. Hoe & Co., and Talley Industries, the ability to defer research and development costs was criticized, among other things. In 1974, the FASB eliminated accounting alternatives permitting deferral of those costs in its Statement No. 2, "Accounting for Research and Development Costs", which requires those costs now to be charged to expense when incurred, unless they have an alternate future use. In the fourth case, Continental Vending Machine Corporation, the court held that adherence to generally accepted accounting principles was not a conclusive defense in the particular circumstances presented, because additional disclosure about receivables from an affiliated party was necessary to present fairly Continental Vending's financial statements. Guidelines in the AICPA's subsequent codification of auditing standards and in the SEC's regulations now prescribe such disclosures.

It is interesting to note that a number of the most recent and disturbing examples of significant financial difficulties and even corporate failure have involved banks, notwithstanding close Federal regulation under the banking laws and required supervisory audits by bank examiners. As the General Accounting Office's recent report on banking problems indicates, financial difficulty and corporate failure play no favorites between regulated and unregulated industries when proper management standards and internal controls are stretched or ignored.

2. *Questionable Payments.*

A number of the corporate accountability problems cited by the Study relate to "questionable" or "improper" payments by corporations. As the SEC noted in its "Report on Questionable and Illegal Corporate Payments and Practices" submitted to a Senate Committee in May 1976, virtually all of these situations involved the deliberate falsification of books and records. The vast majority of these situations have involved off-book accounts, slush funds and other practices involving circumvention of internal controls. They have not, however, reflected a weakness or inadequacy in accounting standards or principles.*

Where irregularities in the financial accounts relating to improper payments did come to the attention of the auditors, the amounts involved generally were quantitatively immaterial in relation to the assets, revenues, income or net worth of the reporting company. Only comparatively recently has the SEC developed the concept of "qualitative materiality", whereby the disclosure of certain matters, because of their nature, are regarded as material to investors and shareholders without regard to their quantitative significance to the company's financial statements. The FASB's Discussion Memorandum, "Criteria for Determining Materiality", covers both quantitative and qualitative materiality.

The development of disclosure standards in the limited area of improper payments, first by the SEC and also by Congress if legislation is adopted, does not support the Study's

* Recently proposed SEC Regulation 13B, "Accuracy of Books, Records and Reports", and Senate Bill S. 305, recognize implicitly that the prevention of illegal and questionable corporate disbursements through the falsification of accounting records rests in the enforcement of internal accounting controls, rather than in new accounting standards. The AICPA's Auditing Standards Executive Committee has also taken action in recent months to clarify auditors' responsibilities relating to illegal acts and the detection of errors and irregularities.

assertions that financial accounting standards are inadequate, or should be established by the Federal Government. Rather, the issues involved in such situations were issues principally of general corporate reporting.

IV. SEC REVIEW AND PARTICIPATION IN THE STANDARD-SETTING PROCESS

Congress created the SEC in 1934 to be the expert representative and guardian of the investing public, and the SEC has been actively involved in accounting matters since its inception. The Commission's policy decision in 1938 to permit the accounting profession to play an active role in establishing and improving accounting standards was made, not as "delegation" of power to the profession, but to assure that Congress' mandate in the Federal Securities Acts as to the position of the accounting profession and the importance of financial statements would be met. As stated at the time, and reaffirmed in 1973 in Accounting Series Release 150, the Commission accepts as authoritative only those accounting standards with which it does not disagree and which it finds are necessary or appropriate for the protection of investors. While looking to the accounting profession to take initiative in setting accounting standards, the Commission has reserved, and over the past 40 years frequently has exercised, its power to anticipate or set aside the profession's standards for those the Commission has found preferable.

ASR 150 benefits public investors by providing a framework for the preparation of financial statements filed under the Federal securities laws, parallel to that imposed on independent auditors through Rule 203 of the AICPA's Code of Professional Ethics. By recognizing the FASB and its predecessors' pronouncements as authoritative and binding and presumptively not misleading for purposes of the SEC's administrative policy, ASR 150 has contributed significantly to certainty and consistency in the preparation of financial statements for publicly-owned companies. ASR 150 is an administrative statement of policy to guide, but not inflexibly control, the SEC's staff in taking such action on a day-to-day basis as may be appropriate to resolve specific accounting problems of individual publicly-owned companies. As a statement of policy which is not finally determinative as to the selection or application of accounting standards or the acceptability of individual filings and reports, ASR 150 has been held not to constitute a substantive rule, for the SEC has not delegated any of its authority, or given up any right to reject, modify or supersede FASB pronouncements through its own rule-making procedures. Contrary to the Study's legal analysis, the Federal District Court referred to on page 178 of the Study clearly understood the benefits and the circumstance of ASR 150 as not being violative of the Commission's rule-making procedures, and not in any sense amounting to any "delegation" or "abdication" of its Congressionally mandated responsibilities. As the Court said in refusing to enjoin application of ASR 150 by the Commission (Study at pp. 1554-55):

> "ASR 150 emerges, then, as a method by which the SEC will evaluate accounting principles. It does not ordain the result of that evaluation. It does not prescribe per se approval to or rejection of any accounting principle. It merely acknowledges a fact, the existence of an authoritative body of principles, and says that it will credit those principles.
>
> "It is not a conditional imperative, which is the characteristic of a substantive rule.
>
> "Nor is ASR 150 rendered invalid by the hyperbole that the SEC has delegated impermissibly its rule-making authority to FASB. True, ASR 150 will encompass not only past, but future accounting principles approved by the FASB, but those

prospective principles will have no greater force than the present ones do. The SEC will consider them authoritative, which they clearly are and will be, but ASR 150 does not even suggest that the SEC will abdicate its ultimate responsibility to judge the propriety of the accounting principles employed by a registrant."

The SEC's record over the years conclusively disposes of any claim that it has "delegated" its responsibilities over accounting matters to the FASB, the AICPA, the accounting profession or anyone else.

In 1940, within two years of first announcing the policy reaffirmed in ASR 150, the Commission adopted its comprehensive Regulation S-X, setting forth its requirements as to the form and content of financial statements filed with it under the Federal Securities Laws. On numerous occasions since then the Commission has amended Regulation S-X to meet new disclosure needs.

The Commission has also issued over 200 Accounting Series Releases (over 70 within the past five years) covering a variety of accounting, auditing and related financial and accounting matters, some of which have conflicted with, or effectively amended or superseded, standards set by the accounting profession's authoritative standard-setting bodies.

For example,

—in its ASR 96, the Commission rejected APB Opinion No. 2 and permitted financial statements filed with it to reflect either of the two most prevalent alternatives for reflecting the effect of the investment tax credit;

—in ASR 147, the Commission characterized lessee disclosures required by APB Opinion No. 31 as inadequate, and imposed additional disclosure requirements of its own;

—in ASR 148, the Commission adopted accounting rules for certain liabilities on the balance sheet, which prompted FASB Statement No. 6, "Classification of Short-Term Obligations Expected to be Refinanced";

—in 1975, the Commission became concerned that gain from early extinguishments of debt, then required by APB Opinions to be reflected as ordinary income, were inflating earnings of some companies and urged the FASB to take prompt action, indicating that it would do so if the FASB did not; the result was FASB Statement No. 4; and

—in recent weeks, the Commission has proposed to amend Regulation S-X to adopt FASB Statement No. 13, "Accounting for Leases", and to accelerate its retroactive applications except for companies unable to resolve problems in connection with restrictive clauses in loan indentures or other agreements.

The Commission has taken still other steps to implement its views in other areas, notwithstanding the existence of accounting standards established by the profession's standard-setting bodies. Among other examples are accounting for business combinations as poolings of interests (ASR's 130, 146 and 146A); catastrophe reserves (ASR's 134 and 145); disclosure of inventory profits (ASR 151); capitalization of interest (ASR 163); disclosure of unusual risks and uncertainties (ASR 166); disclosures relating to the adoption of LIFO (ASR 169); disclosure as to holdings of securities of New York City and accounting for securities subject to exchange offers and moratoria (ASR 188); and disclosure of replacement cost data (ASR's 190 and 203).

The Commission also provides for additional financial information in its general corporate disclosure requirements. For instance, concerned with recent bank failures and financial difficulties, the Commission issued a disclosure guide which requires additional financial statistical information in registration statements of bank holding companies under the Securities Act of 1933. The required information includes average balance sheets for each reported period, analysis of investment portfolio loans and deposits, and return on equity and assets. Similarly, prior to FASB Statement No. 14, "Financial Reporting for Segments of a Business Enterprise," the Commission required revenue and income information with respect to reporting companies' lines of business and revenues for classes of similar products as part of its general disclosure requirements.

Through its continual review of the application of accounting standards in financial statements included in reports and filings of publicly-owned corporations, the SEC also has daily opportunities to evaluate the selection and application of accounting standards to the facts and circumstances of particular cases. This is a very important part of the financial reporting system because it permits the SEC, which otherwise might have to consider accounting standards only in general or theoretical terms, to evaluate the selection and application of standards to the facts and circumstances of particular cases. The SEC has not hesitated to insist upon changes in the accounting standards applied when it has found this to be in the interests of investors.

Since 1975, the SEC has published Staff Accounting Bulletins for the purpose of broadly disseminating the views and practices of its staff on the form and content of financial statements filed with it. In its release announcing these bulletins, the SEC noted that the dynamic and evolutionary character of financial reporting required new and revised interpretations and practices, and that the Commission viewed these bulletins as a means of publicizing broadly, particularly for the benefit of smaller accounting firms with less frequent SEC contacts, SEC staff practices and policies as they evolve.

Staff Accounting Bulletins published to date have covered a wide range of accounting and reporting subjects, including business combinations, financial statements for foreign companies, balance sheet presentations, real estate companies, finance companies, taxes, consolidated financial statements, qualitative disclosures, interim financial statements, replacement cost disclosures, and requirements with respect to accounting changes.

The Commission meets its statutory responsibilities in still other ways which belie the Study's assertion of "delegation".

Pre-filing assistance and interpretative advice are available for resolution of particular accounting problems. These may occur in situations where a company and its independent accountants disagree but typically occur when unusual circumstances are presented, with a solution usually resulting following discussions with the SEC's Division of Corporation Finance and/or the Office of the Chief Accountant. The Commission has also announced procedures by which its views may be obtained when its staff, upon request or on its own motion, presents questions involving matters of substance or where the issues are novel or highly complex. Additionally, the SEC's Rules of Practice provide that any person desiring issuance, amendment or repeal of a substantive or interpretative rule or general statement of policy may petition for such action.

The SEC maintains close review liaison with the FASB. The Commission's Chief Accountant attends meetings of the Advisory Council; members of the Commission's accounting staff attend meetings of the FASB's task forces, the Screening Committee on Emerging Problems, and the FASB's public hearings; and FASB staff members regularly attend meetings of the Commission's Advisory Committee on Corporate Disclosure and its

Replacement Cost Advisory Committee. Projects have been put on the FASB's agenda at the Commission's request, and the FASB included data in its December 1976 Discussion Memorandum on "Financial Accounting and Reporting in the Extractive Industries" which the SEC had prepared to elicit views pursuant to its responsibilities under PL 94-163.

V. CAN GOVERNMENT DO BETTER?

The comprehensive financial information and corporate disclosures required in the United States have greatly contributed to its status as the world's major capital market. Despite troublesome issues involving "questionable" or "improper" corporate payments, the fact remains that the United States' financial accounting standards and corporate disclosure requirements are the most highly developed and most rigidly enforced in the world, providing financial information relied on for its integrity, accepted for investment decisions and presented in a manner understandable to the investing public. The role of the FASB as the authoritative standard-setting body, with support within the private and public sectors and SEC review and participation, should not be displaced or its authority diminished, in favor of experimentation with an untried system of direct Federal accounting standard-setting.

The Study recommends Federal Government accounting standard-setting based on the unfounded conclusion that a Government agency will achieve uniformity in setting accounting standards which the FASB and its predecessors have been unable and unwilling to do. As discussed above and in Exhibits D and E, the FASB and its predecessors have made significant progress in eliminating alternatives not justified by differing circumstances and transactions, and in some cases have eliminated all alternatives in favor of a uniform standard.

To support its recommendations, the Study cites the Cost Accounting Standards Board and suggests creation of a Federal board for financial accounting standards modeled after the CASB. However, the Study devotes less than four pages to the CASB and attempts little or no discussion or analysis of the CASB's published accounting standards other than to conclude that "most of them have been responsive to the Federal Government's needs for uniform and meaningful cost accounting standards." The Study similarly contains no discussion or appraisal of other Federal Government experiences in setting accounting standards, nor does it mention that Government standard-setting bodies have been adopting FASB Statements in rule-making proceedings for companies under their jurisdiction. Some discussion and appraisal of this seems appropriate. The FAF and FASB believe that when viewed objectively, the Federal Government's experience to date does not support the Study's assertions and certainly is not a basis on which to consider the changes the Study recommends.

The following appraisal is not a criticism of Government efforts in setting accounting standards. Rather, it points out two critical facts overlooked by the Study. First, the scope of the Federal Government's efforts in setting accounting standards is limited when compared to the scope of the FASB's work. The FASB is charged with improving standards of financial accounting and reporting for all operations of all companies, in all industries and in all environments. The Federal Government's efforts, on the other hand, have been restricted to particular kinds of transactions or industries or for a specific function of Government. Second, the Federal agencies involved, after studying the facts, have concluded that the existence of accounting alternatives is not necessarily inappropriate *per se.*

A. Cost Accounting Standards Board

The CASB was created as an agent of the Congress in August 1970 by an amendment to the Defense Production Act of 1950 and was formally organized in 1971. The Comptroller General of the United States is Chairman and appoints the other four members of the Board, of whom two are from the accounting profession (currently a partner and the retired senior partner of two "Big Eight" firms), one from private industry and one from the Federal Government. The Act prescribes the CASB's function as follows:

> "The Board shall from time to time promulgate cost-accounting standards designed to achieve uniformity and consistency in the cost accounting procedures followed by defense contractors and subcontractors under Federal contracts."

Standards promulgated by the CASB are submitted to Congress and, unless disapproved within 60 days by concurrent resolution, have the full force and effect of law.

The CASB, like the FASB, is a panel of experienced experts, and the two Boards and their staffs maintain continuing liaison and comment on each other's proposed pronouncements. Additionally, two members of the CASB, including the Comptroller General of the United States, are members of the FASB's Advisory Council. The CASB also relies on cooperation in technical matters from a special AICPA committee formed for that purpose.

The Study cites the CASB as a particular instance of a Government agency performing a standard-setting function similar to that performed by the FASB. Analysis of the purpose and mandate of the CASB reveals several factors which significantly distinguish its task from that of the FASB and does not support the Study's recommendation that the Federal Government take over financial accounting standard-setting.

First, the scope of concern to the CASB—developing cost accounting standards for companies contracting with Federal Government agencies, principally in defense procurement—is much narrower and more specialized than the FASB's responsibility for developing accounting standards to be applied in the preparation and presentation of financial statements for all publicly and privately-owned companies.

Second, the objective of the CASB—to achieve increased comparability and uniformity of cost accounting procedures for Government contracts in order to facilitate Government procurement—is a particularly appropriate objective to be carried out by a Governmental entity. By contrast, the FASB's objective of establishing and improving financial accounting standards is designed to meet the varied needs of investors, creditors and other members of the public engaged in investment decisions and private capital formation and allocation. As discussed above, this task is infinitely more complex, the constituency is significantly larger and more diverse, and the subject matter is not limited to a special function of Government.

Third, the volume of work produced by the FASB and the CASB does not support the Study's assertions. Both bodies have been in existence a relatively short time—just under four years for the FASB and a bit more than six years for the CASB. Without considering the differences in scope and complexity of subject matter and periods of existence, the FASB's output of 14 Statements, 18 Interpretations, 20 Exposure Drafts, 13 Discussion Memoranda, and 15 public hearings compares favorably with that of the CASB.

The Study repeatedly criticizes the accounting profession and the FASB for failing to achieve "uniformity" by not eliminating alternative accounting methods. However, the

CASB has also concluded that uniformity in cost accounting is not always desirable, if indeed possible. In its Statement of Operating Policies, Procedures and Objectives (March 1973) the CASB recognized "the impossibility of defining or attaining absolute uniformity, largely because of the problems related to defining like circumstances." This statement continues: "The Board does not seek to establish a single uniform accounting system or chart of accounts for all the complex and diverse businesses engaged in defense contract work. On the other hand, if the Board were to be satisfied that circumstances among all concerned contractors are substantially the same, the Board would not be precluded from establishing a single accounting treatment for use in such circumstances." Statement of Operating Policies, Procedures and Objectives (March 1973), p. 2.

A brief review of several of the CASB's cost accounting standards is illustrative.

In January 1975, the CASB issued Cost Accounting Standard 409 relating to depreciation, an area in which the Study is critical of the FASB and the accounting profession for not eliminating alternative methods. The CASB studied the depreciation question over a long period, through extensive research involving distribution of a preliminary draft standard, analysis of comments from over 100 respondents, a field survey of over 100 profit centers selected as representative of industry, analysis of data developed by the Treasury Department and the AICPA, publication of a proposed standard, analysis of an additional 200 letters of comment, and discussions with representatives of many groups. After this analysis and review, the CASB concluded in the preamble to its Standard:

> "[N]o particular method [of depreciation] is necessarily appropriate for all contract cost accounting situations. The Board is establishing criteria by which the method or methods appropriate in the specific situation can be determined." (40 FR 4259)

A second area of CASB study has been accounting for costs of material. In 1976, after a lengthy study comparable to its study of depreciation, the CASB issued its Cost Accounting Standard 411. Standard 411 prescribes that, while a contractor must adopt a written policy with respect to the accumulation and allocation of the cost of material and must consistently adhere to that policy, any of the following five methods of costing can be used for Government contract purposes: (1) first-in, first-out (FIFO), (2) moving average cost, (3) weighted average cost, (4) standard cost, or (5) last-in, first-out (LIFO).

CASB Cost Accounting Standard 404 for capitalizing tangible assets is another instance where the CASB concluded that diversity of normal business practice made it undesirable to adopt a uniform cost standard. Standard 404 requires each contractor to establish and adhere to a "reasonable" capitalization policy, but does not require a single standard for all contractors nor provide a specific definition of "reasonableness". In its preamble, the CASB stated "in most cases, the contractor is best able to determine what policy will be most suitable for his situation. . . ." (38 FR 5318)

These Cost Accounting Standards are instructive in that they reflect, even in the comparatively narrow area of costing for Government contracts, that alternative accounting practices frequently are necessary or desirable. The experience of the CASB is independent verification that use of a single accounting method does not necessarily assure the most meaningful and useful information.

B. Securities and Exchange Commission

Significant to evaluating the effectiveness of the FASB in providing meaningful financial information to public investors are SEC's actions to amend or rescind certain of its own requirements and guidelines in order to conform them to subsequent FASB Statements.

—in ASR 173 and ASR 184, the SEC rescinded its guidelines in ASR 148 concerning the classification of commercial paper and short-term debt expected to be refinanced, and directed that financial statements filed with the Commission after December 26, 1975 follow the criteria set forth in FASB Statement No. 6.

—in ASR 178, the Commission amended its Regulation S-X and rescinded its interpretation and guidelines in ASR 141, in order to conform certain of its requirements respecting accounting for research and development costs to FASB Statement No. 2, issued in October 1974.

—in ASR 181, the Commission amended Article 5A and certain rules in Regulation S-X specifying requirements for the form and content of financial statements and schedules filed by certain companies in promotional, exploratory or other stages of development. Noting that these requirements had been adopted by the Commission when there were no authoritative statements of the accounting profession regarding the appropriate accounting and reporting directly applicable to such companies, and referring to ASR 150, the Commission took its action as the result of FASB Statement No. 7, issued in June 1975.

—most recently, in Securities Act Release No.—5812 and ASR 211, the Commission proposed to amend its Regulation S-X and rescinded its interpretation in ASR 132, in order to conform certain of its requirements respecting accounting for leases to FASB Statement No. 13, issued in November 1976.

These significant actions cannot be brushed off and viewed as evidence that the SEC has "delegated" its accounting responsibilities. Each one of these actions was taken or, in the last case, proposed, in full compliance with the Administrative Procedure Act and with ample opportunity for public comment. The only proper analysis is that an agency of the Federal Government, charged with statutory responsibilities to the public, has determined, after opportunity for public comment, that the FASB's accounting standards provide meaningful financial information for public investors.

C. Other Federal Agencies

Conforming Federal accounting practices to FASB pronouncements has not been limited to the SEC. For example, both the Interstate Commerce Commission and the Civil Aeronautics Board have taken action to incorporate FASB Statements and in some cases APB Opinions into their uniform systems of accounts. In fact, the ICC has been directed to take such action by Congress, as discussed below.

1. *Interstate Commerce Commission*

The Interstate Commerce Commission has been setting accounting standards for common carriers subject to its jurisdiction for over 70 years.* Since the mid-1950's, the ICC

* The Interstate Commerce Act of 1867 authorized the ICC to require annual reports from carriers, and in 1907 the ICC established a uniform system of accounts, which has been revised substantially over the years.

has been conforming its uniform system of accounts in many respects to generally accepted accounting principles, and in recent pronouncements the ICC has relied on the FASB (and its predecessor, the APB) as the authoritative source of such principles.* The ICC's Director of Bureau of Accounts is a member of the FASB's Advisory Council.

Since August 1974, the ICC has promulgated a number of significant amendments to its uniform system of accounts to conform to generally accepted accounting principles. In almost every case of revision, the ICC has determined that the pronouncements of the FASB and its predecessor set forth principles appropriate to be adopted by the ICC as being consistent with the purposes of the Interstate Commerce Act and in the public interest.

For example, in December 1975 the ICC's Bureau of Accounts issued two Accounting Series Circulars for the express purpose of conforming the ICC's rules to recent statements by the FASB. Circular No. 154 incorporates FASB Statement No. 6 into the uniform system of accounts. Circular No. 157 establishes standards of accounting for loss contingencies and also incorporates FASB Statement No. 5 into the uniform system of accounts. In October 1976 the ICC's Bureau of Accounts stated that its standards applicable to accounting for marketable securities were those set forth in FASB Statement No. 12, and required carriers to conform to Statement No. 12 or to provide full footnote disclosure of the required information.

In 1974, the ICC made three major changes in its uniform system of accounts, in each case relying on an Opinion of the Accounting Principles Board. These changes required that a statement of changes in financial condition be included in annual reports (APB Opinion No. 19); that investments of more than 20% in non-consolidated subsidiaries be accounted for on the equity method of accounting (APB Opinion No. 18); and that the principles of interperiod tax allocation set forth in APB Opinion No. 11 be followed by carriers subject to its jurisdiction.

Earlier this year, the ICC adopted the principles set forth in FASB Statement No. 13, "Accounting for Leases", as part of its uniform system of accounts.

Finally, Congress, in the Railroad Revitalization and Regulatory Reform Act of 1976, directed the ICC to prescribe a cost and revenue accounting system for railroad carriers in accordance with generally accepted accounting principles, and directed that disclosure in all reports comply with generally accepted accounting principles and SEC requirements.

2. *Civil Aeronautics Board*

Pursuant to the Federal Aviation Act of 1958, the Civil Aeronautics Board ("CAB") established a uniform system of accounts to be used by air carriers subject to its jurisdiction. Since then, the system has frequently been revised with the objective of conforming it to generally accepted accounting principles.

By way of recent illustration, on December 23, 1976 the CAB revised its method of accounting for changes in the valuation allowance for a marketable equity securities portfolio to reflect the standards established by FASB Statement No. 12. Previously, on

* During the 1950's, industry, the accounting profession and Congress expressed concern with respect to the major disparities between accounting principles, particularly for railroads, prescribed by the ICC in its uniform system of accounts, and generally accepted accounting principles. In April 1957 the Legal and Monetary Affairs Subcommittee of the House Committee on Government Operations held hearings on railroad accounting procedures for the purpose of investigating charges that the ICC had not directed that sound accounting principles be followed by the railroads. In response to the hearings, the ICC in 1957 made revisions to its system of accounts to eliminate certain disparities cited by the Committee.

March 9, 1976, the CAB had eliminated self-insurance reserves from its forms to comply with the requirements of FASB Statement No. 5 concerning accounting for contingencies.

Finally and quite recently, the CAB, like the ICC, announced its intention to incorporate the provisions of FASB Statement No. 13 into its regulations for lease transactions.

CONCLUSION

As documented in this Statement of Position and its supporting Exhibits, the FASB acts with integrity, independence and objectivity in establishing meaningful and useful financial accounting and reporting standards. This, and the Board's procedures for broad public participation, its breadth of support and the acceptance of its pronouncements within the private and public sectors, and the SEC's continuing review and participation, are assurances that the FASB's financial accounting standards serve the public interest and are responsive to needs of financial statement users.

The task of setting accounting standards is complex and demanding, and the effort, and risks, in developing and launching a new and untried system without widespread support and cooperation would be substantial and disruptive of progress now being made. The FAF and FASB are confident that the Subcommittee, on review of a complete, accurate and balanced record, will agree that the existing structure with the FASB as the standard-setting body provides the best assurance for continued progress and improved financial accounting and reporting, to the benefit of the public and the Government alike.

For all the reasons discussed and as further documented in Exhibits A through E, the FAF and the FASB respectfully urge the Subcommittee:

1. To reject the Study's recommendation that the Federal Government directly establish financial accounting standards for publicly-owned corporations; and

2. To reject any similar recommendation which might have the effect of replacing the FASB as the authoritative accounting standard-setting body, or reducing its status to that of an advisory or consulting body to others.

FURTHER INFORMATION

The FAF and FASB would be pleased to supplement or elaborate on the matters set forth in this Statement of Position or any of its supporting Exhibits, as may be requested by the Subcommittee in the exercise of its oversight responsibilities.

EXHIBIT A

FINANCIAL ACCOUNTING FOUNDATION
FINANCIAL ACCOUNTING STANDARDS BOARD
FINANCIAL ACCOUNTING STANDARDS ADVISORY COUNCIL

I. FINANCIAL ACCOUNTING FOUNDATION

The Certificate of Incorporation of the Financial Accounting Foundation ("FAF" or "Foundation") creates the Foundation as a non-profit, non-stock corporation under Delaware law with its stated corporate purpose being "to advance and to contribute to the education of the public, investors, creditors, preparers and suppliers of financial information, reporting entities and certified public accountants in regard to standards of financial accounting and reporting; to establish and improve the standards of financial accounting and reporting by defining, issuing and promoting such standards; to conduct and commission research, statistical compilations and other studies and surveys; and to sponsor meetings, conferences, hearings, and seminars, in respect of financial accounting and reporting." The Internal Revenue Service ruled in 1972 and reaffirmed in 1976 that the Foundation is a charitable institution exempt from taxation under Section 501(c)(3) of the Internal Revenue Code.

In the furtherance of its purposes, the Foundation established the Financial Accounting Standards Board ("FASB" or the "Board") to which, by its Certificate of Incorporation and By-Laws, it delegated all power and authority with respect to research, discussion, setting and interpreting of standards of financial accounting and reporting. The Foundation also created a public advisory body, called the Financial Accounting Standards Advisory Council ("FASAC" or the "Advisory Council"), to assist the FASB.

The principal responsibilities of the Foundation's eleven Trustees (listed in Part IV below), who are nominated by the Foundation's six sponsoring organizations* and serve without compensation, are fourfold:

1. To appoint members to the FASB;
2. To appoint members to FASAC;
3. To raise funds for the operation of the Foundation and to approve the annual budgets of the Foundation, the FASB and FASAC; and
4. To review periodically the basic structure of establishing and improving standards of financial accounting and reporting.

Beyond the selection of members of the FASB and FASAC, the Foundation's Trustees have no authority with respect to financial accounting and reporting. The Foundation's Certificate of Incorporation and By-Laws prohibit FAF Trustees from influencing or interfering with the FASB and the exercise of its power and authority in respect of financial accounting and reporting standards, whether directly or through its approval of annual budgets. Additionally, FAF Trustees are prohibited from simultaneously serving on the FASB, its staff or any of its task forces, or FASAC.

* American Accounting Association, American Institute of Certified Public Accountants, Financial Analysts Federation, Financial Executives Institute, National Association of Accountants and Securities Industry Association.

II. FINANCIAL ACCOUNTING STANDARDS BOARD

The FASB, the authoritative standard-setting body designated by the accounting profession for purposes of Rule 203 of the AICPA's Code of Professional Ethics and recognized by the Securities and Exchange Commission for purposes of the Federal Securities Laws, has responsibility for establishing and improving financial accounting and reporting standards through the issuance of Statements of Financial Accounting Standards and Interpretations of its Statements, Opinions of the Accounting Principles Board and Accounting Research Bulletins.

Members of the FASB are appointed by the Foundation's Trustees for staggered terms of five years, which terms may be extended for an additional five years. The Foundation's current By-Laws require that no less than four of the FASB's seven members be certified public accountants and the remaining three, who need not be certified public accountants, must be well versed in financial accounting and reporting. At the present time, six of the FASB's seven members are certified public accountants (four of whom have had extensive experience in public practice), and all have substantial experience and are well-versed in accounting matters, as shown below in Part IV of this Exhibit.

All FASB members, as well as all staff directors and deputy directors ("staff directors") and substantially all other staff members, are full-time employees. Under personnel policies adopted by the Foundation's Trustees, and modeled after comparable requirements in Government and elsewhere in the accounting profession, FASB members and staff directors are required to have severed all prior employment and consulting arrangements (except academic leaves in the case of staff directors but not FASB members) and, until giving notice of intention to leave the FASB, are not permitted to have any arrangements, agreements or understandings, formal or informal, with any former or potential future employer or client with regard to their business activities after leaving the Standards Board. While with the FASB, no FASB member or staff director can be owed, directly or indirectly, any amount by any former employer or client, other than by virtue of publicly traded security holdings and fixed, vested amounts under pension, retirement and severance arrangements. Moreover, FASB members and staff directors are not permitted to have any outside activities which might interfere with their duties to the FASB, nor may they make use of any information coming to them as a result of their service with the FASB for personal benefit or use. Each Board member and staff director is required to report no less frequently than annually on his material securities holdings, and each FASB member and staff director is obligated to conduct his affairs at all times in such a manner as not to reflect detrimentally on the purposes or reputation of the FASB or Foundation. These personnel policies have also been extended in part to the FASB's remaining staff as well as to consultants and others retained by the FASB or the Foundation. These policies leave the question of disqualification on technical matters to each FASB member.

A. FASB Operating Procedures

The FASB's operating procedures establish an explicit structure for standard-setting open to public scrutiny. Thus, as stated in the FASB's Rules of Procedure:

> "The Financial Accounting Standards Board is charged with a responsibility of significant consequence to the economic well-being of the United States. In carrying out this responsibility, no interest, personal or otherwise, will be placed before the public interest, and the Standards Board will endeavor at all times to keep the public informed as to its activities."

In furtherance of this mandate, the FASB's Rules of Procedure not only reflect concern for independence, objectivity and thoroughness, but also are designed to encourage broad public participation in the standard-setting process by providing publicized opportunities for comment by anyone interested in doing so, at all stages of the Board's technical process.

1. *Statements of Financial Accounting Standards*

The Chairman of the FASB develops, with the assistance of the Board's technical staff and the advice of the Advisory Council and others, the agenda of projects and priorities for submission to and ultimate approval by the full FASB. Suggestions for possible agenda topics have originated with members of the Board, the FASB's staff, members of the Advisory Council, members of the FASB's Screening Committee on Emerging Problems and task forces, the Securities and Exchange Commission, the business and financial communities, accounting educators, issuers of financial statements, and others.

After a specific project is added to the FASB's agenda, a task force generally is appointed to assist in identifying the project's problems and issues, to determine the nature and extent of additional research, if any, and to consult with the FASB and its technical staff on preparation of a Discussion Memorandum setting forth the issues, arguments, alternative solutions and the implications relevant to each. Substantially all members of a task force have no other relationship to the FASB and serve without compensation, but a task force may include members of the FASB and its technical staff, members of the Advisory Council, FASB consultants, and anyone else who possesses expertise or a viewpoint relevant to the project.

The FASB currently distributes publicly over 27,000 copies of each Discussion Memorandum. In order to maximize public involvement, at least one copy of each Discussion Memorandum is provided free of charge to anyone requesting a copy.

After issuing a Discussion Memorandum, the FASB holds a public hearing in order to receive public comments and suggested solutions. At least 60 days' public notice is normally given of a hearing, unless the FASB considers a shorter period (not less than 30 days) appropriate. The notice of hearing indicates the date or dates prior to the hearing by which comments and position papers and outlines of oral presentations should be submitted. A public transcript is kept for each hearing, including the question and answer sessions between the FASB and those making oral presentations.

Following the public hearing, the FASB considers the transcript and the comments, position papers and proposed solutions submitted by the public, deliberates the issues, and, with the assistance of its technical staff, prepares an Exposure Draft of a proposed Statement. Each Exposure Draft sets forth the proposed financial accounting and reporting standards, the proposed effective date and method of transition, and specifies the time and manner in which the public may comment. Under the FASB's present Rules of Procedure, no Exposure Draft may be issued for comment unless it is approved by the affirmative vote of at least five of the FASB's seven members. The period of public exposure must be at least 60 days unless a shorter period (not less than 30 days) is considered appropriate and is prescribed by the FASB.

The FASB currently distributes publicly over 37,000 copies of each Exposure Draft. As in the case of Discussion Memoranda, at least one copy of each Exposure Draft is free to anyone for the asking.*

* The FASB may, under its Rules of Procedure, proceed directly to the preparation of an Exposure Draft of a proposed Statement, without appointing a task force, preparing a Discussion Memorandum or holding a public hearing. The FASB has followed this procedure where, in its judgment, an informed decision can be made without a Discussion Memorandum or a public hearing. In other cases, the FASB has held hearings on Exposure Drafts instead of a Discussion Memorandum. In no circumstances may a final Statement be issued without prior exposure for public comment for at least 30 days.

Following public exposure and consideration of the comments received, the FASB deliberates further and, with the assistance of its staff, prepares a final Statement for issuance. Generally, each Statement includes the FASB's conclusions, its effective date of application and method of transition, relevant background information, and the various alternative solutions considered by the FASB, including the reasoning that led to the rejection of some alternatives and the acceptance of others, and those modifications resulting from comments received on the Exposure Draft. Additionally, the FASB's Rules of Procedure require that members' dissents be published as a part of the final Statement.

The FASB currently distributes publicly over 100,000 copies of each final Statement.

The extent of public participation in the FASB's public due process is indicated by the following:

179 different persons have served as members of 14 FASB task forces.

2,200 written comments and position papers have been received on the FASB's 13 Discussion Memoranda.

322 oral presentations have been made at 15 public hearings.

3,160 written comments and position papers have been received on 20 Exposure Drafts.

2. *Interpretations*

The FASB also issues Interpretations of its own Statements, and of Opinions of the Accounting Principles Board and Accounting Research Bulletins. Since Interpretations clarify, explain or elaborate on a Statement, APB Opinion or Accounting Research Bulletin as an aid to its understanding, the FASB's Rules of Procedure provide that the FASB need not appoint task forces, conduct research, prepare Discussion Memoranda, hold public hearings or expose an Interpretation for comment prior to issuance, although it may do so. However, the Rules of Procedure do require that proposed Interpretations be submitted for comment to the members of the FASB's broadly representative Advisory Council for a period of not less than 15 days prior to their issuance. As in the case of Statements, FASB members' dissents are published as a part of final Interpretations. As a matter of policy, the FASB does not issue private or informal, *ex parte* "interpretations".

The FASB currently distributes publicly over 90,000 copies of each final Interpretation.

3. *Emerging Problems Procedures*

Recognizing that a dynamic and changing economy, new forms of business transactions, and regulatory and legislative action can rather quickly create new accounting and reporting problems, the FASB established in mid-1975 a continuing task force to serve as a Screening Committee on Emerging Problems. This Committee assists the FASB in evaluating the magnitude and urgency of these comparatively narrow, but frequently important, accounting problems, and advises on a time frame within which a solution is desirable. The Screening Committee whose non-FASB members serve without com-

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pensation, presently consists of fifteen members, including one FASB member and the FASB's Director of Emerging Problems, seven members of the accounting profession, three financial executives, two financial analysts and one accounting educator. Additionally, representatives of the Office of the Chief Accountant of the Securities and Exchange Commission are observers and attend meetings regularly. The preponderance of accounting representatives on the Screening Committee is in recognition that practicing accountants typically become aware of potential emerging problems first and have the most frequent and extensive contacts with them.

When a problem is brought to the attention of the Screening Committee, the FASB staff prepares background material and information on issues and distributes them to the Screening Committee for its consideration at regularly scheduled meetings. After the Screening Committee considers the problem, the matter is referred to the Board with the Committee's views as to the scope and urgency of the problem. The Board then considers the matter and decides whether to add it to its technical agenda and, if so, its priority and manner of resolution. If, on the other hand, the Board determines not to consider the matter at that time, it so advises the Screening Committee, in which event the Accounting Standards Executive Committee of the AICPA may consider it as a possible subject for an AICPA Statement of Position for the guidance of practitioners, or the Securities and Exchange Commission may decide to take action. Regardless of whether the AICPA proceeds with a Statement of Position, the FASB reserves the right at any time to consider the matter, either as originally proposed or as part of an agenda project.

4. *Review Procedures*

(a) FASB. The FASB has been called upon to reconsider certain authoritative pronouncements, and has developed and publicly announced procedures by which anyone can request FASB reconsideration or review.

If the FASB receives a request for reconsideration of a pronouncement, a copy of the request is circulated to each Board member and appropriate members of the FASB's technical staff. In reviewing the request, Board and staff members seek to determine whether this information and reasoning submitted in support of the request had been properly considered prior to issuing the standard or whether, even though considered previously, subsequent events and circumstances have caused reconsideration to be warranted. When such information is found to be present and persuasive, the Board is prepared to consider appropriate action. For example, FASB Statement No. 11 is a case where the Board amended the transition method of its previously issued Statement No. 5. The Board makes an individual response to each request, whether granted or not.

Additionally, the Board grants requests for meetings when it is anticipated that a meeting will produce new and relevant information not otherwise available. When a meeting is requested, the requesting party is asked to submit in advance a written statement setting forth the purpose of the meeting and a summary of the matters proposed to be discussed. This written material is reviewed by the Board member and project manager assigned to the matter in question. If it is felt that a meeting is advisable, the meeting is held.

While not an appeals mechanism as such, the FASB's Screening Committee on Emerging Problems is another publicly announced means by which FASB and APB pronouncements and existing Accounting Research Bulletins can be and are reviewed.

(b) SEC. Apart from its statutory authority to issue accounting rules and regulations, the Securities and Exchange Commission and its staff have also developed over the years a variety of means by which accounting questions and issues, including ones related to FASB and APB pronouncements and Accounting Research Bulletins, can be reviewed, either generally or with reference to a company's particular circumstances.

Pre-filing assistance and interpretative advice are available for *ad hoc* resolution of particular problems. This typically occurs in cases where a company and its independent accountants disagree or where unusual circumstances are presented, and usually results in a solution following discussions with representatives of the SEC's Division of Corporation Finance and/or the Office of the Chief Accountant.

Also, it is possible to receive an informal statement of the views of the Commission on a particular accounting problem. Thus, the Commission has announced procedures by which its views may be obtained when its staff, upon request or on its own motion, presents questions to the Commission involving "matters of substantive importance and where the issues are novel or highly complex, although the granting of the request or an informal statement by the Commission is entirely within its discretion".

Additionally, the Commission's Rules of Practice provide that any person desiring issuance, amendment or repeal of a substantive or interpretative rule or a general statement of policy may file a petition with the Secretary of the Commission. The SEC's rules provide for public notice and public procedures, except where found to be "impracticable, unnecessary or contrary to the public interest", or where interpretative rules or general statements of policy are involved. In the event of a hearing, the Commission's rules permit a person to be heard, at the discretion of the hearing officer, in any matter that affects that person's interests.

5. *Public Record*

An integral aspect of the FASB's operational process, and of its procedures to encourage maximum public participation and due process, is the degree to which its operations are open to public participation and public view.

Thus, the FASB is required by its Rules of Procedure to make prompt public announcement of any development it regards of importance to the public. In particular, announcements are required in the following circumstances:

Approval of projects for the FASB's agenda and assignment of priorities;

Completion of a significant phase of a project, such as the work of a task force;

Issuance and availability of Discussion Memoranda and background and other materials;

Issuance of notices of public hearings;

Issuance and availability of Exposure Drafts;

Availability of transcripts of public hearings; and

Issuance and availability of Statements and Interpretations.

Further, the FASB's Rules of Procedure require that the following documents, among others, be included in the FASB's public record and be made available for public inspection at the FASB's offices in Stamford, Connecticut:

Written research data (other than proprietary information and confidential, private statistical data and related explanatory text) and summaries of such data, and Discussion Memoranda and background and other materials for public hearings;

Outlines of proposed oral presentations at public hearings;

Written comments and position papers submitted to the FASB (other than confidential, private statistical data and related explanatory text);

Written comments of members of the Advisory Council to the FASB;

Transcripts of public hearings;

The votes and comments of members of the FASB on the issuance of Statements and Interpretations;

Minutes of the meetings of the Foundation, the FASB and the Advisory Council; and

The annual reports of the Foundation and the Chairman of the FASB.

B. Liaison with Other Organizations

Since its formation, the FASB has maintained active liaison with others, in both the public and private sectors, concerned with financial accounting and reporting. The FASB maintains continuing channels of communication with governmental bodies, such as the Securities and Exchange Commission and the Cost Accounting Standards Board.

With respect to the Securities and Exchange Commission, the Commission's Acting Chief Accountant attends meetings of the Advisory Council and members of the Commission's accounting staff regularly attend meetings of the Screening Committee on Emerging Problems and the FASB's task forces, as well as the FASB's public hearings. FASB staff members regularly attend meetings of the Commission's Advisory Committee on Corporate Disclosure and its Replacement Cost Advisory Committee.

In another area, staff representatives of one Congressional committee and several agencies of the Federal Government, including the General Accounting Office and the Cost Accounting Standards Board, attended task force meetings on the Board's project, "Financial Accounting and Reporting in the Extractive Industries". The Comptroller General of the United States, a member of the Cost Accounting Standards Board, and the Director, Bureau of Accounts, Interstate Commerce Commission, are currently serving as members of the FASB's Advisory Council. An FASB senior staff member has attended meetings of the Treasury Department's Advisory Committee on Federal Consolidated Financial Statements.

C. FASB Staff and Budget

At March 31, 1977, the FASB's full-time salaried staff consisted of 79 technical, administrative and clerical personnel. Additionally, the FASB had task force consultants and part-time technical staff members assigned to various of its technical projects.

The FAF/FASB's annual expenditures were $2,277,000 in 1973, $3,212,000 in 1974, $3,514,000 in 1975, and $4,199,000 in 1976. At the present time the estimated budget for 1977 is approximately $4,996,000.

The FAF/FASB's budget is financed from essentially three sources: charitable contributions (including associate membership dues), revenues from the sale of its accounting pronouncements and royalties for reprint rights, and interest on investments.

Of aggregate revenues of $5,464,000 in 1976, contributions (including associate member dues) accounted for $4,007,000, publications and royalties accounted for $1,125,000 and interest income accounted for the balance of $332,000. At March 15, 1977, the FASB had approximately 2,550 associate members, 13,800 regular subscribers to its various publications and 9,041 additional names on its mailing list.

III. FINANCIAL ACCOUNTING STANDARDS ADVISORY COUNCIL

The 1972 Report of the Wheat Study Group concluded that the work of the FASB would be benefited by the participation of knowledgeable individuals and persons with complementary or other skills relevant to financial accounting and reporting. The FASB's Advisory Council, or FASAC, provides this additional dimension, in the words of the Wheat Study Group, as the FASB's "permanent instrument for maintaining contact with the business and professional world."

The only qualification for membership on the Advisory Council is the capacity and willingness of an individual to make a contribution to the FASB's work. Accordingly, the Foundation's current By-Laws provide that membership on the Advisory Council is personal to the individuals appointed and, while members may consult with advisors on technical matters, no member may delegate his function as a FASAC member to another. Council members serve without compensation and are appointed for terms of one year, and may be reappointed for additional terms. The Advisory Council has at least 20 members, which at any particular time may vary upwards as the needs of the FASB change. The current Advisory Council has 29 members, including the Chairman of the FASB, and the Chief Accountant of the SEC regularly attends meetings as an observer. (The current members of FASAC are listed below in Part IV of this Exhibit.) Consistent with the personal nature of membership, the Advisory Council does not vote or otherwise act officially as a body.

As the Advisory Council is the FASB's formal liaison with the business and professional world, the Foundation's By-Laws provide that members of the Advisory Council will consult with the Board concerning its agenda of projects and the assignment of priorities, the selection and organization of task forces, and such other matters as may be requested. The FASB is required to submit proposed Interpretations to members of the Advisory Council for their comments at least 15 days prior to final adoption by the FASB, and members of the Advisory Council may also be asked to review other proposed pronouncements and to provide comments and other input on technical matters to the Board. The recent report of the FAF Trustees' Structure Committee makes several recommendations designed to increase the participation and effectiveness of the Advisory Council in the FASB's technical processes.

It would be impossible as a practical matter to impose restrictions as to financial interests and positions held by members of the Advisory Council and still attract individuals with that level of competence and diversity of expertise providing maximum support to the FASB. This becomes apparent when one considers that among those serving on the Advisory Council at varying times during the last four years have been:

- independent public accountants
- accounting educators
- attorneys

- financial analysts
- investment bankers
- commercial bankers
- financial and accounting executives
- the Comptroller General of the United States
- the former Chairman of the Board of Governors of the Federal Reserve System
- the Assistant Comptroller General of the United States
- former Commissioners of the SEC
- a director of the U.S. General Services Administration
- a former Chief Accountant of the SEC
- the Director of Bureau of Accounts, Interstate Commerce Commission
- the Chairman of the New York Stock Exchange
- the Chairman of the American Stock Exchange
- members of the Federal Government's Cost Accounting Standards Board
- the Chairman of the New York Municipal Assistance Corporation

IV. PERSONNEL

MEMBERS
FINANCIAL ACCOUNTING STANDARDS BOARD
(with immediate former affiliations)

	Term Expires
Marshall S. Armstrong, Chairman (formerly Managing Partner, Geo. S. Olive & Co.)	1979*
Robert T. Sprouse, Vice Chairman (formerly Professor of Accounting, Graduate School of Business, Stanford University)	1980
Oscar S. Gellein (retired Partner, Haskins & Sells)	1980
Donald J. Kirk (formerly Partner, Price Waterhouse & Co.)	1981
Arthur L. Litke (formerly Chief, Office of Accounting and Finance, Federal Power Commission)	1977
Robert E. Mays (retired Controller, Exxon Corporation)	1977
Ralph E. Walters (formerly Partner, Touche Ross & Co.)	1978

* Mr. Armstrong has announced plans to step down as Chairman, effective December 31, 1977, to devote his full time, as Chairman Emeritus, to the Foundation.

TRUSTEES
FINANCIAL ACCOUNTING FOUNDATION

	Term Expires
John C. Biegler, President of the Foundation Senior Partner Price Waterhouse & Co.	1978
Michael N. Chetkovich, Managing Partner Haskins & Sells	1977
Daniel F. Crowley, Executive Vice President—Finance McGraw-Hill, Inc.	1979
James Don Edwards, Secretary of the Foundation J. M. Tull Professor of Accounting Department of Accounting and Business Law College of Business Administration The University of Georgia	1977
J. O. Edwards, Controller Exxon Company, U.S.A.	1977
Ralph E. Kent, Senior Partner Arthur Young & Company	1977
Russell E. Palmer, Managing Partner and Chief Executive Officer Touche Ross & Co.	1979
Stanley J. Scott, Managing Partner Alford, Meroney & Company	1978
Walter P. Stern, Treasurer of the Foundation Senior Vice President and Director Capital Research Company	1978
Alva O. Way, Vice President of the Foundation Vice President—Finance General Electric Company	1979
John C. Whitehead, Senior Partner Goldman, Sachs & Co.	1979

MEMBERS
FINANCIAL ACCOUNTING STANDARDS ADVISORY COUNCIL
(all terms expire December 31, 1977)

Marshall S. Armstrong, Chairman
Chairman, Financial Accounting Standards Board

Norton M. Bedford, Arthur Young Distinguished Professor
and Head of the Department of Accountancy
University of Illinois

William E. Buxbaum, Comptroller
E. I. du Pont de Nemours & Co.

George R. Catlett, Senior Partner
Arthur Andersen & Co.

Joseph P. Cummings, Deputy Senior Partner
Peat, Marwick, Mitchell & Co.

Frank Forester, Jr., Executive Vice President
Morgan Guaranty Trust Company of New York

Charles G. Gillette, Partner
Arthur Young & Company

John A. Grady, Director of Bureau of Accounts
Interstate Commerce Commission

Charles C. Hornbostel, President
Financial Executives Institute

Charles T. Horngren, Edmund W. Littlefield Professor
Graduate School of Business
Stanford University

James J. Kerley, Executive Vice President
Monsanto Company

Allan Kramer, General Counsel
Haskins & Sells

Irving B. Kroll, Managing Partner
Kenneth Leventhal and Company

Raymond C. Lauver, Partner
Price Waterhouse & Co.

Theodore R. Lilley, President,
Financial Analysts Federation

Archie M. Long, Comptroller
General Motors Corporation

Robert A. Malin, Senior Vice President and Director
The First Boston Corporation

Robert K. Mautz, Partner
Ernst & Ernst

Charles T. McGarraugh, Senior Vice President
Northwest Bancorporation

James W. Nethercott, Senior Vice President and Secretary
The Proctor & Gamble Company

William C. Norby, Senior Vice President
Duff and Phelps, Inc.

David Norr, Partner
First Manhattan Company

Ezra Solomon, Dean Witter Professor of Finance
Graduate School of Business
Stanford University

Elmer B. Staats, Comptroller General of the United States

Robert B. Sweeney, Professor and Chairman
Accounting and Information Systems Programs
University of Alabama

Robert C. Thompson, Vice President, Finance
Shell Oil Company

Charles A. Werner, Assistant National
Managing Partner—Technical
Alexander Grant & Company

Francis M. Wheat, Partner
Gibson, Dunn & Crutcher

John A. Willis, Assistant Vice President
Union Carbide Corporation

Observer

A. Clarence Sampson, Acting Chief Accountant
Securities and Exchange Commission

MEMBERS
SCREENING COMMITTEE ON EMERGING PROBLEMS

Martin V. Alonzo, Vice President—Controller
AMAX Inc.

James H. Combes, Vice President—Finance
Hertz Corp.

William H. Conkling, Jr., Partner
Hurdman and Cranstoun

Robert S. Kay, Partner
Touche Ross & Co.

Raymond C. Lauver, Partner
Price Waterhouse & Co.

Robert A. Malin, Senior Vice President and Director
The First Boston Corporation

Robert K. Mautz, Partner
Ernst & Ernst

Professor Carl L. Nelson, Graduate School of Business
Columbia University

David Norr, Partner
First Manhattan Company

Frank J. Tanzola, Senior Vice President
and Corporate Controller
U.S. Industries, Inc.

George Vogt, Partner
Peat, Marwick, Mitchell & Co.

Charles A. Werner, Partner
Alexander Grant & Co.

Arthur R. Wyatt, Partner
Arthur Andersen & Co.

FASB Representatives

Donald J. Kirk, Board Member (Committee Chairman)
J. T. Ball, Director of Emerging Problems

Observer

A. Clarence Sampson, Acting Chief Accountant
Securities and Exchange Commission

MEMBERS
FINANCIAL ACCOUNTING STANDARDS BOARD TASK FORCES
(Since 1973)

Name	Affiliation at Time of Appointment to Task Force	Task Force
Paul M. Albert, Jr.	Morgan Stanley & Co. Incorporated	Interim Financial Reporting
Martin V. Alonzo	AMAX, Inc.	Interest Costs Extractive Industries
M. L. Alper	International Telephone & Telegraph Corporation	Contingencies
Loren Alter	Allstate Insurance Companies	Contingencies
Peter L. Anker	Smith, Barney & Co.	Extractive Industries
Robert N. Anthony	Harvard University	Conceptual Framework
Hector R. Anton	Haskins & Sells	Debtors and Creditors
Kenneth S. Axelson	J. C. Penney Company, Inc.	Leases
William J. Badecker	Hurdman and Cranstoun	Segments
David A. Baker	Boston Company, Inc.	Leases
Andrew Barr	American Institute of CPA's	Materiality
Preston C. Basset	Towers, Perrin, Forster & Crosby, Inc.	Employee Benefit Plans Cost of Pension Plans
William H. Beaver	Stanford University	Materiality
Norton M. Bedford	University of Illinois	R&D and Similar Costs
George S. Bissell	Massachusetts Financial Services, Inc.	Materiality

Name	Affiliation at Time of Appointment to Task Force	Task Force
Dean M. Bloyd	Tesoro Petroleum Corporation	Extractive Industries
John F. Bogaard	Internal Revenue Service	Business Combinations
Horace Brock	North Texas State University	Extractive Industries
R. Gene Brown	Berkeley Bio-Engineering Co.	Materiality
Victor H. Brown	Standard Oil Company (Indiana)	Business Combinations Extractive Industries
Dudley E. Browne	Lockheed Aircraft	R&D and Similar Costs
George N. Buffington	National Assoc. of Real Estate Investment Trusts, Inc.	Debtors and Creditors
Carl B. Burger	Geo. S. Olive & Co.	Business Combinations.
George R. Catlett	Arthur Andersen & Co.	Conceptual Framework
John S. Chalsty	Donaldson, Lufkin & Jenrette, Inc.	Extractive Industries
Edwin Clemens	Forest Oil Corporation	Extractive Industries
Wayland Coe	U.S. Department of Labor	Employee Benefit Plans
Harold Cohan	S. D. Leidesdorf & Co.	Debtors and Creditors
Gordon R. Corey	Commonwealth Edison Company	Contingencies
Putnam L. Crafts, Jr.	Studebaker-Worthington, Inc.	Business Combinations
Allan C. Crane	A. O. Smith Corporation	Interim Financial Reporting
James H. Crowley	The Aetna Life & Casualty Co.	Contingencies
Joseph Cummings	Peat, Marwick, Mitchell & Co.	Foreign Currency Translation
Bernard F. Curry	Morgan Guaranty Trust Co.	Employee Benefit Plans
Clement H. Darby	Builders Investment Group	Debtors and Creditors
Sidney Davidson	University of Chicago	Leases
Robert S. Davis	St. Paul Companies, Inc.	Materiality
Philip Defliese	Coopers & Lybrand	Conceptual Framework
John S. deGraffenried	Merrill Lynch, Pierce, Fenner & Smith Inc.	Debtors and Creditors
Gary L. Depolo	Transamerica Corporation	Interest Costs
Marvin Deupree	Arthur Andersen & Co.	Foreign Currency Translation
Bernard R. Doyle	General Electric Company	Cost of Pension Plans
Alan W. Drew	Peabody Galion Corporation	Segments
Robert C. Drummond	Mobil Oil Corporation	Extractive Industries
Robert W. Ehrlich	American Telephone & Telegraph Corporation	Cost of Pension Plans
Robert G. Ellis	Motorola, Inc.	Cost of Pension Plans
Robert W. Farrell	Bache & Co., Inc.	R&D and Similar Costs
Robert E. Field	Price Waterhouse & Co.	Extractive Industries
Edward P. Fischer	Mobil Oil Corporation	Foreign Currency Translation
Frank Forester	Morgan Guaranty Trust Company of New York	Foreign Currency Translation

Name	Affiliation at Time of Appointment to Task Force	Task Force
William C. Foster	New York Stock Exchange	Segments
Anthony Fox	Connecticut General Life Insurance Company	Debtors and Creditors
Tilford C. Gaines	Manufacturers Hanover Trust Co.	Materiality
Oscar S. Gellein	Haskins & Sells	R&D and Similar Costs
Martin S. Gerstel	Alza Corporation	R&D and Similar Costs
Robert B. Gilmore	DeGoyler & MacNaughton	Extractive Industries
J. Spencer Gould	Arthur Young & Company	Segments
John A. Grady	Interstate Commerce Commission	R&D and Similar Costs
Clyde H. Graves	American Mutual Insurance Alliance	Contingencies
David O. Green	University of Chicago	Interim Financial Reporting
F. William Gridley	Chrysler Corporation	R&D and Similar Costs
Ray J. Groves	Ernst & Ernst	Business Combinations
Harvey V. Guttry, Jr.	The Times Mirror Company	Business Combinations
Joseph W. Halliday	White & Case	Debtors and Creditors
A. Phillip Hanmer	The Dow Chemical Company	Contingencies
John E. Hart	Coopers & Lybrand	Contingencies
Donald J. Hayes	Arthur Young & Company	Interest Costs
Ernest L. Hicks	Arthur Young & Company	Cost of Pension Plans
Thomas L. Holton	Peat, Marwick, Mitchell & Co.	Materiality
A. Charles Howell	John Hancock Mutual Life Insurance Co.	Cost of Pension Plans
Stanley M. Hunt	General Mills, Inc.	Segments
John W. Ingraham	Citicorp, N.A.	Conceptual Framework
Robert O. Isban	Manufacturers Hanover Trust Co.	Interest Costs Debtors and Creditors
Ernest C. Janson, Jr.	Coopers & Lybrand	Extractive Industries
Robert J. Joedicke	Kuhn, Loeb & Co.	Debtors and Creditors
Kenneth P. Johnson	Coopers & Lybrand	Business Combinations Interest Costs
Orace Johnson	Ohio State University	R&D and Similar Costs
Robert S. Kay	Touche Ross & Co.	Business Combinations Interest Costs
Paul J. Kelsey	The Pillsbury Company	Interim Financial Reporting
Jack F. Kincannon	Sears, Roebuck and Co.	Interest Costs
Alfred M. King	American Appraisal Associates Incorporated	Conceptual Framework
Harold Q. Langenderfer	University of North Carolina	Business Combinations
Irving S. Lauterbach	Clarence Rainess & Co.	Contingencies

Name	Affiliation at Time of Appointment to Task Force	Task Force
Raymond C. Lauver	Price Waterhouse & Co.	R&D and Similar Costs Cost of Pension Plans
Robert E. Leech	A. M. Pullen & Company	R&D and Similar Costs
J. Spencer Letts	Teledyne, Inc.	Business Combinations
Theodore R. Lilley	Financial Analysts Federation	Employee Benefit Plans Cost of Pension Plans
Peter C. Lincoln	United States Steel and Carnegie Pension Fund, Inc.	Debtors and Creditors
Leonard Lorensen	American Institute of CPA's	Foreign Currency Translation
Norman J. Luke	Pennzoil Company	Extractive Industries
Oral L. Luper	Exxon Company, U.S.A.	Conceptual Framework
W. Fletcher Lutz	Alexander Grant & Company	Leases
Robert A. Malin	The First Boston Corporation	Business Combinations
John W. March	Arthur Andersen & Co.	R&D and Similar Costs
Edward R. Marshall	Honeywell Inc.	Segments
William McChesney Martin	Retired	Foreign Currency Translation
Randal B. McDonald	Arthur Andersen & Co.	Extractive Industries
Robert K. Mautz	Ernst & Ernst	Conceptual Framework
Maurice H. Mayo	General Electric Company	Segments
Charles T. McGarraugh	Northwest Bancorporation	Materiality
Dan McGill	University of Pennsylvania	Employee Benefit Plans Cost of Pension Plans
C. Edward Midgley	Kidder Peabody & Co., Inc.	Leases
Eugene J. Minahan	Atlantic Richfield Company	Materiality
Francis Mlynarczyk, Jr.	Citibank, N.A.	Interest Costs
Charles H. Montgomery	First National Bank of Chicago and First Chicago Corporation	Debtors and Creditors
Robert A. Morgan	Caterpillar Tractor Co.	R&D and Similar Costs Interim Financial Reporting
T. Lincoln Morison, Jr.	First National Bank of Boston	R&D and Similar Costs
Everett L. Morris	Public Service Electric & Gas Co.	Interest Costs
Gerhard G. Mueller	University of Washington	Foreign Currency Translation
Robert B. Murray	Eastman Kodak Company	Segments
Robert D. Neary	Ernst & Ernst	Interim Financial Reporting
James W. Needham	White, Weld & Co.	Conceptual Framework
Carl L. Nelson	Columbia University	Contingencies Debtors and Creditors
Theodore J. Newton, Jr.	Blyth Eastman Dillon & Co., Inc.	Contingencies
William B. Nicol	Meaden & Moore	Materiality

Name	Affiliation at Time of Appointment to Task Force	Task Force
Edmund R. Noonan	Peat, Marwick, Mitchell & Co.	Leases Debtors and Creditors
William C. Norby	Duff and Phelps, Inc.	Segments
Richard E. Nordquest	Harsco Corporation	Cost of Pension Plans
David Norr	First Manhattan Company	R&D and Similar Costs Extractive Industries
Robert A. Orban	NCR Corporation	Interest Costs
John W. Ostrem	Household Finance Corporation	Interest Costs
C. Reed Parker	Duff and Phelps, Inc.	Business Combinations
Russell Parker	Federal Trade Commission	Segments
R. MacDonald Parkinson	Clarkson, Gordon & Co.	Foreign Currency Translation
Louis G. Peloubet	Textron, Inc.	Segments
Raymond E. Perry	Touche Ross & Co.	Cost of Pension Plans
William E. Pike	Morgan Guaranty Trust Co. of New York	Leases
Charles W. Plum	The Standard Oil Company (Ohio)	Segments
Richard M. Pollard	Touche Ross & Co.	Extractive Industries
Stanley P. Porter	Arthur Young & Company	Extractive Industries
Claude Poulin	UAW Social Security Department	Employee Benefit Plans
Henry A. Quinn	Peat, Marwick, Mitchell & Co.	Interim Financial Reporting
Alfred Rappaport	Northwestern University	Segments
Donald G. Reed	Booz, Allen Acquisition Services, Inc.	Business Combinations
W. Rowland Reed	Continental Oil Company	Extractive Industries
Leonard G. Reichhard, Jr.	Union Service Corp.	Contingencies
Robert Rennie	Touche Ross & Co.	Segments
Frank C. Roberts	Eaton Corporation	Segments
Robert B. Rothermel	Touche Ross & Co.	Interim Financial Reporting
Frank E. Russell	Indianapolis Newspapers, Inc.	Materiality
Leonard Savoie	Clark Equipment Company	Interim Financial Reporting
Edwin A. Schoenborn	Irving Trust Company	Interest Costs Debtors and Creditors
Charles W. Scott	Ernst & Ernst	Debtors and Creditors
Lee J. Seidler	New York University	Foreign Currency Translation
Gerald E. Sherrod	Citibank, N.A.	Extractive Industries
Gordon Shillinglaw	Columbia University	Segments
Charles J. Simons	Eastern Airlines, Inc.	Debtors and Creditors
Bracy Smith	U.S. Steel Corporation	Interest Costs

Name	Affiliation at Time of Appointment to Task Force	Task Force
Dan Throop Smith	Hoover Institution on War, Revolution & Peace	Foreign Currency Translation
George J. Staubus	University of California	Contingencies
Joseph L. Stebick	Robertshaw Controls Company	R&D and Similar Costs
Walter P. Stern	Capital Research Company	Materiality
Frances G. Stone	Merrill Lynch, Pierce, Fenner & Smith Inc.	Foreign Currency Translation
Kenneth W. Stringer	Haskins & Sells	Materiality
E. Palmer Tang	Touche Ross & Co.	R&D and Similar Costs
Frank J. Tanzola	U.S. Industries, Inc.	Interim Financial Reporting
Richard F. Tharp	Fireman's Fund Insurance Co.	Contingencies
Robert C. Thompson	Shell Oil Company	Employee Benefit Plans Cost of Pension Plans
Carl Tietjen	Price Waterhouse & Co.	Conceptual Framework
Harry Van Benschoten	Newmont Mining Corporation	Extractive Industries
J. V. van Pelt III	Retired, formerly with Vulcan Materials Company	Contingencies
Joseph Van Vleck III	Travelers Insurance Companies	Materiality
George Vogt	Peat, Marwick, Mitchell & Co.	Employee Benefit Plans Cost of Pension Plans
Brooks Walker, Jr.	United States Leasing International, Inc.	Leases
Richard Walker	Arthur Andersen & Co.	Interest Costs
Randolph H. Waterfield	Arthur Young & Company	Contingencies
George C. Watt	Price Waterhouse & Co.	Foreign Currency Translation Leases
Allan Wear	Ford Motor Company	Foreign Currency Translation
Glenn Welsch	The University of Texas at Austin	Interest Costs
Francis M. Wheat	Gibson, Dunn & Crutcher	Materiality
Clifford H. Whitcomb	Prudential Insurance Company of America	Employee Benefit Plans
Gerald I. White	Sterling Grace & Company	Interim Financial Reporting
Robert Whitman	American Electric Power Co., Inc.	Leases
John A. Willis	Union Carbide Corporation	Foreign Currency Translation
Arthur Wyatt	Arthur Andersen & Co.	Leases Interim Financial Reporting
James Zid	Ernst & Ernst	Employee Benefit Plans
Charles T. Zlatkovich	The University of Texas at Austin	Conceptual Framework
Charles L. Zody	Exxon Company, U.S.A.	Interest Costs
Alvin Zuckerkorn	J. K. Lasser & Co.	Contingencies

FASB TECHNICAL CONSULTANTS
(Since 1973)

Name	Affiliation	Assignment
Horace Brock	North Texas State University	Chairman of the task force dealing with financial accounting and reporting in the extractive industries.
Joe J. Cramer	Pennsylvania State University	Technical writer on the discussion memorandum on accounting and reporting for employee benefit plans, and the exposure draft on financial reporting in units of general purchasing power.
Bruce Collier	Oklahoma State University	Technical writer on the discussion memorandum on accounting for research and development and similar costs.
Michael Crooch	Oklahoma State University	Technical writer on the discussion memorandum on accounting for research and development and similar costs.
Thomas Dyckman	Cornell University	Consultant on the design and use of research and testing methods.
James Grier	Peat, Marwick, Mitchell & Co.	Consultant on the project on accounting for income taxes—oil and gas producing companies.
Vincent Hennessy	Haskins & Sells	Technical writer on the exposure draft on accounting for employee benefit plans.
Stephen Stewart	Retired Principal, Coopers & Lybrand	Technical consultant on accounting for employee benefit plans.
Curtis Youngdahl	Retired Partner, Haskins & Sells	Researcher and writer on the discussion memorandum on criteria for determining materiality.
John Hanna	McMaster University	Consultant on field test research report on general purchasing power accounting.
Carl Nelson	Columbia University	Technical consultant on discussion memoranda on interim financial reporting and financial accounting and reporting in the extractive industries.
Edward McEnerney	Hurdman and Cranstoun	Editorial consultant on the discussion memoranda on interim financial accounting and reporting with the extractive industries.

EXHIBIT B

ANALYSIS OF DIVERSITY OF RESPONSES TO FASB PROPOSALS

PREFACE

Underlying the Study's criticism of the standard-setting process is its assumption that the FASB is "dominated" by the eight largest accounting firms, the AICPA and, to a lesser extent, its other sponsoring organizations, each of which is in turn alleged to be principally responsive to "big business". As a result, the Study concludes, the FASB lacks the independence and objectivity to establish meaningful accounting standards in the public interest. The FASB staff has analyzed the positions expressed by the largest public accounting firms, their clients listed in the *Fortune's* rankings for 1975, and the FAF's sponsoring organizations on eight FASB projects. The results of this analysis, set forth below, clearly demonstrate that with respect to financial accounting standards there is a wide diversity of responses and views among such accounting firms, their corporate clients, and the sponsoring organizations, and even more clearly that "domination" simply does not exist.

Projects Reviewed. For the purposes of the analysis, the FASB's technical staff reviewed the following eight projects which were deemed to have resulted in the most significant of the FASB's Statements to date. Selection of the projects was made prior to this analysis and without regard to possible outcome.

Statement No.	Title
2	Accounting for Research and Development Costs
5	Accounting for Contingencies
7	Accounting and Reporting by Development Stage Enterprises
8	Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements
9	Accounting for Income Taxes—Oil and Gas Producing Companies
12	Accounting for Certain Marketable Securities
13	Accounting for Leases
14	Financial Reporting for Segments of a Business Enterprise

Excluded from this analysis are the other six Statements that the FASB has issued, one of which provided interim guidelines and five of which provided technical amendments to existing accounting pronouncements.* It was concluded that review of responses to the related Exposure Drafts, which did not evoke wide interest at the time, would not provide additional insight and thus was not needed.

* Specifically, Statement No. 1, "Disclosure of Foreign Currency Translation Information," provided interim guidelines for disclosure until Statement No. 8 could be issued. Statements No. 3, "Reporting Accounting Changes in Interim Financial Statements (an amendment of APB Opinion No. 28)"; No. 4, "Reporting Gains and Losses from Extinguishment of Debt (an amendment of APB Opinion No. 30)"; No. 6, "Classification of Short-Term Obligations Expected to Be Refinanced (an amendment of ARB No. 43, Chapter 3A)"; No. 10, "Extension of 'Grandfather' Provisions for Business Combinations (an amendment of APB Opinion No. 16)"; and No. 11, "Accounting for Contingencies—Transition Method (an amendment of FASB Statement No. 5") did not affect any of the issues analyzed in this Exhibit and provided technical amendments to the existing accounting pronouncements indicated. The Board concluded that it could make an informed decision on the matter addressed by each of those Statements without a public hearing; in contrast, the Board held a public hearing as part of its due process before issuing each of the Statements covered by this analysis.

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The purpose of the analysis was to ascertain the positions on major issues in the reviewed Exposure Drafts of those firms, enterprises and organizations alleged by the Study to "dominate" the FASB. Since the FASB does not express any proposed conclusions in Discussion Memoranda and the respondents analyzed typically responded to Exposure Drafts regardless of whether they previously responded to Discussion Memoranda on the same projects, a review of the responses to Discussion Memoranda was deemed unnecessary, except in certain instances where comments on Discussion Memoranda were reviewed to clarify a respondent's position on the Exposure Draft. Those firms, enterprises and organizations that disagreed with the Exposure Draft or particular issues were probably more likely to respond than those that agreed. As with the selection of the projects reviewed, issues were selected for review prior to the analysis and without regard to their possible outcome.

The issues covered by this analysis are comprehensively addressed in the appendices to the respective Exposure Drafts and Statements, which include a discussion of the Board's reasons for accepting or rejecting various alternatives considered. Accordingly, the reader is encouraged to refer to those appendices in considering this analysis. As stated by the Board and shown by the results of the analysis, it is the substance of arguments put forth by respondents and not the number of respondents or their status that the Board takes into account in considering comments before issuing a Statement.

Categories of Respondents Reviewed. Responses to Exposure Drafts were reviewed for respondents in the following categories:

- 6 sponsoring organizations of the FASB: American Accounting Association (AAA), American Institute of Certified Public Accountants (AICPA), Financial Analysts Federation (Analysts Federation), Financial Executives Institute (FEI), National Association of Accountants (NAA), and Securities Industry Association (SIA)*
- 15 largest public accounting firms
- 500 largest industrial enterprises**
- 50 largest commercial banking enterprises**
- 50 largest life insurance enterprises**
- 50 largest diversified financial enterprises**
- 50 largest retailing enterprises**
- 50 largest transportation enterprises**
- 50 largest utility enterprises**
- academicians

The position ascribed to an organization in the tables may not be the position of its membership, or even of the organization itself. All of the sponsoring organizations have committees charged with considering FASB Exposure Drafts. The AICPA charges its Accounting Standards Executive Committee (AcSEC) with this task. AcSEC's positions are the official view of that Committee only when supported by a majority of its fifteen members, and in no event purport to represent the views of the AICPA's approximately 130,000 members. The NAA and the Analysts Federation similarly present views through committees with authority to represent only the committees' members. Conversely, while the FEI charges its Committee on Corporate Reporting with initial consideration of Exposure Drafts, its Executive Committee has veto power over the comment letters, and the comment letters are intended to be regarded as the views of the membership. The

* The SIA became a sponsoring organization in October 1976. Prior to such time it did not comment on any Exposure Draft covered by this analysis.

**Based on *Fortune's* rankings for 1975.

comments of the AAA's Committee on Financial Accounting Standards constitute neither the views of the AAA nor the Committee, but only the views of those persons participating in preparing a particular letter.

The fifteen accounting firms included in the review were those alleged by the Study to be "a useful and reasonably complete grouping for purposes of measuring the influence of major accounting firms on the Federal Government." Those firms include the eight largest accounting firms (Arthur Andersen & Co.; Arthur Young & Company; Coopers & Lybrand; Ernst & Ernst; Haskins & Sells; Peat, Marwick, Mitchell & Co.; Price Waterhouse & Co.; and Touche Ross & Co.), which the Study claims "are so large and influential in relation to other CPA firms that they are able to control virtually all aspects of accounting and auditing in the United States." The next seven largest accounting firms identified by the Study are Alexander Grant & Co.; Hurdman and Cranstoun; J. K. Lasser & Co.; Laventhol & Horwath; S. D. Leidesdorf & Co.; Main Lafrentz & Co.; and Seidman & Seidman.

The responses of academicians are included in the analysis because those engaged in academic research and educational activities are found by the Study as ostensibly not having "a direct vested interest in the type of standards set by the FASB. . . ."

The views expressed by the Analysts Federation's committee may similarly be of special significance to the analysis, since the Study found most of its members to be users of financial statements and, of the FAF's sponsoring organizations, "only the Financial Analysts Federation and its members have an apparent interest in developing accounting standards which clearly convey the results of corporate activities to the public."

Organization of Information. An overall summary shows for each project reviewed the number of responses for each category of respondents and the number of responses analyzed.

For each project, commentary is presented that:

1. Identifies the issues reviewed and their resolution by the FASB in the Exposure Draft and in the Statement;
2. Summarizes positions taken by all respondents reviewed and in the case of accounting firms compares the responses of such firms to those of the majority of their clients (the commentary does not include those instances in which an accounting firm's clients split evenly or took no position or in which the firm took no position); and
3. Sets forth considerations or circumstances that are significant to the analysis.

For each project, a table sets forth the position, if any, of each respondent or category of respondent as to the issues reviewed. In addition, if appropriate for a particular project, that table also sets forth the overall reaction, if any, of each respondent or category of respondent to the provisions of the Exposure Draft. For most issues reviewed, the responses were classified as (a) "yes" (or "agree"), or (b) "no" (or "disagree"). Classification (a) was used if the response was clearly affirmative, either by an explicit affirmative statement or by comparable wording in the reviewer's judgment. Classification (b) was used if the response was clearly negative, either by an explicit negative statement or by comparable wording in the reviewer's judgment. If the respondent did not address the issue or discussed the issue but did not indicate a position, no classification was indicated for the response. Judgment was required in classifying certain responses. For certain issues having several possible choices as to their resolution, responses were classified as to the preference for a particular choice.

For certain other issues, preferences for choices other than the one proposed were not separately tabulated because they were too numerous to do so meaningfully. In the latter case, all respondents classified under (b) were not necessarily consistent with each other. For example, two respondents might both have disagreed with the Exposure Draft, but have preferences fundamentally different from one another.

SUMMARY OF NUMBERS OF RESPONSES TO EXPOSURE DRAFTS ON FASB PROJECTS REVIEWED

	Statement No.							
	2	5	7	8	9	12	13(2)	14
Sponsoring Organizations(1)	4	5	3	4	3	5	4	5
Public Accounting:								
8 largest public accounting firms(1)	7	8	8	8	8	8	8	7
Next 7 largest public accounting firms(1)	4	4	3	4	2	4	3	4
Others	14	23	13	17	5	24	36	14
	25	35	24	29	15	36	47	25
Business Enterprises and Groups:								
500 largest industrial enterprises(1)	51	45	32	87	28	27	62	96
50 largest commercial banking enterprises(1)	0	1	0	4	0	9	5	4
50 largest life insurance enterprises(1)	0	6	3	1	0	2	3	1
50 largest diversified financial enterprises(1)	0	8	1	1	1	8	2	2
50 largest retailing enterprises(1)	0	3	2	3	0	4	7	4
50 largest transportation enterprises(1)	0	3	0	0	1	4	6	1
50 largest utility enterprises(1)	8	14	11	2	6	5	19	5
Others	50	66	46	41	35	79	66	61
	109	146	95	139	71	138	170	174
Academicians(1)	16	12	4	5	3	4	11	10
Government, Including Individuals in Government	12	6	7	5	3	9	11	12
Other Sources(3)	5	9	5	9	3	11	7	7
Total Responses	171	213	138	191	98	203	250	233

(1) Each response in this category was reviewed to determine the respondent's position on the issues selected for analysis. However, not every respondent took a position on each of the issues reviewed.

(2) Responses are indicated only for the first Exposure Draft of FASB Statement No. 13. Responses also were received to a second Exposure Draft, but were not analyzed for the reasons stated in the commentary in this exhibit for that Statement.

(3) These responses are primarily from respondents in the securities industry and the legal profession.

FASB STATEMENT NO. 2
"ACCOUNTING FOR RESEARCH AND DEVELOPMENT COSTS"
(October 1974)

Background

Statement No. 2 established standards of financial accounting and reporting for research and development costs and eliminated at least three alternative accounting and reporting practices previously followed. Statement No. 2 specifies (a) those activities that shall be identified as research and development for financial accounting and reporting purposes; (b) the elements of costs that shall be identified with research and development activities; (c) the accounting for research and development costs; and (d) the financial statement disclosures related to research and development costs.

Analysis of Responses to Exposure Draft

The responses to the Exposure Draft by respondents in the categories specified in the preface to this review were analyzed as to the positions taken on two major issues. No separate question focusing on each respondent's overall reaction, if any, was necessary inasmuch as the first issue addresses the primary area dealt with in the Exposure Draft.

Issue No. 1: Should all research and development costs not directly reimbursable by others be charged to expense when incurred?

FASB Position in ED: Yes

FASB Position in Statement: Yes (The scope of the Statement excluded "accounting for the costs of research and development activities conducted for others under a contractual arrangement," which, according to some, is a slightly broader category than "research and development costs directly reimbursable by others.")

1. The AICPA, Analysts Federation and FEI agreed with or at least found acceptable the Exposure Draft and Statement on this issue.
2. Eleven academic commentators disagreed with the Exposure Draft and the Statement; three agreed.
3. Six major accounting firms agreed with the Exposure Draft and the Statement; three disagreed.
4. Thirty-four major business corporations agreed with the Exposure Draft and the Statement; seventeen disagreed.
5. Three accounting firms took positions consistent with those of the majority of their clients responding; one firm took an inconsistent position with those of a majority of its clients responding.

Issue No. 2: Should research and development costs incurred on the basis of a contractual arrangement be encompassed and accounted for in the manner proposed in the Exposure Draft?

FASB Position in ED: Yes

FASB Position in Statement: No

1. The Analysts Federation and FEI agreed with the Exposure Draft on this issue; the AICPA disagreed with the Exposure Draft.

2. The one academic commentator who took a position agreed with the Exposure Draft.
3. The five major accounting firms responding on the issue disagreed with the Exposure Draft.
4. Sixteen major business corporations agreed with the Exposure Draft; twelve disagreed.
5. Four accounting firms took positions inconsistent with those of the majority of their clients responding.
6. A number of the respondents whose responses have been classified as "yes" or "agree" under this issue did not explicitly address this issue; instead, they indicated overall agreement with the provisions in the Exposure Draft.
7. Because in the Statement the scope excluded costs incurred in research and development activities conducted for others under a contractual arrangement, the Board did not accept or reject the various positions taken by respondents about appropriate accounting for this issue. Accordingly, no comparison is possible of the Statement's position to the respondents' positions.

FASB Statement No. 2
"Accounting for Research and Development Costs"
(October 1974)

	1. R&D Costs Expensed		2. R&D Under Contract	
	Yes	No	Yes	No
FASB Exposure Draft	•	—	•	—
FASB Statement	•	—	—	•
Sponsoring Organizations(a)				
AICPA	•	—	—	•
Analysts Federation(b)	•	—	•	—
FEI(c)	•	—	•	—
NAA(d)	—	—	—	—
Academicians	3	11	1	0
Major Accounting Firms	6	3	0	5
Business Enterprises	34	17	16	12
Total for Responses Analyzed	46	31	19	18
Major Accounting Firms and Responding Clients				
Arthur Andersen & Co.	•	—	—	—
Its Clients	4	3	2	1
Arthur Young & Company	—	—	—	—
Its Clients	5	1	2	3
Coopers & Lybrand (no response)				
Its Clients	4	0	1	2
Ernst & Ernst	—	•	—	•
Its Clients	3	3	2	1
Haskins & Sells	—	•	—	•
Its Clients	3	3	2	1
Hurdman and Cranstoun	•	—	—	—
Its Clients	2	0	0	1
J. K. Lasser & Co.	•	—	—	—
Its Clients (no response)				
Peat, Marwick, Mitchell & Co.(e)	•	—	—	•
Its Clients	2	2	1	0
Price Waterhouse & Co.	•	—	—	•
Its Clients	10	2	6	3
S. D. Leidesdorf & Co.	—	—	—	—
Its Clients	0	1	0	0
Seidman & Seidman	—	•	—	—
Its Clients (no response)				
Touche Ross & Co.(e)	•	—	—	•
Its Clients	1	2	0	0

Notes are on the following page.

Statement No. 2

Notes to Table

(a) The "sponsoring organization" designation for these comment letter positions is for convenience only. As discussed in the preface to this exhibit, these positions represent the majority view of each organization's responding committee and, except as stated in the preface, do not represent the views of the organization as such or the views of its membership.

(b) The response indicates that the replies received, from " those to whom we have circulated the proposed Statement . . . indicated enthusiastic affirmation of the position taken."

(c) The response indicated that the FEI could support the provisions in the Exposure Draft, though it "believes that the Standard adopted should permit reasonable variations to reflect underlying circumstances." Its position paper on the FASB Discussion Memorandum, "Accounting for Research and Development and Similar Costs," proposed that certain kinds of research and development costs be capitalized if those costs meet certain criteria (in general, a high degree of probability of future economic benefits).

(d) The response of the Management Accounting Practices Committee of the NAA was limited to "the need for clarification in certain areas to lessen misunderstanding." Its position paper to the aforementioned Discussion Memorandum proposed capitalization for research and development costs that meet certain criteria.

(e) The respondent noted participation in and general agreement with the response by the Accounting Standards Executive Committee of the AICPA.

FASB STATEMENT NO. 5
"ACCOUNTING FOR CONTINGENCIES"
(March 1975)

Background

Statement No. 5 establishes standards of financial accounting and reporting for contingencies. The Statement reduced the number of alternative accounting practices previously followed and improved the disclosure of loss contingencies in financial statements. The Statement specifies (a) the accounting for both loss and gain contingencies; (b) criteria for determining when a loss contingency should be accrued; and (c) the financial statement disclosures related to loss contingencies. It also provides examples of its application to the various contingencies that an enterprise may experience.

Analysis of Responses to Exposure Draft

The responses to the Exposure Draft by respondents in the categories specified in the preface to this exhibit were analyzed as to the positions taken on three major issues. Those respondents' overall reactions, if any, to the provisions of the Exposure Draft were also analyzed.

Overall

1. The AICPA and Analysts Federation agreed with the Exposure Draft and Statement; the FEI and NAA disagreed.
2. The seven academic commentators who indicated overall reactions agreed with the Exposure Draft and Statement.
3. Six major accounting firms agreed with the Exposure Draft and Statement; five disagreed.
4. Forty-two major business corporations disagreed with the Exposure Draft and Statement; fourteen agreed.
5. Four accounting firms took positions consistent with those of the majority of their clients responding; two firms took positions inconsistent with those of the majority of their clients responding.

Issue No. 1: Should accruals be permitted for loss contingencies from self-insured risks?

FASB Position in ED: No

FASB Position in Statement: No

1. The AICPA and the Analysts Federation agreed with the Exposure Draft and Statement on this issue; the FEI and NAA disagreed with the Exposure Draft and Statement.
2. The six academic commentators who took positions agreed with the Exposure Draft and Statement.
3. Five major accounting firms agreed with the Exposure Draft and Statement; one disagreed.
4. Fifty major business corporations disagreed with the Exposure Draft and Statement; two agreed.
5. One accounting firm took a position consistent with those of the majority of its clients responding; four firms took positions inconsistent with those of a majority of their clients responding.

Issue No. 2: Should accruals be permitted for loss contingencies from catastrophe losses of casualty insurers?

FASB Position in ED: No

FASB Position in Statement: No

1. The AICPA and Analysts Federation agreed with the Exposure Draft and Statement on this issue; the FEI disagreed.
2. The five academic commentators who took positions agreed with the Exposure Draft and Statement.
3. Four major accounting firms agreed with the Exposure Draft and Statement; three disagreed.
4. Nineteen major business corporations disagreed with the Exposure Draft and Statement; six agreed.
5. Three accounting firms took positions consistent with those of their clients responding; one firm took a position inconsistent with those of its clients responding.

Issue No. 3: Should accruals be permitted for loss contingencies from non-imminent expropriations of foreign assets?

FASB Position in ED: No

FASB Position in Statement: No

1. The AICPA and Analysts Federation agreed with the Exposure Draft and Statement on this issue; the NAA disagreed.
2. Academic commentators did not address this issue.
3. Five major accounting firms agreed with the Exposure Draft and Statement; none disagreed.
4. Four major business corporations disagreed with the Exposure Draft and Statement; two agreed.
5. Two accounting firms took positions inconsistent with those of their clients responding.

FASB Statement No. 5

"Accounting for Contingencies"

(March 1975)

	Overall Reaction		Issues—Should accruals be permitted for loss contingencies from: 1. Self-Insured Risks		2. Catastrophe Losses of Casualty Insurers		3. Expropriations of Foreign Assets(a)	
	Agree	Disagree	Yes	No	Yes	No	Yes	No
FASB Exposure Draft			—	•	—	•	—	•
FASB Statement			—	•	—	•	—	•
Sponsoring Organizations(b)								
AAA	—	—	—	—	—	—	—	—
AICPA	•	—	—	•	—	•	—	•
Analysts Federation	•	—	—	•	—	•	—	•
FEI	—	•	•	—	•	—	—	—
NAA	—	•	•	—	—	—	•	—
Academicians	7	0	0	6	0	5	0	0
Major Accounting Firms	6	5	1	5	3	4	0	5
Business Enterprises	14	42	50	2	19	6	4	2
Total for Responses Analyzed	29	49	53	15	23	17	5	9
Major Accounting Firms and Responding Clients								
Arthur Andersen & Co.	•	—	—	•	—	—	—	•
Its Clients	3	3	7	0	2	0	1	0
Arthur Young & Company	—	•	—	•	—	•	—	—
Its Clients	0	4	2	0	2	0	0	1
Coopers & Lybrand	—	•	—	—	•	—	—	—
Its Clients	1	6	6	0	3	0	0	0
Ernst & Ernst	•	—	—	—	—	—	—	—
Its Clients	2	8	7	0	2	4	1	0
Haskins & Sells	—	—	—	—	•	—	—	•
Its Clients	1	5	8	0	3	0	0	0
Hurdman and Cranstoun	•	—	—	—	—	—	—	—
Its Clients (no response)								
J. K. Lasser & Co.	•	—	—	•	—	•	—	•
Its Clients (no response)								
Main Lafrentz & Co.	—	—	—	—	—	—	—	—
Its Clients	1	0	0	0	1	0	0	0
Peat, Marwick, Mitchell & Co.	—	•	—	•	—	•	—	•
Its Clients	3	5	7	2	2	2	1	1
Price Waterhouse & Co.	—	•	•	—	•	—	—	—
Its Clients	3	10	9	0	4	0	0	0
S. D. Leidesdorf & Co.	•	—	—	—	—	—	—	—
Its Clients (no response)								
Seidman & Seidman	—	•	—	—	—	—	—	—
Its Clients (no response)								
Touche Ross & Co.	•	—	—	•	—	•	—	•
Its Clients	0	1	4	0	0	0	1	0

(a) Accruals for loss contingencies from expropriation of foreign assets were permitted in the Exposure Draft and are permitted in the Statement only if expropriation is "imminent".

(b) The "sponsoring organization" designation for these comment letter positions is for convenience only. As discussed in the preface to this exhibit, these positions represent the majority view of each organization's responding committee and, except as stated in the preface, do not represent the views of the organization as such or the views of its membership.

FASB STATEMENT NO. 7
"ACCOUNTING AND REPORTING BY DEVELOPMENT STAGE ENTERPRISES"
(June 1975)

Background

Prior to Statement No. 7, some development stage enterprises had adopted special financial accounting and reporting practices that were inconsistent with those applied by other developing companies and differed from those used by established operating enterprises. Statement No. 7 establishes guidelines for identifying a development stage enterprise and provides that financial statements issued by a development stage enterprise shall conform to the generally accepted accounting principles that apply to established operating enterprises. The Statement also eliminates those special accounting practices and reporting formats that were applied to development stage enterprises and requires such an enterprise to disclose certain additional information.

Analysis of Responses to Exposure Draft

The responses to the Exposure Draft by respondents in the categories specified in the preface to this exhibit were analyzed as to the positions taken on three major issues. In addition, responses were analyzed according to respondents' overall reactions to the Exposure Draft.

A number of responses suggested that the scope of the Exposure Draft was open to misinterpretation.

First, a number of respondents interpreted the inclusion of subsidiaries, divisions, or other components of an established operating enterprise to mean that new financial accounting standards were being proposed for costs incurred by established operating enterprises in expanding their existing businesses.

Second, the Exposure Draft stated without qualification that the proposed statement would apply to companies in the development stage in all industries. A number of respondents interpreted that sentence to mean that: (a) the Statement would establish new accounting standards for costs uniquely incurred in the extractive industries; or (b) the general exemption applicable to situations in which the rate-making process in regulated industries calls for special accounting practices would not apply to this Statement.

In Statement No. 7, the Board made clear that those interpretations did not reflect its intent. However, in analyzing responses to the Exposure Draft, it could not be determined in a number of cases whether a respondent's overall reaction and its position on the first issue were based on a misinterpretation of the intended scope. The analysis of responses in these two cases is therefore subject to that limitation.

Overall

1. The Analysts Federation and FEI agreed with the Exposure Draft and Statement.
2. The four academic commentators who indicated overall reactions split evenly on the Exposure Draft and Statement.
3. The four major accounting firms that indicated an overall reaction all disagreed with the Exposure Draft and Statement.

4. Twenty-four major business corporations disagreed with the Exposure Draft and Statement; eighteen agreed.
5. Two accounting firms took positions consistent with those taken by the majority of their clients responding; one firm took a position inconsistent with those of the majority of its clients responding.

Issue No. 1: Should a development stage enterprise apply the same financial accounting and reporting standards as an established operating enterprise?

FASB Position in ED: Yes

FASB Position in Statement: Yes

1. The Analysts Federation, AICPA and FEI agreed with the Exposure Draft and Statement on this issue.
2. The four academic commentators that took positions split evenly on the Exposure Draft and Statement.
3. The eight major accounting firms that took positions split evenly on the Exposure Draft and Statement.
4. Nineteen major business corporations agreed with the Exposure Draft and Statement; fifteen disagreed.
5. Three accounting firms took positions consistent with those taken by the majority of their clients responding; two firms took positions inconsistent with those of the majority of their clients responding.

Issue No. 2: Should development stage enterprises in certain industries be exempt from the financial accounting and reporting standards to be applied by development stage enterprises generally?

FASB Position in ED: No

FASB Position in Statement: No

1. No sponsoring organizations or academic commentators took a position on this issue.
2. One major accounting firm responding on this issue disagreed with the Exposure Draft and Statement as did the majority of its clients responding. One agreed with the Exposure Draft and Statement but took a position inconsistent with those of its clients responding.
3. All twenty-two major business corporations that took positions disagreed with the Exposure Draft and Statement.

Issue No. 3: Should the Board establish accounting standards for start-up costs and similar costs before prescribing accounting standards for development stage enterprises?

FASB Position in ED: No

FASB Position in Statement: No

1. The AICPA disagreed with the Exposure Draft and Statement on this issue.
2. All nine major accounting firms that took positions disagreed with the Exposure Draft and Statement.
3. The four major business corporations that took positions disagreed with the Exposure Draft and Statement.
4. Three accounting firms took positions consistent with those of their clients responding.

FASB Statement No. 7

"Accounting and Reporting by Development Stage Enterprises"

(June 1975)

	Overall Reaction		1. Same Standards		2. Certain Industries Exempt		3. Start-up and Similar Costs First	
	Agree	Dis-agree	Yes	No	Yes	No	Yes	No
FASB Exposure Draft			●	—	—	●	—	●
FASB Statement			●	—	—	●	—	●
Sponsoring Organizations(a)								
AICPA	—	—	●	—	—	—	●	—
Analysts Federation	●	—	●	—	—	—	—	—
FEI	●	—	●	—	—	—	—	—
Academicians	2	2	2	2	0	0	0	0
Major Accounting Firms	0	4	4	4	1	1	9	0
Business Enterprises	18	24	19	15	22	0	4	0
Total for Responses Analyzed	22	30	28	21	23	1	14	0
Major Accounting Firms and Responding Clients								
Arthur Andersen & Co.	—	—	●	—	—	●	●	—
Its Clients	2	5	2	2	5	0	0	0
Arthur Young & Company	—	—	●	—	—	—	●	—
Its Clients	1	0	1	0	0	0	0	0
Coopers & Lybrand	—	—	●	—	●	—	●	—
Its Clients	3	2	3	1	3	0	1	0
Ernst & Ernst	—	●	—	●	—	—	●	—
Its Clients	2	1	2	0	1	0	0	0
Haskins & Sells	—	●	—	●	—	—	●	—
Its Clients	2	5	2	4	3	0	0	0
J. K. Lasser & Co.	—	—	—	—	—	—	●	—
Its Clients (no response)								
Peat, Marwick, Mitchell & Co.	—	—	●	—	—	—	●	—
Its Clients	3	3	3	3	2	0	1	0
Price Waterhouse & Co.	—	●	—	●	—	—	—	—
Its Clients	4	5	5	2	6	0	1	0
S. D. Leidesdorf & Co.	—	—	—	—	—	—	—	—
Its Clients	0	1	0	1	0	0	0	0
Seidman & Seidman	—	●	—	●	—	—	●	—
Its Clients (no response)								
Touche Ross & Co.	—	—	—	—	—	—	●	—
Its Clients	1	2	1	2	2	0	1	0

(a) The "sponsoring organization" designation for these comment letter positions is for convenience only. As discussed in the preface to this exhibit, these positions represent the majority view of each organization's responding committee and, except as stated in the preface, do not represent the views of the organization as such or the views of its membership.

FASB STATEMENT NO. 8
"ACCOUNTING FOR THE TRANSLATION OF FOREIGN CURRENCY TRANSACTIONS AND FOREIGN CURRENCY FINANCIAL STATEMENTS"
(October 1975)

Background

Statement No. 8 specifies the method for translating foreign currency transactions and foreign currency financial statements. It eliminated all previously accepted foreign currency translation methods and required that exchange gains or losses be included in net income currently except for exchange gains or losses relating to a hedge of an identifiable foreign currency commitment. Those exchange gains or losses are deferred and included in the dollar basis of the related foreign currency transactions.

Analysis of Responses to Exposure Draft

The responses to the Exposure Draft by respondents in the categories specified in the preface to this review were analyzed with respect to the positions taken on three major issues:

Issue No. 1: Should the modified temporal method be used in translating foreign currency transactions and financial statements?

1. Yes
2. Yes with Qualification*
3. No

FASB Position in ED: Yes

FASB Position in Statement: Yes

1. The Analysts Federation agreed with the Exposure Draft and Statement on this issue; the AICPA, FEI and NAA agreed with qualification to the Exposure Draft.
2. Academic commentators were split with two fully agreeing with the Exposure Draft and Statement, two disagreeing and one agreeing with qualification.
3. Five major accounting firms disagreed with the Exposure Draft and Statement, and four agreed with qualification. Only one firm fully agreed.
4. Thirty-eight major business corporations agreed with qualification; twenty-nine disagreed; ten fully agreed.
5. Two accounting firms took positions consistent with those of the majority of their clients responding; six took positions inconsistent with those of the majority of their clients responding.

Issue No. 2: Should exchange gains and losses be included in net income currently?

FASB Position in ED: Yes

FASB Position in Statement: Yes

* Because the issue is relatively complex, a separate category is necessary to designate those respondents agreeing with the basic principle but disagreeing with some specific requirement of the translation method. For example, some respondents indicated general agreement with the Exposure Draft but suggested that inventory be translated at the current rate.

1. The Analysts Federation agreed with the Exposure Draft and Statement on this issue; the NAA disagreed.
2. One academic commentator agreed with the Exposure Draft and Statement; one disagreed.
3. Three major accounting firms disagreed with the Exposure Draft; three agreed.
4. Fifty-four major business corporations disagreed with the Exposure Draft and Statement; five agreed.
5. Two accounting firms took positions consistent with those of the majority of their clients responding; two took positions inconsistent with those of the majority of their clients responding.

Issue No. 3: How should changes in market value of unperformed forward exchange contracts be treated?

1. Accrued and included in net income for the period in which the market value changes
2. Accrued but defer gain or loss where contract is a hedge of an identifiable foreign currency commitment
3. Other

FASB Position in ED: Accrued and included in net income for the period in which the market value changes

FASB Position in Statement: Accrued but defer gain or loss where contract is a hedge of an identifiable foreign currency commitment

1. The only sponsoring organization that responded to this issue was the AICPA, which disagreed with the Exposure Draft and recommended the position taken in the Statement.
2. One academic commentator agreed with the Exposure Draft; one disagreed.
3. Seven major accounting firms disagreed with the Exposure Draft, six of which recommended the position of the Statement; one agreed.
4. Twenty-four major business corporations disagreed with the Exposure Draft, fourteen of which recommended the position of the Statement; two agreed.
5. Four accounting firms took positions consistent with those of the majority of their clients responding in generally opposing the Exposure Draft; one supporting the Exposure Draft took a position inconsistent with those of its clients responding. Three firms took positions inconsistent with those of the majority of their clients responding on the particular position taken, and two firms took positions consistent with those of the majority of their clients responding.

In many cases, judgment was required in categorizing specific responses. For instance, judgment had to be used to categorize a respondent's choice of translation method if a method was adequately described but not expressly named.

FASB Statement No. 8

"Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements"

(October 1975)

	1. Modified Temporal Method			2. Exchange Adj. to Income		3. Forward Exchange Contract		
	Yes	Yes with Qualif.	No	Yes	No	Income	Allow Hedging	Other
FASB Exposure Draft	•	—	—	•	—	•	—	—
FASB Statement	•	—	—	•	—	—	•	—
Sponsoring Organizations(a)								
AICPA	—	•	—	—	—	—	•	—
Analysts Federation	•	—	—	•	—	—	—	—
FEI	—	•	—	—	—	—	—	—
NAA	—	•	—	—	•	—	—	—
Academicians	2	1	2	1	1	1	0	1
Major Accounting Firms	1	4	5	3	3	1	6	1
Business Enterprises	10	38	29	5	54	2	14	10
Total for Responses Analyzed	14	46	36	10	59	4	21	12
Major Accounting Firms and Responding Clients								
Alexander Grant & Company	—	•	—	—	—	—	•	—
Its Clients	0	0	1	0	0	0	1	0
Arthur Andersen & Co.	—	•	—	•	—	•	—	—
Its Clients	0	8	4	0	10	0	3	0
Arthur Young & Company	—	—	•	—	•	—	•	—
Its Clients	1	4	2	0	5	0	0	2
Coopers & Lybrand	—	—	•	—	•	—	•	—
Its Clients	1	2	6	1	5	1	1	2
Ernst & Ernst	—	—	—	—	—	—	—	—
Its Clients	1	3	2	0	4	0	0	1
Haskins & Sells	—	—	•	—	—	—	—	—
Its Clients	1	4	3	0	6	1	4	1
Hurdman and Cranstoun	•	—	—	•	—	—	•	—
Its Clients	0	1	0	0	0	0	0	0
Main Lafrentz & Co.	—	—	—	—	•	—	—	—
Its Clients	0	1	0	0	0	0	1	0
Peat, Marwick, Mitchell & Co.	—	•	—	•	—	—	—	—
Its Clients	2	5	3	2	7	0	1	3
Price Waterhouse & Co.	—	—	•	—	—	—	•	—
Its Clients	4	7	6	2	13	0	3	1
Seidman & Seidman	—	•	—	—	—	—	—	•
Its Clients (no response)								
Touche Ross & Co.	—	—	•	—	—	—	•	—
Its Clients	0	3	2	0	4	0	0	0

(a) The "sponsoring organization" designation for these comment letter positions is for convenience only. As discussed in the preface to this exhibit, these positions represent the majority view of each organization's responding committee and, except as stated in the preface, do not represent the views of the organization as such or the views of its membership.

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FASB STATEMENT NO. 9
"ACCOUNTING FOR INCOME TAXES—OIL AND GAS PRODUCING COMPANIES"
(October 1975)

Background

In computing taxable income, oil and gas producing companies generally deduct intangible development costs and other costs of exploration for and development of oil and gas reserves (IDC) in the year incurred and capitalize IDC for financial reporting purposes and amortize them over the productive lives of producing properties. Prior to Statement No. 9, generally accepted accounting principles did not require the recording of deferred income taxes for intangible development costs that oil and gas producing companies capitalized for financial reporting and expensed for federal income tax reporting because percentage depletion over the life of oil and gas properties was generally expected to exceed the amount of costs capitalized and amortized in the financial statements (sometimes referred to as "interaction"). While some oil and gas producing companies recorded deferred taxes applicable to intangible development costs, most did not.

The Tax Reform Act of 1975 substantially reduced or eliminated percentage depletion as a federal income tax deduction for many oil and gas producing companies as of January 1, 1975. Statement No. 9 requires that commencing January 1, 1975 all enterprises must record deferred income taxes for intangible development costs and other costs of exploration for, and development of, oil and gas reserves entering into the determination of financial accounting income and taxable income in different periods.

Analysis of Responses to Exposure Draft and at Public Hearing

The responses to the Exposure Draft by respondents in the categories specified in the preface to this exhibit were analyzed as to the positions taken on two major issues:

Issue No. 1: Should interperiod tax allocation be required for intangible drilling cost if percentage depletion is no longer available?

FASB Position in ED: Yes

FASB Position in Statement: Yes

All respondents that indicated a position agreed with the Exposure Draft and Statement. Two respondents did not take a position on this issue, but sought reconsideration of APB Opinion No. 11 and elimination of interperiod tax allocation for all firms.

Issue No. 2: In adopting interperiod tax allocation how should the retroactive effect, if any, be treated?

a. Charge to income

b. Retroactive restatement

c. Direct charge to retained earnings

d. Allocate taxes prospectively—"gross" method (This method would allocate income taxes only with respect to financial statement/tax differences arising from costs incurred after December 31, 1974.)

e. Allocate taxes prospectively—"net" method (This method would allocate income taxes commencing January 1, 1975 on the excess of timing differences arising on or after that date over reversals of financial statement/tax differences that had arisen prior to that date.)

FASB Position in ED: (a)

FASB Position in Statement: (b) or (e)

Exposure Draft Responses

1. The Analysts Federation agreed with the Exposure Draft on this issue; other sponsoring organizations indicated they could not reach a majority position or did not respond.
2. One academic commentator agreed with the Exposure Draft; one recommended a method adopted in the Statement.
3. Eight major accounting firms disagreed with the Exposure Draft; two agreed; eight recommended a method adopted in the Statement.
4. Thirty-three major business corporations disagreed with the Exposure Draft; one agreed; twenty-four recommended methods adopted in the Statement.
5. The two accounting firms agreeing with the Exposure Draft took positions inconsistent with those of the majority of their clients responding. Of the firms disagreeing with the Exposure Draft, one firm took a position consistent with that of its client responding as to the particular method to be used; six firms took positions inconsistent with those of the majority of their clients responding as to the particular method to be used.

In light of those responses and further consideration, the Board announced a public hearing and solicited additional views. Thirty-one of the parties responding to the Exposure Draft responded to the second solicitation of views, and twenty-seven presented oral testimony at a public hearing held on September 10-11, 1975. In most cases, the views of particular respondents were the same as expressed for the Exposure Draft, but a few respondents added an acceptable alternative method and others dropped a second preference.

Public Hearing

1. No sponsoring organization or academic commentators took a position on the Exposure Draft at the public hearing.
2. Each method adopted in the Statement was recommended by four major accounting firms.
3. Twelve major business corporations recommended Method b; ten recommended Method e; nine recommended at least one method not adopted in the Statement.
4. No accounting firm recommended a particular method that also was recommended by a majority of its clients.

FASB Statement No. 9

"Accounting for Income Taxes—Oil and Gas Producing Companies"

(October 1975)

	1. Tax Allocation		2. Transition Method (a)									
			Exposure Draft					Public Hearing				
	Yes	No	Agree. (a)	(b)	(c)	(d)	(e)	(a)	(b)	(c)	(d)	(e)
FASB Exposure Draft	●	—	●	—	—	—	—	—	—	—	—	—
FASB Statement	●	—	—	●	—	—	●	—	—	—	—	—
Sponsoring Organizations (b)												
AICPA	●	—	(c)	(c)	—	—	—	—	—	—	—	—
Analysts Federation	●	—	●	—	—	●	—	—	—	—	—	—
FEI	—	—	—	—	—	—	—	—	—	—	—	—
Academicians	1	0	1	1	0	0	0	0	0	0	0	0
Major Accounting Firms	10	0	2	5	0	1	4	0	4	0	0	4
Business Enterprises	35	0	1	15	7	8	10	0	12	5	4	10
Total for Responses Analyzed	48	0	6	22	7	10	14	0	16	5	4	14
Major Accounting Firms and Responding Clients												
Arthur Andersen & Co.	●	—	—	●	—	—	—	—	●	—	—	—
Its Clients	8	0	1	3	0	1	4	0	1	0	0	4
Arthur Young & Company	●	—	●	—	—	—	—	—	—	—	—	—
Its Clients	3	0	0	2	0	1	0	0	2	0	1	0
Coopers & Lybrand	●	—	—	●	—	—	●	—	●	—	—	—
Its Clients	4	0	0	2	2	1	0	0	2	1	1	1
Ernst & Ernst	●	—	—	●	—	—	—	—	●	—	—	—
Its Clients	2	0	0	1	1	0	0	0	0	1	0	0
Haskins & Sells	●	—	—	—	—	—	●	—	—	—	—	●
Its Clients	1	0	0	1	1	0	0	0	1	1	0	0
Hurdman and Cranstoun	●	—	—	—	—	—	●	—	—	—	—	●
Its Clients (no response)												
Main Lafrentz & Co.	●	—	—	—	—	●	—	—	—	—	—	—
Its Clients	1	0	0	0	0	1	0	0	0	0	1	0
Peat, Marwick, Mitchell & Co.	●	—	●	●	—	—	—	—	●	—	—	—
Its Clients	4	0	0	1	1	1	2	0	1	0	0	1
Price Waterhouse & Co.	●	—	—	—	—	—	●	—	—	—	—	●
Its Clients	11	0	0	5	2	3	3	0	5	2	1	4
Touche Ross & Co.	●	—	—	●	—	—	—	—	—	—	—	●
Its Clients	1	0	0	0	0	0	1	0	0	0	0	0

Notes are on the next page.

Statement No. 9

Notes to Table

(a) Several respondents identified two or more alternative methods as being acceptable, and the analysis includes for those respondents each method so identified.

(b) The "sponsoring organization" designation for these comment letter positions is for convenience only. As discussed in the preface to this exhibit, these positions represent the majority view of each organization's responding committee and, except as stated in the preface, do not represent the views of the organization as such or the views of its membership.

(c) The AICPA Accounting Standards Executive Committee was unable to agree on transition. There was support for both methods a and b.

FASB STATEMENT NO. 12
"ACCOUNTING FOR CERTAIN MARKETABLE SECURITIES"
(December 1975)

Background

The FASB was asked to determine the appropriate carrying amount for marketable securities and was informed that an answer was needed as expeditiously as possible. Accordingly, this project was confined to that question for marketable equity securities (essentially quoted common and preferred stocks). The Board ruled out the possible use of market value alone as the determinant of carrying value, since consideration of that possibility would raise pervasive issues concerning the valuation of other types of assets, including the concept of historic cost versus current or realizable value. The Board concluded that it would not examine those conceptual issues in a project of limited scope.

Statement No. 12 requires that both current and noncurrent portfolios of marketable equity securities are to be valued at and shown in the financial statements at the lower of cost or market value. If market value is below cost, the difference is included in the determination of net income for securities classified as current assets or included in stockholders' equity for securities classified as noncurrent assets. The Exposure Draft would have required all changes in the carrying amounts of the marketable equity securities portfolio to be reflected in determining income currently and made no distinction between the current or noncurrent classifications of such securities.

Analysis of Responses to Exposure Draft

The responses to the Exposure Draft by respondents in the categories specified in the preface to this exhibit were analyzed as to the positions taken on two major issues. In addition, responses were analyzed according to respondents' overall reactions to the Exposure Draft.

Overall

1. The Analysts Federation, AICPA and AAA agreed with the Exposure Draft; the FEI disagreed.
2. The four academic commentators who indicated overall reactions were evenly divided on the Exposure Draft.
3. Five major accounting firms disagreed with the Exposure Draft; four agreed.
4. Thirty-eight major business corporations disagreed with the Exposure Draft; thirteen agreed.
5. Four accounting firms took positions consistent with those of the majority of their clients responding; four firms took positions inconsistent with those of the majority of their clients responding.

Issue No. 1: Should marketable equity securities be carried on the balance sheet at the lower of cost or market value?

FASB Position in ED: Yes

FASB Position in Statement: Yes

1. The Analysts Federation, AICPA and AAA agreed with the Exposure Draft and Statement on this issue; the FEI disagreed.
2. Two academic commentators agreed with the Exposure Draft and Statement; one disagreed.
3. Major accounting firms were evenly divided on the Exposure Draft and Statement (5 to 5).
4. Thirty-eight major business corporations disagreed with the Exposure Draft and Statement; only two agreed.
5. Three accounting firms took positions consistent with those of their clients responding; five firms took positions inconsistent with those of the majority of their clients responding.

Issue No. 2: Should declines in market value below cost of marketable equity securities be included in determining income currently?

FASB Position in ED: Yes

FASB Position in Statement: Yes, where listed as current assets

1. The Analysts Federation, AICPA and AAA agreed with the Exposure Draft on this issue; the FEI disagreed.
2. The two academic commentators who indicated positions agreed with the Exposure Draft.
3. Five major accounting firms disagreed with the Exposure Draft; four agreed.
4. Twenty-nine major business corporations disagreed with the Exposure Draft; two agreed.
5. Four accounting firms took positions consistent with those of the majority of their clients responding; four firms took positions inconsistent with those of the majority of their clients responding.
6. Since the Board modified its position from the Exposure Draft to the Statement, as described above, it is not possible to determine the extent to which the thirty-four respondents classified as disagreeing with the Exposure Draft on Issue 2 would also have disagreed with the Statement. However, most of them were opposed to recognizing changes in the value of securities classified as non-current assets.

FASB Statement No. 12
"Accounting for Certain Marketable Securities"
(December 1975)

	Overall Reaction		1. Lower of Cost or Market Value		2. All Declines Included in Income	
	Agree	Disagree	Yes	No	Yes	No
FASB Exposure Draft			●	—	●	—
FASB Statement			●	—	—	● (a)
Sponsoring Organizations(b)						
AAA	●	—	●	—	●	—
AICPA	●	—	●	—	●	—
Analysts Federation	●	—	●	—	●	—
FEI	—	●	—	●	—	●
NAA	—	—	—	—	—	—
Academicians	2	2	2	1	2	0
Major Accounting Firms	4	5	5	5	4	5
Business Enterprises	13	38	2	38	2	29
Total for Responses Analyzed	22	46	12	45	11	35
Major Accounting Firms and Responding Clients						
Arthur Andersen & Co.	●	—	●	—	●	—
Its Clients	3	4	0	4	0	3
Arthur Young & Company	—	—	●	—	—	●
Its Clients	1	2	0	3	0	2
Coopers & Lybrand	—	●	—	●	—	●
Its Clients	1	2	1	1	1	2
Ernst & Ernst	—	●	—	●	—	●
Its Clients	0	7	0	7	0	6
Haskins & Sells	—	●	—	●	—	●
Its Clients	2	6	0	6	0	5
Hurdman and Cranstoun	—	●	—	●	—	—
Its Clients	0	1	0	1	0	1
J. K. Lasser & Co.	—	●	—	●	—	●
Its Clients (no response)						
Laventhol & Horwath	—	—	—	—	—	—
Its Clients	0	1	0	1	0	0
Main Lafrentz & Co.	—	—	—	—	—	—
Its Clients	0	0	0	1	0	1
Peat, Marwick, Mitchell & Co.	●	—	●	—	●	—
Its Clients	4	8	0	9	0	6
Price Waterhouse & Co.	●	—	●	—	●	—
Its Clients	2	5	1	3	1	2
Touche Ross & Co.	●	—	●	—	●	—
Its Clients	0	2	0	2	0	1

(a) See Note 6 in the commentary for Issue 2.

(b) The "sponsoring organization" designation for these comment letter positions is for convenience only. As discussed in the preface to this exhibit, these positions represent the majority view of each organization's responding committee and, except as stated in the preface, do not represent the views of the organization as such or the views of its membership.

FASB STATEMENT NO. 13
"ACCOUNTING FOR LEASES"
(November 1976)

Background

This Statement establishes accounting and reporting standards for leases, including leverage leases, from the standpoints of both lessees and lessors.

A revised Exposure Draft was issued for comment on this project because the changes the Board decided to make to the first Exposure Draft were in the Board's judgment sufficiently extensive to warrant re-exposure. For purposes of this analysis, only the responses to the first Exposure Draft were reviewed, as it was felt that the letters of comment received in response to the first Exposure Draft were more likely to reveal respondents' preferences as to the major issues of the project. The second Exposure Draft apparently convinced many respondents that their preferences had little chance of being adopted and, as a result, many letters of comment on the second Exposure Draft were limited to relatively minor points of implementation.

Analysis of Responses to Exposure Draft

The responses to the first Exposure Draft by respondents in the categories specified in the preface to this exhibit were analyzed as to three major issues. In addition, responses were analyzed according to respondents' overall reactions to the Exposure Draft.

Overall

1. The Analysts Federation and NAA agreed with the Exposure Draft; no other sponsoring organization clearly agreed or disagreed with the Exposure Draft.
2. Four academic commentators agreed with the Exposure Draft; two disagreed.
3. Four major accounting firms agreed with the Exposure Draft; five disagreed.
4. Thirty-six business corporations agreed with the Exposure Draft; 30 disagreed.
5. Three accounting firms took positions consistent with those of the majority of their clients responding; three took positions inconsistent with those of a majority of their clients responding.
6. The FASB changed some provisions of the first Exposure Draft to reflect the expressed views of some respondents and also made changes that were contrary to their views and to the views of others. For example, though the 25 percent residual value and special purpose property criteria were each supported, either as written or with certain modifications, by approximately 55 percent of all respondents expressing a view on them, the FASB eliminated both and substituted a criterion based on lessor recovery, which was suggested by only 15 respondents included in the analysis. Also, despite the preference of most respondents for prospective application, the FASB changed the Exposure Draft to require delayed retroactivity, a suggestion made by only four respondents.

Issue No. 1: What criteria should be used, any one of which, if met, would identify those leases that a lessee must capitalize?

(a) The lease transfers title to the property to the lessee by the end of the lease term.

(b) The lease contains a bargain purchase option.

(c) The lease term is equal to 75 percent or more of the estimated economic life of the leased property.

(d) The estimated residual value of the leased property is less than 25 percent of the property's fair value at the inception of the lease.

(e) The leased property as a whole is special purpose to the lessee, i.e., it either cannot be used by anyone other than the lessee or can be used by someone else only through incurring excessive (uneconomic) costs to obtain, convert, relocate or operate the property.

(f) The present value of lease payments to the lessor is greater than 90 percent of the value of the leased property.

FASB Position in ED: (a), (b), (c), (d) and (e)

FASB Position in Statement: (a), (b), (c) with modification and (f)

1. The FEI agreed with the Exposure Draft on criteria a and b; would have modified criteria c and d; and disagreed with criterion e. The NAA would also have modified criteria c and d. The AICPA disagreed with criterion d and advocated criterion f.
2. One academic commentator agreed with criteria a through e; one would have modified criteria c and d; four academic commentators advocated criterion f; two commentators advocated other criteria.
3. Major accounting firms agreed with criteria a (2 to 1) and b (2 to 1); they disagreed with c (2 to 5), d (1 to 5) and e (1 to 3). In addition, seven firms recommended criterion f and four firms recommended other criteria.
4. Business corporations agreed with criteria a (34 to 2), b (32 to 4) and e (21 to 18). They disagreed with criteria c (15 to 22) and d (16 to 26). If recommendations for modifications are counted as general approval of criteria, business corporations agreed to all five criteria. Three firms advocated criterion f, and thirteen recommended other criteria.
5. When the response of each accounting form to each of the criterion a through e is compared with the responses of the majority of its clients to each of the criterion a through e, the accounting firms took positions consistent with those of the majority of their clients responding in 11 cases and took positions inconsistent with those of the majority of their clients responding in 17 cases.
6. The sixth note under "Overall" also applies to this issue. Because of the complexity and interrelationship of the possible criteria, no conclusions beyond those set forth in that note have been reached as to the agreement or disagreement of respondents to criteria in the Statement.

Issue No. 2: Should the present value of operating leases be presented as supplemental information on the face of the balance sheet?

FASB Position in ED: Yes

FASB Position in Statement: No

1. The AICPA, Analysts Federation, FEI and NAA disagreed with the Exposure Draft on this issue.

2. The two academic commentators who indicated positions split evenly.
3. Seven major accounting firms disagreed with the Exposure Draft; one agreed.
4. All but one of the 84 business corporations disagreed with the Exposure Draft.
5. Five major accounting firms took positions consistent with those of the majority of their clients responding; one took a position inconsistent with those of its clients responding.
6. In total, 95 of the 98 respondents with a position on this issue disagreed with the Exposure Draft's position. The FASB found persuasive the arguments by those respondents and concluded in the Statement that such supplemental information about operating leases not be disclosed, the position supported by virtually all of those respondents.

Issue No. 3: Should the provisions of the Statement be applied prospectively or retroactively?

FASB Position in ED: Prospectively

FASB Position in Statement: Apply prospectively to new leases entered into on or after January 1, 1977; apply retroactively with restatement for years beginning after December 31, 1980; and disclose effect of retroactive application beginning with financial statements for December 31, 1977.

1. The AICPA, FEI and NAA agreed with the Exposure Draft on this issue; the Analysts Federation disagreed.
2. The three academic commentators who indicated positions disagreed with the Exposure Draft.
3. Three major accounting firms disagreed with the Exposure Draft; one agreed.
4. Thirty-seven business corporations agreed with the Exposure Draft; 10 disagreed.
5. One accounting firm took a position consistent with that of its client responding; two took positions inconsistent with those of a majority of their clients responding.
6. Despite the preference for prospective implementation by 41 of the 58 respondents with a position on this issue, the FASB required delayed retroactivity in the Statement, a suggestion made by only four respondents. It is impossible to reliably determine from the responses the number of additional respondents, if any, that would have supported that approach.

CONTINUED

1 OF 2

FASB Statement No. 13
"Accounting For Leases"
(November 1976)

	Overall Reaction		1. Lease Capitalization Criteria: First ED Criterion					1. Lease Capitalization Criteria: Others Recommended		2. Operating Leases on Face of B/S		3. Implementation	
	Agree	Disagree	(a)	(b)	(c)	(d)	(e)	(f)	Other	Yes	No	Prospective	Retroactive
FASB Exposure Draft (First)			A	A	A	A	A	—	—	●	—	●	—
FASB Statement			A	A	M	—	—	A	—	—	●	—	● (a)
Sponsoring Organizations (b)													
AICPA	—	—	—	—	—	D	—	85-90%(d)	—	—	●	●	—
Analysts Federation (c)	●	—	—	—	—	—	—	—	—	—	●	—	●
FEI	—	—	A	A	M	M	D	—	—	—	●	●	—
NAA	●	—	—	—	M	M	—	—	—	—	●	●	—
Academicians	4	2	A-1	1	1	1	1	4	2	1	1	0	3
			D-0	0	0	0	0						
			M-0	0	1	1	0						
Major Accounting Firms	4	5	A-2	2	2	1	1	7	4	1	7	1	3
			D-1	1	5	5	3						
			M-1	1	2	4	3						
Business Enterprises	36	30	A-34	32	15	16	21	3	13	1	83	37	10
			D-2	4	22	26	18						
			M-1	5	17	14	1						
Total for Responses Analyzed	46	37	A-38	36	18	18	23	15	19	3	95	41	17
			D-3	5	27	32	22						
			M-2	6	22	21	4						
Major Accounting Firms and Responding Clients													
Alexander Grant & Company	—	●	—	—	—	—	—	—	—	—	●	—	● (a)
Its Clients (no response)													
Arthur Andersen & Co.	—	●	D	D	D	D	D	100%(d)	●	—	●	—	●
Its Clients	4	6	A-5	5	3	3	2	1	4	0	12	6	4
			D-1	2	6	6	5						
			M-0	0	0	0	0						
Arthur Young & Company	—	●	A	A	A	A	A	—	●	—	●	—	● (a)
Its Clients	1	2	A-3	3	1	1	3	0	1	0	4	1	0
			D-0	0	1	1	0						
			M-0	0	1	1	0						
Coopers & Lybrand	●	—	M	—	D	M	—	100%(d)	—	—	—	—	—
Its Clients	4	4	A-2	2	1	1	1	1	2	1	9	4	1
			D-0	0	2	2	2						
			M-0	0	2	3	0						

Response to Criterion Coding

A = agree
D = disagree
M = modify

Notes are at the end of the table.

	Overall Reaction		1. Lease Capitalization Criteria: First ED Criterion					1. Lease Capitalization Criteria: Others Recommended		2. Operating Leases on Face of B/S		3. Implementation	
	Agree	Disagree	(a)	(b)	(c)	(d)	(e)	(f)	Other	Yes	No	Prospective	Retroactive
Ernst & Ernst	●	—	A	A	A	M	D	100%(d)	—	—	●	—	—
Its Clients	8	1	A-4	3	2	2	3	0	0	0	7	3	2
			D-0	0	1	3	1						
			M-0	2	3	1	0						
Haskins & Sells	●	—	—	—	M	M	M	90%(d)	●	—	●	—	—
Its Clients	1	4	A-6	6	2	2	2	0	3	0	11	6	1
			D-0	0	5	5	5						
			M-0	0	0	0	0						
Hurdman and Cranstoun	—	●	—	—	D	D	—	80-90%(d)	—	●	—	●	—
Its Clients	1	0	A-1	1	0	0	1	0	0	0	2	1	0
			D-0	0	0	0	0						
			M-0	0	1	1	0						
Main Lafrentz & Co. (no response)													
Its Clients	0	0	A-0	0	0	0	0	1	0	0	1	0	0
			D-0	0	1	1	0						
			M-0	0	0	0	0						
Peat, Marwick, Mitchell & Co.	—	●	—	—	—	D	M	100%(d)	—	—	●	—	—
Its Clients	8	7	A-5	5	3	3	4	0	2	0	14	4	2
			D-1	1	3	4	2						
			M-0	0	3	3	0						
Price Waterhouse & Co.	—	—	—	M	M	M	M	—	●	—	—	—	—
Its Clients	8	5	A-8	7	3	4	5	0	1	0	22	12	0
			D-0	1	3	4	3						
			M-1	3	7	5	1						
Seidman & Seidman	●	—	—	—	D	D	—	●	—	—	●	—	—
Its Clients (no response)													
Touche Ross & Co.	—	—	—	—	D	D	D	—	—	—	—	—	—
Its Clients	1	1	A-0	0	0	0	0	0	0	0	1	0	0
			D-0	0	0	0	0						
			M-0	0	0	0	0						

(a) Delayed retroactivity.

(b) The "sponsoring organization" designation for these comment letter positions is for convenience only. As discussed in the preface to this exhibit, these positions represent the majority view of each organization's responding committee and, except as stated in the preface, do not represent the views of the organization as such or the views of its membership.

(c) Although the Analysts Federation disagreed with the Exposure Draft as to presentation of operating leases on the face of the balance sheet and as to implementation of the Statement and did not explicitly agree with the criteria, it nevertheless expressed explicit agreement with the Exposure Draft as a whole.

(d) The respondent recommends adoption of the criterion (f) (see issue No. 1). The percentage given is the respondent's recommendation for the percentage of the value of the leased property to be recovered through the present value of the lease payments.

FASB STATEMENT NO. 14
"FINANCIAL REPORTING FOR SEGMENTS OF A BUSINESS ENTERPRISE"
(December 1976)

Background

Statement No. 14 requires that companies include within their financial statements information about operations in different industries, foreign operations and export sales, and major customers. Prior to Statement No. 14, some companies included information of that type in reports to securityholders and in filings with the SEC, but the nature and extent of the information disclosed and the methods of presentation varied considerably; moreover, only a portion of that information was included within the financial statements and, therefore, subject to examination by an independent auditor.

With respect to operations in different industries, the Statement requires disclosure of (a) revenue, (b) operating profit (revenue less operating expenses), and (c) identifiable assets for each significant industry segment of the company. Certain other related disclosures also are required, and guidelines are provided for determining whether an industry segment is significant.

Information similar to that required for industry segments also is required for a company's operations in different geographic areas of the world, and the Statement provides guidelines for distinguishing foreign and domestic operations and for grouping foreign operations by geographic area.

Analysis of Responses to Exposure Draft

The responses to the Exposure Draft by respondents in the categories specified in the preface to this exhibit were analyzed as to the positions taken on five major issues. Those respondents' overall reactions, if any, to the provisions of the ED were also analyzed.

Overall

1. The AAA, Analysts Federation and NAA agreed with the Exposure Draft and Statement.
2. Five academic commentators agreed with the Exposure Draft and Statement.
3. Seven major accounting firms agreed with the Exposure Draft and Statement; two disagreed.
4. Major business corporations were almost split on the Exposure Draft and Statement (37 agreed to 42 disagreed).
5. Two accounting firms took positions consistent with those of the majority of their clients responding, three took positions inconsistent with those of the majority of their clients responding.

Issue No. 1: Should segment information be required to be included in annual financial statements (and, therefore, to be audited if the financial statements are audited)?

FASB Position in ED: Yes

FASB Position in Statement: Yes

1. The Analysts Federation agreed with the Exposure Draft and Statement on this issue; the FEI and NAA disagreed with the Exposure Draft and Statement.

2. One academic commentator disagreed with the Exposure Draft and Statement.
3. The five major accounting firms responding disagreed with the Exposure Draft and Statement; none agreed.
4. All but two of fifty-one major business corporations disagreed with the Exposure Draft and Statement.
5. Two accounting firms took positions consistent and one accounting firm took a position inconsistent with those of their clients responding in opposition to the FASB's position.

Issue No. 2: Should segment information be required to be included in complete financial statements for interim periods?

FASB Position in ED: Yes

FASB Position in Statement: Yes, but only in financial statements expressly described as being in conformity with generally accepted accounting principles.

1. The Analysts Federation agreed with the Exposure Draft and Statement on this issue; the FEI disagreed.
2. Academic commentators expressed no clear position on the Exposure Draft and Statement.
3. The five major accounting firms responding disagreed with the Exposure Draft and Statement.
4. All but one of thirty-nine major business corporations disagreed with the Exposure Draft and Statement.
5. Two accounting firms took positions consistent with those of their clients responding in opposition to the FASB position.
6. With respect to Issue No. 2 (inclusion of segment information in interim financial statements), an overwhelming majority of respondents took the position that segment information should not be required in financial statements for interim periods. Although the modifications reflected in the final Statement are expected to result in inclusion of segment information in fewer interim financial statements than would the position in the Exposure Draft, the Board did not accept the view of the majority of respondents.

Issue No. 3: Should companies below a certain size or whose securities are not publicly traded be exempted from the final Statement?

FASB Position in ED: No

FASB Position in Statement: No

1. The Analysts Federation agreed with the Exposure Draft and Statement on this issue; the AICPA disagreed.
2. Academic commentators expressed no position on the Exposure Draft and Statement.
3. Eight major accounting firms disagreed with the Exposure Draft and Statement; one agreed.
4. Three of four major business corporations responding disagreed with the Exposure Draft and Statement.
5. Two accounting firms took positions consistent with those of their clients responding; one took a position inconsistent with that of its clients responding.

Issue No. 4: Should disclosure of information about an industry segment's assets be required?

FASB Position in ED: Yes

FASB Position in Statement: Yes

1. The Analysts Federation, FEI and AAA agreed with the Exposure Draft and Statement on this issue; the AICPA disagreed.
2. One academic commentator disagreed with the Exposure Draft and Statement.
3. Three of four major accounting firms responding disagreed with the Exposure Draft and Statement.
4. Twenty-five major business corporations disagreed with the Exposure Draft and Statement; fifteen agreed.
5. Three accounting firms took positions consistent with those of the majority of their clients responding in opposition to the Exposure Draft.

Issue No. 5: Should disclosure of information about a company's major customers be required?

FASB Position in ED: Yes

FASB Position in Statement: Yes

1. The Analysts Federation and FEI agreed with the Exposure Draft and Statement.
2. One academic commentator agreed with the Exposure Draft and Statement.
3. The six major accounting firms responding on this issue agreed with the Exposure Draft and Statement.
4. Twenty-three major business corporations agreed with the Exposure Draft and Statement; fourteen disagreed.
5. One accounting firm took a position consistent with those of the majority of its clients responding, and one took a position inconsistent with those of the majority of its clients responding.

FASB Statement No. 14

"Financial Reporting for Segments of a Business Enterprise"

(December 1976)

	Overall		1. Annual Statements		2. Interim Statements		3. Exemption For Small Co.'s		4. Assets		5. Major Customers	
	Agree	Disagree	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
FASB Exposure Draft			•	—	•	—	—	•	•	—	•	—
FASB Statement			•	—	• (a)	—	—	•	•	—	•	—
Sponsoring Organizations (b)												
AAA	•	—	—	—	—	—	—	—	•	—	—	—
AICPA	—	—	—	—	—	—	•	—	—	•	—	—
Analysts Federation	•	—	•	—	•	—	—	•	•	—	•	—
FEI	—	—	—	•	—	•	—	—	•	—	•	—
NAA	•	—	—	•	—	—	—	—	—	—	—	—
Academicians	5	0	0	1	0	0	0	0	0	1	1	0
Major Accounting Firms	7	2	0	5	0	5	8	1	1	3	6	0
Business Enterprises	37	42	2	49	1	38	3	1	15	25	23	14
Total for Responses Analyzed	52	44	3	57	2	44	12	3	19	30	32	14
Major Accounting Firms and Responding Clients												
Alexander Grant & Company	—	•	—	•	—	•	•	—	—	—	—	—
Its Clients	1	0	0	1	0	0	0	0	0	1	0	1
Arthur Andersen & Co.	•	—	—	—	—	—	—	—	•	—	•	—
Its Clients	7	4	0	7	0	5	0	0	5	3	2	4
Arthur Young & Company	•	—	—	—	—	—	•	—	—	—	—	—
Its Clients	2	2	0	3	0	5	0	1	2	2	2	0
Coopers & Lybrand	—	—	—	•	—	—	•	—	—	—	—	—
Its Clients	4	7	0	6	0	3	0	0	1	1	2	2
Ernst & Ernst	—	•	—	—	—	—	•	—	—	•	•	—
Its Clients	3	8	1	8	0	4	2	0	3	4	3	3
Haskins & Sells	•	—	—	—	—	—	—	—	—	—	•	—
Its Clients	4	6	0	7	1	5	0	0	0	6	3	2
Hurdman and Cranstoun	•	—	—	—	—	•	•	—	—	—	•	—
Its Clients	0	0	0	1	0	1	0	0	0	0	0	0
J. K. Lasser & Co.	•	—	—	•	—	•	•	—	—	•	•	—
Its Clients (no response)												
Main Lafrentz & Co. (no response)												
Its Clients	0	1	0	0	0	0	0	0	0	0	1	0
Peat, Marwick, Mitchell & Co.	•	—	—	—	—	—	•	—	—	•	—	—
Its Clients	5	7	0	6	0	7	1	0	2	3	4	0
Price Waterhouse & Co. (no response)												
Its Clients	10	7	0	10	0	7	0	0	2	4	5	2
Seidman & Seidman	•	—	—	•	—	•	•	—	—	—	•	—
Its Clients (no response)												
Touche, Ross & Co.	—	—	—	•	—	•	—	•	—	—	—	—
Its Clients	1	0	1	0	0	1	0	0	0	1	1	0

(a) Position in Exposure Draft was modified in the final FASB Statement.

(b) The "sponsoring organization" designation for these comment letter positions is for convenience only. As discussed in the preface to this exhibit, these positions represent the majority view of each organization's responding committee and, except as stated in the preface, do not represent the views of the organization as such or the views of its membership.

94-081 O - 77 - 19

EXHIBIT C

COMPARATIVE ANALYSIS OF SPECIFIC STANDARDS OF CONDUCT

ORGANIZATION	PROHIBITIONS		
	Obligations from Former Employers	Obligations to Former Employers	Outside Employment or Activities
FASB[1] (Members, Directors and Deputy Directors)	Prohibited except for fixed, vested amounts and annuities[2]	Prohibited[3]	Employment prohibited[4]
FASB[9] (Staff)	No restriction	No restriction	Restricted[10]
U.S. Senate[13] (Senators)	No restriction, but see XLIV 3.(c)(13)	No restriction	Generally prohibited, XLV. Earned income limited to 15% of Senate salary (exceptions)[23], XLIV
U.S. House of Representatives[14] (Representatives)	No restriction	No restriction	Earned income limited to 15% of House salary (exceptions)[22] XLVII
SEC (Members)	Not specifically prohibited. See 17 C.F.R. 200.735-3	Not specifically prohibited. See 17 C.F.R. 200.735-3	Prohibited, 17 C.F.R. 200.70; 15 U.S.C. 78d(a)
SEC (Staff)	Not specifically prohibited. See 17 C.F.R. 200.735-3	Not specifically prohibited. See 17 C.F.R. 200.735-3	Prohibited if outside activity is incompatible[16] with SEC employment, 17 C.F.R. 200.735-4
CASB (Members and Staff)	Not specifically provided. See 4 C.F.R. 302.35	Not specifically provided. See 4 C.F.R. 302.35	Prohibited if outside activity is incompatible[18] with employment, 4 C.F.R. 302.38
GAO (Employees)	Not specifically provided. See 4 C.F.R. 6.26	Not specifically provided. See 4 C.F.R. 6.26	Prohibited if outside activity is incompatible[18] with employment, 4 C.F.R. 6.30
Federal Judiciary[19] (Judges)	Not specifically prohibited. See 28 U.S.C. 455; Canons 2, 3 and 5. Disqualified if he or former associate served as a lawyer in the matter, 28 U.S.C. 455(b)(2); Canon 3C(1)(b)	Not specifically prohibited. See 28 U.S.C. 455; Canons 2, 3 and 5. Disqualified if he or former associate served as a lawyer in the matter, 28 U.S.C. 455 (b)(2); Canon 3C(1)(b)	Prohibited from practicing law, 28 U.S.C. 454, or participating actively in any business, Canon 5C(2)

ORGANIZATION	PROHIBITIONS		
	Arrangements for Future Employment Made While Currently Employed	Honoraria	Investments
FASB (Members, Directors and Deputy Directors)	Prohibited until notice of resignation has been given[5]; academic leaves allowed for Directors and Deputy Directors	Prohibited[6]	No specific restriction but subject to general policy against potential conflicts[8]
FASB (Staff)	Two-month notice is preferred; otherwise no restriction	Prohibited[11]	No specific restriction but subject to general policy against potential conflicts[8]
U.S. Senate (Senators)	Disclosure required, XLII 2.(R)	None in excess of $1,000 for a single appearance, XLIV.2	Not specifically restricted. See XLVI
U.S. House of Representatives (Representatives)	No restriction	None in excess of $750 for a single appearance, XLVII.2	No restriction
SEC (Members)	Prohibited if Member participates in a matter in which the prospective future employer has a financial interest, 18 U.S.C. 208	Prohibited if appearance is related to the SEC or draws on non-public information, 5 C.F.R. 735.203(c); Ex. Order 11222	Permitted only if for "investment purposes" (held more than one year); other restrictions[15], 17 C.F.R. 200.735-5
SEC (Staff)	Negotiations prohibited if future employer is party to a matter or chiefly affected by it, 17 C.F.R. 200.735-7(a); undertaking any matter in which the future employer is even indirectly affected also prohibited, 17 C.F.R. 200.735-7(b); 18 U.S.C. 208	Prohibited if appearance draws on non-public SEC information or if part of employee's official duties, 17 C.F.R. 200.735-4	Permitted only if for "investment purposes" (held more than one year); other Restrictions[15], 17 C.F.R. 200.735-5
CASB (Members and Staff)	Disqualified if prospective future employer has a financial interest in a matter before the Board, 4 C.F.R. 302.35; 18 U.S.C. 208	Prohibited if appearance draws on non-public information; written approval required, 4 C.F.R. 302.38(b), (c)	Disqualified if employee has a financial interest in any matter before the Board, 4 C.F.R. 302.35; 18 U.S.C. 208; prohibited if appears to conflict substantially with Government duties, 4 C.F.R. 302.33
GAO (Employees)	Disqualified if prospective future employer has a financial interest in a matter before the Board, 4 C.F.R. 6.48, 6.49; 18 U.S.C. 208	Prohibited if appearance draws on non-public information; written approval required, 4 C.F.R. 6.31	Disqualified if employee has a financial interest in a matter before the GAO, 4 C.F.R. 6.26; 18 U.S.C. 208; prohibited if appears to conflict substantially with Government duties, 4 C.F.R. 6.24
Federal Judiciary (Judges)	Not specifically prohibited. See 28 U.S.C. 455; Canons 2, 3 and 5	Permitted if no interference with judicial duties and do not exceed reasonable amount; public disclosure required, Canons 5A and 6	Disqualified if he or any member of his family has a financial interest[20] in the proceedings, 28 U.S.C. 455; Canons 3C(1)(c) and 5C

ORGANIZATION	PROHIBITIONS		
	Use of Inside Information	Gifts, Entertainment, etc. from Those Regulated	Appearances by Former Employees of the Organization
FASB (Members, Directors and Deputy Directors)	Prohibited[7]	Not specifically prohibited but subject to general policies against potential conflicts[8]	No restriction
FASB (Staff)	Prohibited[12]	Not specifically prohibited but subject to general policies against potential conflicts[8]	No restriction
U.S. Senate (Senators)	No restriction	Prohibited, XLIII; bribery prohibited, 18 U.S.C. 201	Lobbying prohibited for one year after leaving office, XLV 9.
U.S. House of Representatives (Representatives)	No restriction	Prohibited, XLIII.4.; bribery prohibited, 18 U.S.C. 201	No restriction
SEC (Members)	Prohibited, 17 C.F.R. 200.735-3(a); Ex. Order 11222; 15 U.S.C. 78d(a)	Prohibited (exceptions)[17] 17 C.F.R. 200.735-3(b)(1)	Prohibited if he appears within one year after termination in a matter over which he had "official responsibility" within one year before termination, or if he appears in any matter which he personally considered, 17 C.F.R. 200.735-8; 18 U.S.C. 208
SEC (Staff)	Prohibited, 17 C.F.R. 200.735-3(a); Ex. Order 11222	Prohibited (exceptions)[17] 17 C.F.R. 200.735-3(b)(1)	Prohibited if he appears within one year after termination in a matter over which he had "official responsibility" within one year before termination, or if he appears in any matter which he personally considered, 17 C.F.R. 200.735-8; 18 U.S.C. 208
CASB (Members and Staff)	Prohibited, 4 C.F.R. 302.32	Prohibited (exceptions)[17] 4 C.F.R. 302.24	Prohibited if he appears within one year after termination in a matter over which he had "official responsibility" within one year before termination, or if he appears in any matter which he personally considered, 4 C.F.R. 302.61; 18 U.S.C. 208
GAO (Employees)	Prohibited, 4 C.F.R. 6.23, 6.24(b)	Prohibited (exceptions)[17] 4 C.F.R. 6.15, 6.16, 6.19	Prohibited if he appears within one year after termination in a matter over which he had "official responsibility" within one year before termination, or if he appears in any matter which he personally considered, 4 C.F.R. 6.48, 6.49; 18 U.S.C. 208
Federal Judiciary (Judges)	Prohibited, Canon 5C(7)	Prohibited (exceptions)[21] Canon 5C(4)	No restriction

ORGANIZATION	PROCEDURES	
	Annual Questionnaire	Specific Body to Advise on Conduct
FASB (Members, Directors and Deputy Directors)	Provided	Provided
FASB (Staff)	Provided; no disclosure of financial information required.	Provided
U.S. Senate (Senators)	Provided, XLIV	Provided, XLIV.2
U.S. House of Representatives (Representatives)	Provided, XLIV	Provided, XLIV
SEC (Members)	Provided, Ex. Order 11222	Provided, 17 C.F.R. 200.735-15
SEC (Staff)	Provided, 17 C.F.R. 200.735-11	Provided, 17 C.F.R. 200.735-15
CASB (Members and Staff)	Provided, 4 C.F.R. 302.72	Provided, 4 C.F.R. 302.3
GAO (Employees)	Provided, 4 C.F.R. 6.50-6.64	Provided, 4 C.F.R. 6.53
Federal Judiciary (Judges)	Not Provided	Not Provided

NOTES

1. Members, Directors and deputy directors are governed by the rules set out in "Policies in Respect of Investments, Personal Activities, Speeches and Publications of Members, Directors and Deputy Directors of the Financial Accounting Standards Board (As amended December 21, 1976)."
2. The rule states that "no financial or other obligations shall be owed, directly or indirectly, to such Member or Director by any former employer, business partnership or client." Exceptions are made for normal banking relationships, limited partnerships, and holdings in government or publicly traded securities. No retirement or deferred benefits may be paid except fixed, vested amounts or annuities not materially affected by the prospects of the business.
3. The rule states that "no Member or Director shall have any financial or other obligations to any former employer, business relationship or client." Obligations such as normal banking relationships and covenants not to divulge trade secrets are excepted.
4. Members and Directors may be affiliated with non-profit organizations and may serve as directors or officers of family or personal investment holding companies, as executors, administrators, guardians, trustees of inter vivos or testamentary trusts, custodians for minors and in similar representative capacities, provided that such activities do not interfere materially with their devoting their full business time to the FASB and do not affect their independence or objectivity.
5. The rule states that "no Member or Director shall have any formal or informal agreement, arrangement or understanding with any person to the effect that after termination of his employment relationship with the Foundation or the Standards Board he can or will return to, or become affiliated with, an employer or business partnership, or resume or enter into consulting or other similar arrangements; *provided, however,* that, in the case of a Director, this subparagraph . . . shall not prohibit a leave of absence of an academician with or without tenure from an educational institution; . . . ."
6. The rule states, "Members and Directors may accept reimbursement for out-of-pocket expenses incurred in connection with any such speech or writing, but any fees, honorariums or other payments in connection therewith shall be remitted or paid over to the Foundation."
7. The rule states, "Members and Directors shall not, directly or indirectly, use or otherwise place themselves in a situation to benefit personally from, or, directly or indirectly, disclose or make available to others (other than as required by their employment and duties), any information which might be regarded as material relating to the functions or activities of the Foundation or the Standards Board obtained in the course of their employment and which has not been released or announced or otherwise made available publicly."
8. Both sets of rules provide that each member, director, deputy director, and staff member "should take great care to conduct himself and all his activities in such a manner so that [they] will not affect his independence or objectivity or be detrimental to the interests or repute of the Foundation or the Standards Board."
9. Staff members are governed by Internal Policy Bulletin, File Ref. 1.07, "Policies in Respect of Personal Activities, Speeches and Publications of Members of the Staff of the Financial Accounting Standards Board" (April 1976).

10. The rule states, "Each member of the staff is expected to devote his full business time to the activities of the Standards Board, and shall not engage in any outside activity which interferes with the performance of his duties to the Standards Board, or which in any way may be, or appear to be in conflict with the staff member's responsibilities to the Standards Board. Each member of the staff is urged to consult with the Chairman of the Standards Board at the earliest possible time if he feels that he is involved in an outside activity which might conflict with his responsibilities to the Standards Board."
11. The rule states, "Staff members may accept reimbursement for out-of-pocket expenses incurred in connection with any such speech or writing, but any fees, honorariums or other payments in connection therewith shall be remitted or paid over to the Foundation."
12. The rule states, "Members of the staff shall not, directly or indirectly, use or otherwise place themselves in a situation to benefit personally from, or, directly or indirectly, disclose or make available to others (other than as required by their employment and duties), any information which might be regarded as material relating to the functions or activities of the Foundation or the Standards Board obtained in the course of their employment and which has not been released or announced or otherwise made available publicly."
13. Citations are to Standing Rules of the Senate set out in the Senate Manual, 95th Cong.
14. Citations are to Rules of the House of Representatives set out in Jefferson's Manual and Rules of the House of Representatives, 95th Cong.
15. No member or employee of the SEC may effect transactions in commodity futures; margin accounts; short sales; securities of an issuer who has had any registration statement declared effective within 60 days or which is pending; securities of any registered public utility holding company, investment company, broker, dealer or investment adviser; or securities which are involved in any investigation.
16. Incompatible activities include employment or association with any registered broker, dealer, public utility holding company, investment company or investment adviser, work in which any government may be significantly interested, employment which creates, or appears to create, a conflict of interest, and employment which impairs any employee's ability.
17. Exceptions to the general prohibition apply when an obvious family relationship motivates the gift; when food and refreshments are offered in the course of a proper conference or tour; when promotional material such as pens, notepads and other items of nominal value are offered; or when the Commission makes an exception.
18. Incompatible activities include those which may result in, or create the appearance of, a conflict of interest and those which impair the employee's ability.
19. Citations are to the U. S. Code and the Code of Judicial Conduct adopted by the American Bar Association.
20. "Financial interest" means ownership of a legal or equitable interest, however small, or active participation in the affairs of a party. Excepted are ownership in a mutual fund, provided the judge does not participate in management; ownership by holding policies of a mutual insurance company, deposits in a mutual savings association and holdings of government securities, provided the outcome of the proceedings do not substantially affect the value of the interest; and offices in educational, religious, charitable, fraternal or civic organizations.

21. The prohibition applies to judges and members of his family residing in his household. Exceptions are made for gifts incident to public testimonials, books supplied by publishers, invitations to bar-related functions, ordinary social hospitality, gifts from relatives, wedding or engagement gifts, loans from lending institutions made in the regular course of business, scholarships and fellowships. Other gifts, etc. are permitted from those whose interests have not come and are not likely to come before the judge, but any gift over $100 must be disclosed publicly.
22. "Earned income" does not include pensions, profit-sharing or stock bonus plans or amounts not "significant" received from family-controlled businesses.
23. Exclusions from "outside earned income" include book royalties, income from family businesses and partnerships (provided Senators' services are not materially income producing), gains from dealing in property or investments, interest, rents, dividends, alimony, annuities and buy-out arrangements not related to future profitability of the enterprise.

The FAF's Trustees have recently directed its Committee on Personnel Policies to review existing Personnel Policies. In particular, the Trustees have charged the Committee to consider a requirement that FASB members and staff directors schedule all investments, even immaterial ones; specific limitations on certain securities transactions and receipt of gifts from non-family members; and adoption of a more general rule with respect to potential conflicts of interest. The Committee is expected to make its recommendations at a meeting of the FAF Trustees later this spring.

EXHIBIT D

THE RECORD OF THE FASB AND THE ACCOUNTING PROFESSION IN SETTING ACCOUNTING STANDARDS

I. Introduction

Since its formation in 1973, the FASB has issued:

—14 Statements of Financial Accounting Standards;

—18 Interpretations of FASB Statements, APB Opinions and Accounting Research Bulletins;

—20 Exposure Drafts; and

—13 Discussion Memoranda analyzing significant issues, soliciting written comments and serving as bases for public hearings, including in December 1976 its second Discussion Memorandum on a *Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement* and its *Tentative Conclusions on Objectives of Financial Statements of Business Enterprises.*

In addition, the FASB has not yet taken final action on one Exposure Draft of a proposed Statement of Financial Accounting Standards. Public hearings have been announced on two projects (Conceptual Framework and Accounting for Business Combinations and Purchased Intangibles), and public hearings on the FASB's Extractive Industries Project were held on March 30-April 1 and on April 4, 1977. Additionally, the FASB has other technical projects on its agenda.

The Study asserts that the FASB's output has not improved financial accounting and reporting. As examples, the Study claims that the FASB and its standard-setting predecessors have not dealt with the significant accounting issues, have not eliminated alternative accounting practices, have not developed objectives of financial statements or a conceptual framework within which all accounting standards may be established, and have protected the prerogatives of "special interest groups."*

This Exhibit examines the record in relation to these charges.

II. Table of Statements, Interpretations and Discussion Memoranda Issued and Public Hearings Held by the FASB and Current Projects

Statements of Financial Accounting Standards

No. 1 —Disclosure of Foreign Currency Translation Information—Issued December 1973

No. 2 —Accounting for Research and Development Costs—Issued October 1974

No. 3 —Reporting Accounting Changes in Interim Financial Statements—An Amendment of APB Opinion No. 28—Issued December 1974

No. 4 —Reporting Gains and Losses from Extinguishment of Debt—An Amendment of APB Opinion No. 30—Issued March 1975

No. 5 —Accounting for Contingencies—Issued March 1975

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* See also Exhibit B as to the independence and objectivity of the FASB as evidenced by the analysis of responses to its most significant accounting proposals.

No. 6 —Classification of Short-Term Obligations Expected to Be Refinanced—An Amendment of ARB No. 43, Chapter 3A—Issued May 1975

No. 7 —Accounting and Reporting by Development Stage Enterprises—Issued June 1975

No. 8 —Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements—Issued October 1975

No. 9 —Accounting for Income Taxes—Oil and Gas Producing Companies—An Amendment of APB Opinions No. 11 and 23—Issued October 1975

No. 10 —Extension of "Grandfather" Provisions for Business Combinations—An Amendment of APB Opinion No. 16—Issued October 1975

No. 11 —Accounting for Contingencies—Transition Method—An Amendment of FASB Statement No. 5—Issued December 1975

No. 12 —Accounting for Certain Marketable Securities—Issued December 1975

No. 13 —Accounting for Leases—Issued November 1976

No. 14 —Financial Reporting for Segments of a Business Enterprise—Issued December 1976

Interpretations

No. 1 —Accounting Changes Related to the Cost of Inventory (APB Opinion No. 20)—Issued June 1974

No. 2 —Imputing Interest on Debt Arrangements Made under the Federal Bankruptcy Act (APB Opinion No. 21)—Issued June 1974

No. 3 —Accounting for the Cost of Pension Plans Subject to the Employee Retirement Income Security Act of 1974 (APB Opinion No. 8)—Issued December 1974

No. 4 —Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method—Issued February 1975

No. 5 —Applicability of FASB Statement No. 2 to Development Stage Enterprises—Issued February 1975

No. 6 —Applicability of FASB Statement No. 2 to Computer Software—Issued February 1975

No. 7 —Applying FASB Statement No. 7 in Financial Statements of Established Operating Enterprises—Issued October 1975

No. 8 —Classification of a Short-Term Obligation Repaid Prior to Being Replaced by a Long-Term Security (FASB Statement No. 6)—Issued January 1976

No. 9 —Applying APB Opinions No. 16 and 17 When a Savings and Loan Association or a Similar Institution Is Acquired in a Business Combination Accounted for by the Purchase Method—Issued February 1976

No. 10 —Application of FASB Statement No. 12 to Personal Financial Statements—Issued September 1976

No. 11 —Changes in Market Value after the Balance Sheet Date (FASB Statement No. 12)—Issued September 1976

No. 12 —Accounting for Previously Established Allowance Accounts (FASB Statement No. 12)—Issued September 1976

No. 13 —Consolidation of a Parent and Its Subsidiaries Having Different Balance Sheet Dates (FASB Statement No. 12)—Issued September 1976

No. 14 —Reasonable Estimation of the Amount of a Loss (FASB Statement No. 5)—Issued September 1976

No. 15 —Translation of Unamortized Policy Acquisition Costs by a Stock Life Insurance Company (FASB Statement No. 8)—Issued September 1976

No. 16 —Clarification of Definitions and Accounting for Marketable Equity Securities That Become Nonmarketable (FASB Statement No. 12)—Issued February 1977

No. 17 —Applying the Lower of Cost or Market Rule in Translated Financial Statements (FASB Statement No. 8)—Issued February 1977

No. 18 —Accounting for Income Taxes in Interim Periods (APB Opinion No. 28)—Issued March 1977

Discussion Memoranda

An Analysis of Issues Related to Accounting for Research and Development and Similar Costs—Issued December 28, 1973

An Analysis of Issues Related to Reporting the Effects of General Price-Level Changes in Financial Statements—Issued February 15, 1974

An Analysis of Issues Related to Accounting for Foreign Currency Translation—Issued February 21, 1974

An Analysis of Issues Related to Accounting for Future Losses—Issued March 13, 1974

An Analysis of Issues Related to Financial Reporting for Segments of a Business Enterprise—Issued May 22, 1974

Conceptual Framework for Accounting and Reporting: Consideration of the Report of the Study Group on the Objectives of Financial Statements—Issued June 6, 1974

An Analysis of Issues Related to Accounting for Leases—Issued July 2, 1974

An Analysis of Issues Related to Criteria for Determining Materiality—Issued March 21, 1975

An Analysis of Issues Related to Accounting and Reporting for Employee Benefit Plans—Issued October 6, 1975

Accounting by Debtors and Creditors When Debt is Restructured—Issued May 11, 1976

An Analysis of Issues Related to Accounting for Business Combinations and Purchased Intangibles—Issued August 19, 1976

An Analysis of Issues Related to Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement—Issued December 2, 1976

An Analysis of Issues Related to Financial Accounting and Reporting in the Extractive Industries—Issued December 23, 1976

Public Hearings

Subject	Dates	Number of Oral Presentations
Accounting for Research and Development and Similar Costs	March 15, 1974	14
Reporting the Effects of General Price-Level Changes in Financial Statements	April 23-24, 1974	23
Accounting for Contingencies	May 13, 1974	19
Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements	June 10-11, 1974	15
Financial Reporting for Segments of a Business Enterprise	August 1-2, 1974	21

Subject	Dates	Number of Oral Presentations
Conceptual Framework for Financial Accounting and Reporting	September 23-24, 1974	21
Accounting for Leases	November 18-21, 1974	32
Accounting for Income Taxes—Oil and Gas Producing Companies	September 10-11, 1975	27
Accounting for Certain Marketable Securities	December 8, 1975	20
Restructuring of a Debt in a Troubled Loan Situation	December 12, 1975	5
Accounting and Reporting for Employee Benefit Plans	February 4-5, 1976	23
Criteria for Determining Materiality	May 20-21, 1976	16
Accounting by Debtors and Creditors When Debt is Restructured	July 27-30, 1976	37
Prior Period Adjustments	October 15, 1976	10
Financial Accounting and Reporting in the Extractive Industries	March 30-31 and April 1 and 4, 1977	39
	Total	322

Current Projects

Exposure Draft of Proposed Statement of Financial Accounting Standards

Accounting by Debtors and Creditors for Troubled Debt Restructurings—Issued December 30, 1976

Other Technical Projects

Accounting for the Cost of Pension Plans
Accounting and Reporting for Employee Benefit Plans
Interim Financial Reporting
Reporting Redeemable Preferred Stock and Long-Term Debt
Accounting for Interest Costs
Accounting for Business Combinations and Purchased Intangibles
Criteria for Determining Materiality
Accounting and Reporting in the Extractive Industries
Conceptual Framework for Financial Accounting and Reporting

III. Summary of Work of the FASB

A. Statements of Financial Accounting Standards

Certain of the FASB's Statements have dealt with broad, pervasive accounting questions long in need of resolution, such as:

- Accounting for Research and Development Costs. (FASB Statement No. 2)
- Accounting for Contingencies. (FASB Statement No. 5)

- Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements. (FASB Statement No. 8)
- Accounting for Leases. (FASB Statement No. 13)

Other Statements have also addressed and resolved long-standing issues (although their application may not be as pervasive as the Statements listed above), including:

- Accounting and Reporting by Development Stage Enterprises. (FASB Statement No. 7)
- Financial Reporting for Segments of a Business Enterprise. (FASB Statement No. 14)

Still other FASB Statements have been issued in response to emerging problems perceived as urgently in need of solution:

- Reporting Accounting Changes in Interim Financial Statements. (FASB Statement No. 3)
- Reporting Gains and Losses from Extinguishment of Debt. (FASB Statement No. 4)
- Classification of Short-Term Obligations Expected to Be Refinanced. (FASB Statement No. 6)
- Accounting for Income Taxes—Oil and Gas Producing Companies. (FASB Statement No. 9)
- Accounting for Certain Marketable Securities. (FASB Statement No. 12)

Set forth below is a summary discussion of these FASB Statements of Financial Accounting Standards, prepared by the FASB technical staff, indicating the contribution of each to improving financial accounting and reporting, and the extent to which alternative accounting practices have been eliminated.*

Statement No. 2—"Accounting for Research and Development Costs." October 1974. This Statement established standards of financial accounting and reporting for research and development costs and eliminated alternative accounting practices for such costs by requiring that they be charged to expense when incurred unless related to an item with an alternative future use. Prior to the issuance of the Statement, at least four alternative methods of accounting for research and development costs existed, including (a) capitalizing all costs when incurred, (b) capitalizing some costs when incurred and charging other costs to expense, (c) deferring all costs until the existence of future benefits can be determined at which time costs without future benefits are charged to expense, and (d) charging all costs to expense when incurred.

Statement No. 2 also sets forth guidelines specifying activities that should be identified as research and development and the elements of costs that should be identified with such activities—matters that were previously undefined by the authoritative accounting literature.

* Discussion of Statements Nos. 1, 10 and 11 was omitted because: Statement No. 1 was superseded by Statement No. 8; Statement No. 10 simply extends the grandfather provisions of APB Opinion No. 16—"Business Combinations" until the Board completes its current project on business combinations and purchased intangibles; and Statement No. 11 only amends the transition method in Statement No. 5.

Statement No. 3—"Reporting Accounting Changes in Interim Financial Statements." December 1974. Prior to the issuance of this Statement, management making an accounting change in other than the first interim period of an enterprise's fiscal year (e.g. during the second, third or fourth quarter of the fiscal year) included in net income for the period the cumulative effect of the change. In general, the cumulative effect of the change in accounting method is the difference between net income (a) as reported using the old method of accounting, and (b) computed as if the newly adopted method were used in all prior years.

Statement No. 3 requires that the cumulative effect of the change be included in net income of the first interim period of the year of change. Further, the effect of the change on the current year must be recorded in the pre-change interim periods by applying the newly adopted accounting principle to those pre-change interim periods. The result was to eliminate the option of choosing the interim period in which a change would be made and then including the cumulative effect of the change entirely in net income for that interim period.

Statement No. 4—"Reporting Gains and Losses from Extinguishment of Debt." March 1975. Prior to the issuance of Statement No. 4, gains and losses from the early repayment of debt were included in ordinary income with little or no separate disclosure of the details of the transaction or the related income tax effects.

Statement No. 4 requires that the aggregate of gains and losses from extinguishment of debt, if material, be shown separately on the face of the income statement as an extraordinary item net of the income tax effect. It also requires that the transaction be described and that the income tax effect and the per share amount of the aggregate gain or loss be shown, either on the face of the income statement or in a note to the financial statements. Thus, Statement No. 4 improved the ability of users of financial statements to determine the components of a company's earnings.

Statement No. 5—"Accounting for Contingencies." March 1975. This Statement eliminated the diversity in practice as to when an enterprise must record a loss from a loss contingency. Prior to this Statement, some enterprises accrued estimated losses from contingencies by a charge to income prior to the occurrence of a loss, while under similar circumstances other enterprises accounted for the losses only when they actually occurred.

Statement No. 5 defines a contingency as an existing condition, situation or set of circumstances involving uncertainty as to possible gain or loss that will be resolved when one or more future events occurs or fails to occur and permits accruals for loss from a loss contingency only when it is probable that an asset has been impaired or a liability has been incurred at the date of the balance sheet and the amount of the loss can be reasonably estimated.

Statement No. 5 also prohibits reserves for general contingencies or unspecified business risks or for losses that have not occurred. Prior to the issuance of Statement No. 5, reserves for a variety of contingencies were permitted, including self-insurance reserves, reserves against general losses, reserves on foreign exchange transactions, catastrophe loss reserves of casualty insurers, and reserves for future repairs, plant conversions, blast furnace relining, future losses on investments, future costs of work force reductions, and the like. The accumulation of these reserves by discretionary charges to operations, often over a number of years, and the charging of significant or recurring losses against these reserves had the effect of reducing fluctuations in earnings (often called "smoothing").

In connection with the Study's contention that the FASB often bows to pressure from "big business", it should be noted that the FASB was and continues to be criticized within the business community over the adoption of Statement No. 5.

Statement No. 6—"Classification of Short-Term Obligations Expected to Be Refinanced." May 1975. Statement No. 6 conformed the various practices with respect to the balance sheet classification of short-term obligations that are expected to be refinanced. The Statement provides criteria that must be met for a short-term obligation to be excluded from current liabilities. Short-term obligations may be excluded from current liabilities only if the enterprise intends to refinance the obligation on a long-term basis *and* has the ability to consummate such a refinancing. The Statement specifies the ways that an enterprise may demonstrate its ability to consummate a refinancing.

Prior to Statement No. 6, because existing authoritative literature did not provide definitive criteria, short-term obligations expected to be refinanced were presented in balance sheets in a number of ways, including: a) classification as current liabilities, b) classification as long-term liabilities, and c) presentation as a class of liabilities distinct from both current liabilities and long-term liabilities.

Statement No. 7—"Accounting and Reporting by Development Stage Enterprises." June 1975. Statement No. 7 applies to companies devoting substantially all of their efforts to establishing a new business and not yet commencing substantial operations and requires them to follow generally accepted accounting principles applicable to established operating enterprises.

Prior to the issuance of Statement No. 7, many development stage enterprises had adopted special accounting and reporting practices, including special forms of financial statement presentation or types of disclosure. Special accounting practices included (a) deferring all costs without regard to the possibility of recovering them, (b) offsetting revenue against deferred costs, and (c) not assigning dollar amounts to shares of stock issued for consideration other than cash. Special reporting formats included statements of (a) assets and unrecovered pre-operating costs, (b) liabilities, (c) capital shares, and (d) cash receipts and disbursements. Before eliminating these alternatives, the FASB investigated the potential economic effects of such action. The Board was advised that conforming development stage accounting to accounting principles applicable to established operating enterprises was unlikely to have a significant adverse effect on the ability of development stage enterprises to obtain capital.

Statement No. 8—"Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements." October 1975. This Statement continues to be one of the FASB's most controversial Statements, eliciting strong criticism from business.

Statement No. 8 specifies the method for translating foreign currency transactions and foreign currency financial statements. It requires that exchange gains or losses resulting from application of that method must be included in net income currently (except for exchange gains or losses relating to the hedge of an identifiable foreign currency commitment, which gains or losses are deferred and included in the dollar basis of the related foreign currency transaction). It eliminated all alternative methods of accounting and reporting for foreign currency transactions and for translating foreign currency financial statements incorporated in the financial statements of a domestic enterprise. To incorporate foreign currency transactions and foreign currency financial statements in its own financial statements, an enterprise must translate (i.e. express in its reporting currency—generally the U.S. dollar for U.S. companies) all assets, liabilities, revenues, or expenses that are measured or denominated in foreign currency.

Prior to Statement No. 8, a wide variety of methods of translating foreign currency had evolved and a variety of methods of determining and accounting for exchange gains and losses existed in practice. In addition to those divergent practices, international business activities of U.S. companies had expanded rapidly after the publication of the basic accounting pronouncements in this area, and the international monetary system had undergone significant changes, including U.S. dollar devaluations in 1971 and 1973 and the switch from fixed to floating rates in most foreign exchange markets.

Statement No. 9—"Accounting for Income Taxes—Oil and Gas Producing Companies." October 1975. Statement No. 9 was issued to provide new accounting standards required as a result of the passage by Congress of the Tax Reform Act of 1975 (the "Act"). Among other things, the Act substantially reduced or eliminated percentage depletion as a federal income tax deduction for many oil and gas producing companies as of January 1, 1975. APB Opinions issued prior to the Act had not required the recording of deferred income taxes for intangible development costs that oil and gas producing companies capitalized for financial reporting and expensed for Federal income tax reporting, because percentage depletion over the life of oil and gas properties was generally expected to exceed the amount of costs capitalized and amortized in the financial statements (sometimes referred to as "interaction"). Prior to Statement No. 9, some oil and gas producing companies had recorded deferred taxes applicable to intangible development costs but most had not.

Statement No. 9 requires that commencing January 1, 1975 all enterprises must record deferred income taxes for intangible development costs and other costs of exploration for, and development of, oil and gas reserves entering into the determination of financial accounting income and taxable income in different periods. Oil and gas producing companies that the Act still permits to deduct statutory depletion for income tax reporting and that have statutory depletion in excess of cost depletion may elect to recognize that excess statutory depletion in the computation of the amount of deferred taxes to be recorded. The Statement permits oil and gas producing companies to adopt interperiod tax allocation retroactively for intangible development costs without recognizing interaction with percentage depletion.

Statement No. 12—"Accounting for Certain Marketable Securities." December 1975. This Statement also continues to be highly controversial. The Statement requires that both current and non-current equity security portfolios be valued at and shown in the financial statements of an enterprise at the lower of cost or market value, with the difference between cost and market value being shown as a reduction of income for current portfolios and as a reduction of stockholders' equity for non-current portfolios.

Prior to the issuance of Statement No. 12 and in accordance with then existing accounting requirements, many companies reported marketable securities at cost, with disclosure of market value, even though market value was less than cost. A significant decline in the market prices of equity securities occurred during the recession of 1973-1975.

Certain specialized industries (e.g., insurance companies, broker-dealers, and investment companies) are exempt from the lower of cost or market requirement of Statement No. 12, because companies in those industries report marketable securities at current market value, whether above or below cost, under specialized industry accounting practices.

Statement No. 13—"Accounting for Leases." November 1976. This Statement eliminates inconsistencies in lease accounting practices and provides specific and objective criteria for determining when a lease is a capital lease (which must be accounted for as if the lessee purchased an asset and incurred a liability), and when a lease is an operating lease (which does not result in the recording of an asset and liability).

The Statement provides standards of financial accounting and reporting for leases that are consistent for both lessees and lessors and also eliminates alternative methods of accounting for leveraged leases and all alternative definitions of what constitutes a leveraged lease.

Over the years the Accounting Principles Board had issued several Opinions and the SEC had issued several Accounting Series Releases as to accounting by lessees and lessors. Despite these Opinions and Releases, criteria were stated in broad terms so that similar transactions sometimes were accounted for differently. In addition, the same lease was often accounted for differently (i.e., capital vs. operating) by the lessor and the lessee. Moreover, a variety of accounting practices had developed with respect to leveraged leases, a comparatively recent method of financing but one of growing significance.

Statement No. 13 provides standards applicable to substantially all leasing transactions. It is based on the premise that a lease which transfers substantially all of the benefits and risks incident to the ownership of property should be accounted for as the acquisition of an asset and the incurrence of an obligation by the lessee and as a sale or financing by the lessor. All other leases should be accounted for as operating leases. Criteria are specified for determining whether substantially all benefits and risks incident to ownership have been transferred. Special provisions apply to leases of land, sales and leasebacks, related party leases, subleases and leveraged leases.

This Statement has received a great deal of attention, even though it has only been issued recently. For example, the Interstate Commerce Commission and the Civil Aeronautics Board have already announced that they will adopt it in its entirety for purposes of carriers and air carriers subject to their respective jurisdictions.

Statement No. 14—"Financial Reporting for Segments of a Business Enterprise." December 1976. Statement No. 14 requires that an enterprise report specified financial information including revenues, profitability, assets, depreciation and capital expenditures for each significant segment of its business. A segment is regarded as significant if its sales, operating profit, or identifiable assets are 10% or more of the related combined amounts for all a company's industry segments. Information similar to that required for industry segments also is required for a company's operations in different geographic areas of the world, as is certain information as to sales to major customers. The Statement also provides guidelines as to the manner in which such information is to be derived and presented.

Prior to Statement No. 14, authoritative accounting literature did not require comprehensive reporting of segment information in an enterprise's financial statements, although existing pronouncements required disclosures related to an enterprise's foreign operations, information concerning companies accounted for by the equity method, and information as to discontinued operations of a segment of a business. Information as to sales and profits by lines of business was required by the SEC in certain of its filings, but because this information was not a part of the financial statements, it was not required to be assembled in any particular way.

Statement No. 14 is significant in terms of the Study in that it demonstrates that the FASB not only can, but will, require more than a Federal agency when the Board views this to be in the public interest.

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B. Interpretations

FASB Interpretations are issued to explain, clarify or elaborate on FASB Statements of Financial Accounting Standards and the pronouncements of its predecessors. The Interpretations eliminate or severely restrict differing applications of the related accounting standards or practices.

For example, FASB Interpretation No. 1 interpreted the criteria in APB Opinion No. 20 to require that an accounting change must be justified on the basis that the new accounting method is preferable and will constitute an improvement in financial reporting; tax savings alone are not adequate justification for an accounting change.

Another example is FASB Interpretation No. 3, which the Board issued shortly after passage of the Employee Retirement Income Security Act of 1974 (ERISA). The Board interpreted APB Opinion No. 8 so that any change in pension cost resulting from compliance with the new Act would be recorded when the plan became subject to the Act's participation, vesting and funding requirements.

In a case involving the application of APB Opinions No. 16 and 17, the Board found that two methods were being used to record certain acquisitions. FASB Interpretation No. 9 rejected the use of one method before its use became widely accepted, thereby eliminating an alternative practice.

The FASB's most recent interpretation, No. 18, "Accounting for Income Taxes in Interim Periods", also demonstrates the Board's willingness to eliminate differences in accounting for similar situations. Interpretation No. 18 describes the general computation of interim period income taxes and its application in specific complex situations.

C. Summary of Significant Current Projects

1. Conceptual Framework and Objectives

A recurring theme of the Study is that the accounting profession and more recently the FASB have failed to prescribe a clear set of objectives and a conceptual framework within which further improvements in financial accounting and reporting can occur. These charges do not take into account the substantial progress that the Board has made, particularly in the past year.

The history of the accounting profession's efforts to establish a more logical conceptual basis for its principles and standards includes (a) two important studies prior to the establishment of the FASB and (b) the major program that the Board currently has well under way. APB Statement No. 4, "Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises," was issued by the Accounting Principles Board in October 1970 following work extending over a five-year period. In that Statement, the APB (i) discussed the nature of financial accounting, the environmental forces influencing it, and the potential and limitations of accounting in providing useful information, (ii) suggested objectives of financial accounting and financial statements, (iii) discussed the basic elements of financial accounting, (iv) emphasized the dynamic nature of accounting, and (v) set forth proposals for future changes. The heart of APB Statement No. 4 was a description of those accounting principles that were generally accepted at the time. The "Statement" was not an "Opinion" of the APB, however, so members of the profession were not obligated to call attention to departures from it.

In 1971 the Board of Directors of the AICPA constituted a special study group to hold hearings and to investigate thoroughly the objectives of financial statements. This Study Group, chaired by the late Robert Trueblood, issued its report, "Objectives of Financial Statements" (often referred to as the Trueblood Report), in October 1973. The Trueblood Report was in the nature of a research study with recommendations and was to provide a basis for the FASB's further consideration of objectives.

Before the Trueblood Report was issued, the FASB was established. On April 1, 1973 the Board placed on its initial technical agenda a comprehensive project to identify the objectives of financial statements and provide a conceptual framework for financial accounting. This project was to build on the Trueblood Report and on APB Statement No. 4. In June 1974, the FASB issued a Discussion Memorandum on the objectives of financial statements and in September 1974 held public hearings on this subject. In December 1976, the Board published its *Tentative Conclusions on the Objectives of Financial Statements of Business Enterprises* and issued an additional Discussion Memorandum entitled *Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement.* Public hearings have been scheduled for June 1977.

At the time the Board issued its second Discussion Memorandum in December 1976, it also issued a document entitled *Scope and Implications of the Conceptual Framework Project,* a non-technical summary of the other two 1976 publications and their significance. A brief review of this simplified summary indicates the enormous complexity of the subject. For example, the summary describes a conceptual framework as a constitution to provide "a coherent system of interrelated objectives and fundamentals that can lead to consistent standards"; it characterizes objectives as identifying the goals and purposes of accounting, and fundamentals as the underlying concepts that guide the events to be accounted for, their measurement and the means of summarizing and communicating them to users. The summary states that the project is expected to lead to FASB pronouncements involving (i) objectives of financial statements, (ii) qualitative characteristics of financial statement information (e.g. relevance, objectivity and comparability), (iii) basic elements (e.g. what is an asset, a liability, revenue, expense; should earnings be defined in terms of changes in assets and liabilities or should assets and liabilities be determined only after revenue, expenses and earnings have been defined?), (iv) bases of measurement (e.g. historical cost, replacement cost, current selling price and present values of future cash flows), and (v) units of measure (e.g. current dollars or dollars adjusted for changes in general purchasing power). These issues are extremely complex and require logical, objective and thorough analysis by the most competent professionals available. Work on this critical project is continuing as a matter of priority.

2. Extractive Industries: PL 94-163

The Board also is engaged currently in a project related to Section 503 of the "Energy Policy and Conservation Act" enacted in 1975 (Public Law 94-163). In that Section, Congress empowered the SEC either to prescribe accounting rules applicable to persons engaged in the production of crude oil or natural gas or to recognize accounting practices developed by the Financial Accounting Standards Board if the SEC is assured that such practices will be observed to the same extent as if the SEC had prescribed the practices by rule.

In December 1976, the FASB issued its Discussion Memorandum, *Financial Accounting and Reporting in the Extractive Industries.* This project is broader than the concern of the "Energy Policy and Conservation Act" with oil and gas producers in that the FASB is considering the accounting and reporting issues applicable to companies engaged in other extractive industries. In addition, the Discussion Memorandum presents issues and seeks public comment relevant to the financial information needed for the energy data base specified by the Act. At the request of the SEC, the FASB also included in its Discussion Memorandum a series of issues developed by the SEC in connection with its responsibilities under the Act, and the FASB expects to issue a Statement of Financial Accounting Standards prior to the end of 1977 on which the SEC may rely. Representatives of the SEC, the Federal Energy Administration, the General Accounting Office, the Cost Accounting Standards Board and the Federal Power Commission, as well as one committee of the Congress, have observed the activities of the FASB's task force on this project. Public hearings were held on March 30-April 1 and on April 4, 1977. Apart from the national significance of accounting and energy data compilation in respect of oil and gas producers, the issues involved in this project have been debated for years, and the FASB regards this project as not only one of priority, but one of the most difficult it has faced.

3. Other Significant Projects

Of the other projects on the Board's current technical agenda, several are also matters of priority and of great significance in the improvement of financial accounting and reporting.

For example, a project receiving national attention is the Board's project on *Accounting by Debtors and Creditors for Troubled Debt Restructurings.* This project has evolved because of the many loan restructurings involving the nation's financial institutions. The significant increase in restructurings resulted from the economic recession and inflation affecting the economy in recent years and the attempts by the City of New York to resolve its financial difficulties through moratoriums on the payment of its maturing debt and through exchange offers by the Municipal Assistance Corporation.

The Board issued an Exposure Draft relating to accounting by debtors in such circumstances in November 1975, and held hearings in December of that year. It became clear at this stage of the project that accounting by creditors should also be encompassed within the scope of the project, and, accordingly, the Board appointed a task force and issued a Discussion Memorandum in May 1976. The Board received nearly 900 written responses to its Discussion Memorandum, and heard 37 oral presentations at four days of public hearings in July. In December 1976, the Board issued an Exposure Draft covering accounting by both debtors and creditors for troubled debt restructurings. The public comment period on this Exposure Draft ended on March 10, 1977. The Board expects to issue a final Statement towards the middle of this year.

While the FASB acted promptly in 1974 to issue an Interpretation to prevent divergent practices from developing following enactment of the Employee Retirement Income Security Act of 1974, the significance of this legislation caused the FASB to add two related major projects to its technical agenda—*Accounting for the Cost of Pension Plans* and *Accounting and Reporting for Employee Benefit Plans.* The Board issued a comprehensive Discussion Memorandum on the latter project in October 1975 and held public hearings in February 1976. The staff is currently developing a proposed Statement for exposure and public comment within the next few months.

4. Summary of Work of the Accounting Principles Board

The Accounting Principles Board, the FASB's predecessor standard-setting body, made significant contributions to financial accounting and reporting in its 31 Opinions and 4 Statements by reducing alternatives in some very significant areas. A table listing the

Opinions and Statements is set forth at the end of this section. Set forth below is a summary discussion of certain of the more significant APB Opinions and their contribution to improved accounting and reporting.*

APB Opinion No. 8—"Accounting for the Cost of Pension Plans." November 1966. This Opinion made a significant contribution to accounting literature in view of the increasing significance of pension cost in relation to the financial position and results of operations of many businesses. This Opinion establishes the basic accounting method for pension plans, acceptable actuarial cost methods and the accounting for actuarial gains and losses. The Opinion requires that pension costs be accrued during the period of employment and prohibits accounting for pensions on a pay-as-you-go basis.

In light of the enactment of the ERISA legislation, the FASB is currently reassessing accounting for pension costs and is considering accounting for employee benefit plans.

APB Opinion No. 9—"Reporting the Results of Operations," Part I—"Net Income and the Treatment of Extraordinary Items and Prior Period Adjustments", December 1966, and APB Opinion No. 30—"Reporting the Results of Operations", June 1973. Part I of Opinion No. 9 made a significant contribution by eliminating an alternative accounting practice that permitted an enterprise to exclude significant items from net income.

Prior to Opinion No. 9, extraordinary items, other material charges and credits, and prior period adjustments often were charged or credited directly to stockholders' equity thereby bypassing the income statement. Opinion No. 9 resolved a considerable diversity of view as to this practice. According to one viewpoint, if extraordinary items or prior period adjustments were required to be included in net income for a current period, the significance of "net income" as a measurement of the ordinary recurring operations of an enterprise would be impaired and misleading inferences might be drawn. A contrary view was that "net income" should reflect all transactions affecting the net increase or decrease in owners' equity of the enterprise during a current period (except dividend distributions and transactions of a capital nature). APB Opinion No. 9 requires that net income for a current period should reflect all items of profit and loss recognized during the period, including extraordinary items, except for certain limited prior period adjustments. APB Opinion No. 9 also requires that extraordinary items be segregated from the results of ordinary operations and be shown separately in the income statement and that their nature and amounts be disclosed.

APB Opinion No. 30 addressed certain differences of opinion that continued to exist after the issuance of Opinion No. 9 with respect to determining what was an extraordinary item. It provides that an event or transaction should be presumed to be an ordinary and usual activity, the effects of which should be included in income from operations, unless the transaction is distinguished by both its unusual nature and the infrequency of its occurrence. The Opinion also specifies accounting and reporting standards for disposal of a segment of a business, requiring that the results of continuing operations should be reported separately from discontinued operations and that any gain or loss from disposal of a segment of a

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* The Opinions not discussed were omitted because: they were superseded by subsequent APB Opinions or FASB Statements (for example, FASB Statement No. 13, "Accounting for Leases", superseded four APB Opinions); or they dealt with special applications of an Opinion discussed below (for example, Opinion No. 23 deals with special areas of accounting for income taxes; income taxes were dealt with by Opinion No. 11); or they may not have pervasive application, even though they resolved long-standing issues (for example, Opinion No. 14 deals with accounting for convertible debt and debt issued with stock purchase warrants).

business should be reported in conjunction with the related results of discontinued operations and not as an extraordinary item.

APB Opinion No. 11—"Accounting for Income Taxes." December 1967. This Opinion eliminated numerous alternative practices in accounting for income taxes, principally involving accounting for the tax effects of transactions that enter into the determination of financial accounting income and taxable income in different reporting periods (referred to as "timing differences").

The amount of income taxes payable for a period is not necessarily equal to income tax expense applicable to transactions recognized for financial accounting purposes in that period because the objectives of financial reporting are not the same as the goals and objectives of Federal tax policy. Divergent practices existed as to the measurement and the recording of the effects of differences between financial accounting and taxable income. For example, the Internal Revenue Service permits a "net operating loss" in one period to be deducted in determining taxable income of other periods. In some instances the tax effects of an operating loss were reflected in the financial statements in the period of the loss, while in other cases the tax effects of the loss were reflected in income of the periods in which income taxes payable were reduced.

Opinion No. 11 requires that income tax expense include the tax effects of all revenue and expense transactions included in the determination of pretax accounting income for that period. The Opinion also establishes reporting requirements concerning the reporting of income tax expense and deferred income taxes and guidelines for accounting for the tax effects of timing differences, operating losses and similar items.

APB Opinion No. 15—"Earnings per Share." May 1969. Opinion No. 15 establishes guidelines to assure that earnings per share data are computed on a consistent basis and presented uniformly in financial statements. This was an important contribution to accounting in view of the increasing preoccupation of investors in the 1960's with earnings per share data. Among other things, the Opinion aids investors by requiring corporations with complex capital structures to present two measures of earnings per share with equal prominence on the face of the income statement—the first based on the number of common shares outstanding plus those securities that are in substance equivalent to common shares (e.g., stock options and warrants) and that would have a dilutive effect ("primary earnings per share"); the second, a pro-forma presentation to show the maximum potential dilution of current earnings on a prospective basis by assuming that all contingent issuances of common stock having a dilutive effect had taken place at the beginning of the period ("fully diluted earnings per share").

APB Opinion No. 16—"Business Combinations" and Opinion No. 17—"Intangible Assets." August 1970. The era of the 1960's was marked by increased acquisition activity, and the complexity and variety of these transactions multiplied greatly. APB Opinions No. 16 and 17 eliminated as accounting alternatives a number of divergent accounting practices that had evolved at the time, and prescribed strict rules to standardize accounting in this important area.

Among other things, Opinion No. 16 drastically reduces the availability of pooling of interests as an acceptable method of accounting for a business combination. Although both the purchase method and the pooling of interests method of accounting for a business combination remain in use, the two methods are no longer available alternatives in accounting for the same business combination. Opinion No. 16 sharply defines the circumstances in which each method must be used. In the case of a purchase transaction,

the Opinion specifies how to allocate the purchase price among assets received and liabilities assumed. Amounts remaining after that allocation are considered an intangible asset, often called goodwill. It also requires substantial additional disclosure of information for business combinations.

Opinion No. 17 prescribes standards for accounting and disclosure of intangible assets purchased from others. A generally accepted practice prior to this Opinion was not to amortize the cost of intangibles. No specific disclosure requirements as to intangibles existed prior to Opinion No. 17. Among other things, this Opinion requires that the cost of intangibles, including the excess of the purchase price over the fair value of the assets acquired ("goodwill"), be amortized by systematic charges to income over the estimated life of the intangibles but not more than 40 years.

The FASB currently has the subject of "Accounting for Business Combinations and Purchased Intangibles" on its technical agenda and issued a Discussion Memorandum on this subject in August 1976.

APB Opinion No. 18—"The Equity Method of Accounting for Investments in Common Stock." March 1971. This Opinion clearly defines the circumstances under which the "cost" method or the "equity" method must be used and eliminates the use of these methods as alternatives in accounting for investments in common stock.

Under the equity method, an investor initially records his investment in stock of another enterprise (the "investee") at cost and adjusts the carrying amount of the investment to recognize his share of the earnings or losses of the investee after the date of acquisition. Under the cost method, an investor records income on his investment only when dividends are paid or when the investment is liquidated. In the circumstances specified by the Opinion, the equity method is considered superior to the cost method because the results of the investment (i.e., equity in earnings and losses) are reflected currently rather than only when dividends are received.

Prior to APB Opinion No. 18, the equity method was required in consolidated financial statements in accounting for investments in nonconsolidated domestic subsidiaries. While both the equity method and the cost method were permitted in accounting for investments of nonconsolidated foreign subsidiaries, the cost method was generally used for corporate joint ventures and investments in common stocks of enterprises not controlled by the investor. The use of the equity method was not permitted, however, for investments in any subsidiaries whose principal activity was leasing property to its parent or other affiliates; consolidation of those subsidiaries was required. APB Opinion No. 18 extends the applicability of the equity method to all nonconsolidated subsidiaries of an enterprise (except subsidiaries that lease property to a parent or affiliates and that must be consolidated) and to investments in common stock of joint ventures and other investees over which an investor has the ability to exert significant influence.

APB Opinion No. 19—"Reporting Changes in Financial Position." March 1971. This Opinion requires a third basic financial statement—a statement summarizing changes in financial position for each period for which an income statement is presented. This new financial statement, which summarizes financial and investment activities and the extent to which the enterprise generated funds from operations during a period, is of particular public benefit, as it requires information that financial statements and footnotes either had not previously provided or had previously provided only to those able to derive such information by analysis.

APB Opinion No. 20—"Accounting Changes." July 1971. This Opinion serves to limit accounting changes to those that are to a preferable method and that result in an improvement in financial reporting.

Prior to this Opinion, practice varied as to the circumstances under which an accounting principle once adopted could subsequently be changed, as well as the method by which the effects of the change were reflected in an enterprise's financial statements. Opinion No. 20 concludes that there is a presumption that an accounting principle once adopted should not be changed in accounting for events and transactions of a similar type. That presumption could be overcome only if the enterprise justifies the use of an alternative acceptable accounting principle on the basis that it is preferable and constitutes an improvement in financial reporting. Further, the Opinion requires extensive disclosure of the reasons for and the effects of the accounting change.

This Opinion is of special significance in assessing the accuracy and completeness of the Study's assertions that businesses have an "unrestricted" ability to change from one accounting principle to another.

APB Opinion No. 21—"Interest on Receivables and Payables." August 1971. Opinion No. 21 eliminated numerous variations in accounting for the exchange of cash or property for a note or similar instrument when the face amount and the stated interest rate of the note or instrument did not reasonably represent either the present value of the obligation or the prevailing market rate of interest. The Opinion specifies that accounting for such transactions should be based on the economic substance of the financing transaction rather than its form.

Prior to the issuance of the Opinion, authoritative accounting literature generally did not distinguish between indebtedness issued for cash and that issued in exchange for property or goods, and did not address transactions involving interest rates or principal amounts that appeared unrealistic in the light of existing conditions. The authoritative literature also provided no guidelines for determining an appropriate discount rate in computing the present value of long-term receivables or payables.

Among other things, the Opinion sets forth general guidelines for determining an appropriate interest rate, including recognition of the credit standing of the issuer, collateral, repayment terms, tax consequences of the transaction to both buyer and seller, and a proviso that the rate should be at least equal to the rate at which the debtor could obtain financing of a similar nature at the date of the transaction.

APB Opinion No. 22—"Disclosure of Accounting Policies." April 1972. While brief in content, APB Opinion No. 22 is long in significance. By requiring disclosure of all significant accounting policies used by an enterprise for which there are generally accepted alternatives, users may assess matters such as whether the enterprise is using conservative accounting methods. Information of this type may also facilitate some assessment as to future prospects or risks associated with a continuing, or new, investment in the enterprise.

APB Opinion No. 26—"Early Extinguishment of Debt." October 1972. APB Opinion No. 26 eliminated two alternative practices for reflecting gains and losses on debt retirements.

Debt is frequently extinguished in various ways before its scheduled maturity and generally the amount paid upon acquisition of the debt securities differs from the amount at which the debt is carried on the enterprise's books at the time of acquisition. The Opinion addresses the question of which of three generally accepted methods should be used to account for gains and losses on such transactions—(i) amortization over the remaining life of the extinguished issue, (ii) amortization over the life of the new issue, or (iii) recognition of gain or loss currently in income. It concludes that all extinguishments of debt prior to

maturity are fundamentally alike, and thus the accounting treatment should be the same regardless of the means used to achieve the extinguishments. The Opinion requires that the difference between the acquisition price and the net carrying amount of the extinguished debt should be recognized currently in income as losses or gains in the period in which the extinguishment occurs and identified as a separate item.

FASB Statement No. 4, "Reporting Gains and Losses from Extinguishment of Debt", now requires that such gains or losses be reported as extraordinary items; this presentation benefits users by facilitating their assessment of the components of an enterprise's earnings. Debt restructurings in troubled situations have grown in significance as a result of the recent economic recession, and the FASB is currently considering specific accounting for these debt restructurings.

APB Opinion No. 28—"Interim Financial Reporting." May 1973. Prior to Opinion No. 28, there was no definitive pronouncement on interim reporting and a wide variety of divergent practices had evolved. In recognition of this fact and the increasing significance of interim reports to investors, Opinion No. 28 prescribes modifications of annual accounting practices required in the preparation of interim financial information. The Opinion also sets forth guidelines for the preparation, presentation and reporting of interim financial information, with particular attention to problems involving revenues, costs and expenses, income tax provisions, seasonal factors, accounting changes, disposal of a segment of a business, and extraordinary, unusual, infrequently occurring and contingent items.

APB Opinion No. 29—"Accounting for Nonmonetary Transactions." May 1973. In Opinion No. 29, the APB addresses business transactions involving (a) an exchange with another entity that involves principally nonmonetary assets (e.g., inventory or real estate) or liabilities (e.g., rent collected in advance) or (b) a transfer of nonmonetary assets where no assets are received or relinquished in exchange (as contrasted with business transactions involving exchanges of cash or other monetary assets or liabilities).

The Opinion notes varying practices as to the amount to assign to a nonmonetary asset transferred to or from an enterprise in a nonmonetary transaction and to the recognition of gain or loss on a nonmonetary asset transferred in a nonmonetary transaction. Some nonmonetary transactions had been accounted for at the estimated fair value of the assets transferred and some at the amounts at which the assets transferred were previously recorded. The Opinion concludes that, with certain exceptions, accounting for nonmonetary transactions should be based on the fair values of the assets involved (which is the same basis as that used in monetary transactions), thus eliminating a then accepted alternative. Accordingly, the cost of a nonmonetary asset acquired in exchange for another nonmonetary asset is the fair value of the asset surrendered to obtain it, and a gain or loss should be recognized on the exchange.

Addendum to APB Opinion No. 2, "Accounting for the 'Investment Credit'." December 1962. The Addendum to APB Opinion No. 2, "Accounting for the 'Investment Credit'," discusses the application of generally accepted accounting principles to regulated industries (such as electric utility companies) and states that differences may arise in the application of generally accepted accounting principles as between regulated and non-regulated businesses because of the effect of the rate-making process. These differences usually concern the time at which various items enter into the determination of net income. FASB Statements and Interpretations and APB Opinions are applied to regulated companies in accordance with the provisions of the Addendum. For example, FASB Statement No. 2, "Accounting for Research and Development Costs," requires that research and development costs must be charged to expense when incurred. An electric utility may be permitted for rate-making purposes to amortize these expenses to operations over a specified number of future periods. In this situation the Addendum permits the utility to defer to future periods those research and development costs that are to be amortized to future operations.

When the Addendum permits regulated companies to follow accounting practices other than those required by FASB Statements and Interpretations and APB Opinions, disclosure may be required of the effect on reported results of operations and financial position as a result of using those alternative accounting practices.

5. Table of Opinions and Statements issued by the APB

Opinions

No. 1 —New Depreciation Guidelines and Rules—Issued November 1962
No. 2 —Accounting for the "Investment Credit"—Issued December 1962
No. 3 —The Statement of Source and Application of Funds—Issued October 1963
No. 4 —Accounting for the "Investment Credit" (Amending No. 2)—Issued March 1964
No. 5 —Reporting of Leases in Financial Statements of Lessee—Issued September 1964
No. 6 —Status of Accounting Research Bulletins—Issued October 1965
No. 7 —Accounting for Leases in Financial Statements of Lessors—Issued May 1966
No. 8 —Accounting for the Cost of Pension Plans—Issued November 1966
No. 9 —Reporting the Results of Operations—Issued December 1966
No. 10 —Omnibus Opinion—1966—Issued December 1966
No. 11 —Accounting for Income Taxes—Issued December 1967
No. 12 —Omnibus Opinion—1967—Issued December 1967
No. 13 —Amending Paragraph 6 of APB Opinion No. 9, Application to Commerical Banks—Issued March 1969
No. 14 —Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants—Issued March 1969
No. 15 —Earnings per Share—Issued May 1969
No. 16 —Business Combinations—Issued August 1970
No. 17 —Intangible Assets—Issued August 1970
No. 18 —The Equity Method of Accounting for Investments in Common Stock—Issued March 1971
No. 19 —Reporting Changes in Financial Position—Issued March 1971
No. 20 —Accounting Changes—Issued July 1971
No. 21 —Interest on Receivables and Payables—Issued August 1971
No. 22 —Disclosure of Accounting Policies—Issued April 1972
No. 23 —Accounting for Income Taxes—Special Areas—Issued April 1972
No. 24 —Accounting for Income Taxes—Investments in Common Stock Accounted for by the Equity Method (Other than Subsidiaries and Corporate Joint Ventures)—Issued April 1972
No. 25 —Accounting for Stock Issued to Employees—Issued October 1972
No. 26 —Early Extinguishment of Debt—Issued October 1972
No. 27 —Accounting for Lease Transactions by Manufacturer or Dealer Lessors—Issued November 1972
No. 28 —Interim Financial Reporting—Issued May 1973

No. 29 —Accounting for Nonmonetary Transactions—Issued May 1973
No. 30 —Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions—Issued June 1973
No. 31 —Disclosure of Lease Commitments by Lessees—Issued June 1973

Statements

No. 1 —Statement by the Accounting Principles Board—Issued April 1962
No. 2 —Disclosure of Supplemental Financial Information by Diversified Companies—Issued September 1967
No. 3 —Financial Statements Restated for General Price-Level Changes—Issued June 1969
No. 4 —Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises—Issued October 1970

EXHIBIT E

THE STUDY'S OUTDATED ANALYSIS OF ALTERNATIVE ACCOUNTING PRINCIPLES

The Study supports its criticism of accounting alternatives by reproducing a table attributed to Professor Abraham Briloff which shows a variety of alternative accounting methods available to account for the same business transactions.

The Study's reliance on that table is misplaced, for the data presented are based on a 1965 research study which was not updated in the Study to reflect 12 years of progress by the FASB and its predecessor, the Accounting Principles Board. The Study also makes no effort to distinguish among those alternatives necessary to reflect clearly different circumstances or wholly different transactions, even though the 1965 research study took care to do so when originally published.

This Exhibit E, prepared by the FASB's technical staff, discusses in detail the Study's outdated tabulation and the Staff's assertions. Set forth at the conclusion of this Exhibit is a table which restates the information shown in the Study on the basis of accounting principles in effect in 1977.

Of the 42 "alternatives" listed in the Study's table, 30 are not alternatives or are of such minor import as to be immaterial in their effect on financial statements, as the following tabulation and the reconciliation on page E-8, updating and correcting the Study's table, show:

14	apply to circumstances which clearly differ and for which there are recognized criteria for determining the appropriate practice, or apply to wholly different transactions.
4	have been eliminated.
1	is now the sole practice.
1	is not an accounting method.
10	relate to items having no material effect on financial statements.
2	are rare and disappearing.
10	are practices which may be alternatives.
42	

Of the 10 practices which may be alternatives, 2 are currently under study by the FASB in its Extractive Industries project.

The basis for the Study's chart is a tabulation from *Accounting Research Study No. 7,* "Inventory of Generally Accepted Accounting Principles," prepared for the AICPA by Paul Grady in 1965. As mentioned, no attempt was made in the Study to update Mr. Grady's research to account for developments in the twelve years since its publication. Further, in borrowing from Grady's inventory, the Study distorts its significance and ignores the distinctions Grady highlighted between true alternatives and variant practices required

by differing circumstances or transactions. In this regard, Mr. Grady was careful to preface his "inventory" with the following statement:

> "The following list of alternative methods does not purport to be all inclusive. The methods listed are not all of the same nature, some are truly 'either-or' choices of management while others are applicable or not applicable depending on the circumstances. The latter illustrate the versatility of accounting to meet different conditions and to prevent financial and accounting abuses." *(Accounting Research Study No. 7,* at 373)

The following summary of the accounting methods tabulated by the Study shows that—rather than constituting interchangeable alternatives—certain of the methods are essential to meet differing circumstances or wholly different transactions, others have been or are being addressed in official pronouncements aimed at narrowing areas of difference and inconsistencies in practice, and with respect to others, the method chosen has little effect on financial statements generally used by investors and creditors.

1. *When revenue generally recognized*

Grady stated in 1965 that revenue is recognized in the sale of products or services on three bases:

1. At the time of sale
2. At the time of collection of sales price
3. At the time of completion of the product.

Notwithstanding the existence of separate approaches to revenue recognition, accounting standards provide criteria for the application of the appropriate method, depending upon the circumstances. Generally, revenue recognition is based upon the principle of realization. Thus, under ARB No. 43, Chapter 1A and APB Opinion No. 10, where the collection of receivables can be estimated with reasonable accuracy, revenue is realized at the time of sale and it is recognized for financial accounting purposes at that time. When the collectibility of a receivable is subject to a significant degree of uncertainty, proper recognition of revenue must await collection following sale. As Grady explains and as existing accounting literature confirms, it is only in the exceptional case that revenue may be properly recognized upon completion of the product and prior to its sale. As stated in ARB No. 43, Chapter 4, Statement 9, such method of recognition is appropriate only in highly specialized circumstances where, by the nature of the product, an assured market and price exist, as, for example, in the case of certain agricultural products and precious metals.

Clearly, each of the three "alternatives" cited by the Study addresses a specific set of circumstances, and no one uniform method of revenue recognition would be appropriate for all.

2. *When revenue recognized for long-term contractors*

Grady's inventory noted in 1965 that revenue is recognized in the context of long-term contracting operations on two alternative bases: either proportionately over the period of performance ("percentage-of-completion method") or at the time the contract is completed ("completed contract method").

Percentage-of-completion accounting was developed in response to the unique character of long-term construction contracts that often require years to complete. When reliable estimates are available, the percentage-of-completion method permits the financial statements of construction contractors to reflect periodic progress over a period of years. In the same circumstances, the completed-contract method might produce wide swings of losses and profits because all accumulated progress would be reported in the year the contract is completed. APB Statement No. 4 states that the appropriateness of the recognition of revenue as construction progresses is based on the consensus that a better measure of periodic income results. ARB No. 45 expressly notes that, when estimates of costs to complete and the extent of progress toward completion are reasonably dependable, the percentage-of-completion method is preferable. Where the lack of dependable estimates or inherent hazards cause estimates to be doubtful, however, ARB No. 45 states that recognition upon completion of the contract is preferable.

Here again, the existence of alternative modes of revenue recognition provides improved financial reporting where circumstances differ.

3. *Accounting for unfunded pension cost*

The Study lists the two methods of accounting for pension payments to employees that were cited by Mr. Grady in 1965. It overlooks, however, that in 1966 APB Opinion No. 8 prohibited one of the two methods and affirmed the appropriateness of the other for accounting for such payments.

The first method, commonly referred to as "pay-as-you-go", was, at the time of Grady's research, a vestige of earlier pensions "voluntarily" granted by corporations. With the surge of formal pension plans in the late 1940's and 1950's, however, advance funding of pensions developed as a general practice. In 1956, ARB No. 47 prohibited "pay-as-you-go" accounting for vested pension benefits and required that those benefits be accounted for on the accrual basis. In 1966, APB Opinion No. 8 responded to the surviving diversity in accounting practice by prohibiting pay-as-you-go accounting for the cost of pension plans and by requiring that unfunded pension costs be accounted for on the accrual basis (the second of the prior two methods) independent of the method of funding.

Thus, "pay-as-you-go" is no longer an acceptable method of accounting for unfunded pension costs. Also, as a result of the Employee Retirement Income Security Act of 1974 (ERISA), the subject of accounting for pension costs is on the FASB's technical agenda as noted below.

4. *Accounting for funded pension cost*

Grady stated in 1965 that pension payments made indirectly to retired employees through the medium of a fund are charged to expense on three different bases:

"1. When payments are made to the fund

2. Normal or current costs on an accrual basis over the period of service of the employees . . .

3. So-called past service credits at time of adoption of plan—

(a) Not provided for, except as to interest

(b) Accrued over period permitted in Income Tax Code, over remaining service life of employees or over longer period such as total average service life of employees . . . "

In borrowing from Mr. Grady's 1965 tabulation, the Study overlooks the fact that in 1966 APB Opinion No. 8 prohibited the first of Grady's three "alternatives". Items 2 and 3 are not, in fact, alternatives but are different subjects: normal costs and past service costs (i.e., costs related to service prior to adoption of the pension plan or amendment of it). Actuarial methods determine the annual pension costs to be accrued for normal costs and past service costs. APB Opinion No. 8 requires that pension costs be accrued annually on a consistent basis and sets limits within which the annual accrual must fall.

In view of the recent ERISA legislation, the FASB has the subject of accounting for pension costs on its technical agenda.

With regard to pension funding methods, it is interesting to note that, in enacting ERISA, Congress allowed alternative practices in a number of important areas in recognition of the variety of conditions existing among employers and their pension plans.

5. *Charging of real and personal property taxes to income*

Grady cited in 1965 eight different methods of charging real and personal property taxes against income. Grady's list quoted verbatim from ARB No. 43 (1953), which, in turn, summarized ARB No. 10 (1941). ARB No. 10 and ARB No. 43, though observing that the eight methods listed were methods that had been followed, recommended the monthly accrual of such taxes during the fiscal period of the taxing authority as the most acceptable basis.

The differences in methods stem basically from the question of when these taxes should be accrued and recognize legal technicalities that may vary significantly among taxing jurisdictions.

The subject of accounting for real and personal property taxes has not appeared in subsequent pronouncements of accounting standards because of the relative insignificance of these taxes in almost all financial statements. Moreover, any of the eight methods, followed consistently, produces virtually the same result year after year as any other, with any differences caused by changes in assessed valuations or tax rates from year to year.

For the above reasons, these items are poor examples for any of the Study's assertions on alternatives. It is nevertheless interesting that the methods cited by the Study for this relatively unimportant item account for almost 20% of its outdated listing of accounting alternatives.

6. *Treatment of tax versus financial accounting divergencies*

Grady stated in 1965 that "when items affecting taxable income are reported in financial statements and income tax returns in different periods:

1. The tax effect is allocated between periods in the financial statements

2. The tax effect is not allocated between periods

3. The tax effect is allocated for some items but not for others."

The three different practices cited by Grady in 1965 were used in accounting for the tax effects of "timing differences" (transactions that are reported in financial statements and income tax returns in different periods). Subsequent to the date of Grady's study the differences in tax allocation practices have been substantially narrowed through the issuance of *APB Opinion No. 11* (1967), *APB Opinions No. 23* and *No. 24* (1972), AICPA Interpretations (1969-1972), and *FASB Statement No. 9* (1975).

Nonallocation of the tax effects of timing differences among periods (the second practice cited by Grady) has been eliminated. Allocation of the tax effects of timing differences among periods is now required except for a limited number of specific timing differences or in circumstances for which recognized criteria have been established to determine whether tax allocation is required.

7. *Methods of depreciation*

Grady cited in 1965 the following four methods of depreciation for charging off the cost of depreciable assets over their estimated lives:

1. Increasing charge (annuity, sinking fund)
2. Production or "use" methods
3. Straight-line
4. Decreasing charge (declining balance, sum-of-years' digits).

Depreciation has probably been the subject of more legal controversy in the rate-making and tax accounting contexts than any other accounting subject. The underlying economic theory is that depreciable cost should be amortized over the useful life of an item in proportion to the consumption of its economic potential. The difficulty in its application is that in most cases no one method can be objectively demonstrated as best carrying out the theory. Therefore, the general accounting principle simply requires that depreciable cost be amortized over the estimated useful life in a systematic and rational manner. All four of the depreciation methods listed by Grady meet this criterion.

The annuity or sinking fund depreciation method is rarely used.

The unit-of-production (production or use) method is encountered more frequently, but is quite clearly a minority practice. The idea of charging each unit of output the same depreciation cost as all others over the estimated life of a facility is perhaps the most logical method of all. However, in most circumstances, estimating the likely total number of units of output over the useful life of the facility is far more difficult than estimating the useful life itself, and thus for sound practical reasons, this method is not widely used.

The straight-line method is by far the most widely used method. Its rationale is that the passage of time is as good as any standard by which to measure the expiration of economic potential of a depreciable asset.

The use of accelerated depreciation methods has increased considerably in the last 25 years, in large part because the Internal Revenue Code of 1954 permits the use of accelerated depreciation methods for Federal income tax purposes. The earlier, higher cash flow, through reduced income taxes, recovers dollars of investment sooner.

The Government's Cost Accounting Standards Board accepts all three of the above-described widely used depreciation methods.

8. *Inventory methods*

The Study's tabulation relies on the following five "alternative" methods for determining inventory cost described by Grady:

1. First in, first out (FIFO)
2. Last in, first out (LIFO)
3. Average cost
4. Base stock, and
5. Various combinations of these methods.

The "base stock" method cited by Grady in 1965 is a forerunner of the LIFO method but for all practical purposes this method is now extinct. Item 5 is not a separate accounting practice, and thus discussion of "alternative" inventory methods must focus on FIFO, LIFO and average cost.

An analysis of inventory accounting methods reveals that no single method listed above is likely to result in a fair matching of revenues and costs for all companies under all circumstances.

So long as the rate of inflation experienced by an enterprise is not substantial, the FIFO or average cost methods of valuing inventory permit a reasonable matching of revenues and costs. Under inflationary conditions, however, FIFO or average cost results in including in income for the year an "unrealized inventory profit" when lower beginning-of-the-year costs, rather than higher current replacement costs, are matched with current revenues. Under such circumstances, many companies have elected to use the LIFO method of inventory costing, which charges higher current costs against higher current revenues.

One aspect of inventory accounting is that the method that achieves a better matching of cost and revenue in the income statement may not produce the most realistic balance sheet. For example, in an inflationary period LIFO puts current cost in the income statement and leaves earlier costs in the balance sheet, while FIFO would put more current costs in the balance sheet.

The Government's Cost Accounting Standards Board permits any of the three alternatives. The SEC has given particular consideration to the disclosure of information about inventory values in ASR 151 and ASR 190 without, however, eliminating any of the acceptable inventory methods.

9. *Accounting for discounts*

Grady noted in 1965 two existing accounting practices for cash discounts on sales: discounts may be recognized either at the time of sale or at the time of collection.

Discounts are among the numerous types of transactions that have not been dealt with to any degree in recent accounting literature. This is probably because the timing of recognition of discounts taken on repetitive transactions makes little difference in financial statements. Also, in terms of accounting for discounts, the potential for what the Study calls "creative accounting" is almost nil because one method must be used consistently.

94-081 O - 77 - 21

10. *Fixed asset acquisition*

Grady's 1965 survey states that acquired properties may be recorded at:

1. cost
2. appraisal amounts
3. original cost to first owner using them for utility purposes, in the case of public utilities, and
4. book value to previous owner in business combinations accounted for as poolings of interests.

As with many of the practices tabulated by the Study, those four methods are not true "alternatives" because each particular method applies to a different type of transaction.

Except where special circumstances require a different treatment, acquired properties are recorded at cost. (Method 1). Although in the early part of this century there were examples of write-ups to appraised values (Method 2), this procedure was generally eliminated by APB Opinion No. 6. Today, appraisal values are used only to allocate the total cost paid to acquire a group of assets among the various assets acquired. Method 3 describes an accounting practice required by most public utility regulatory authorities and is unique to public utilities. Finally, Method 4 describes the accounting treatment required for assets obtained in a business combination that meets specified criteria to be accounted for as a pooling of interests.

Accounting for business combinations is currently on the FASB's technical agenda.

11. *Fixed asset construction*

Grady's 1965 inventory shows constructed properties recorded at:

1. direct costs only
2. direct costs plus partial overhead costs
3. direct costs plus all overhead costs, including interest on all funds used in the construction (funds from equity sources as well as debt).

The three methods listed usually apply to three different types of relationships between a company's construction activities and its main business activities. The relationship of construction to main activities can vary widely among companies, of course, as can the involvement of executive and other overhead personnel.

A company that uses employees normally employed in its principal business activity in occasional construction may charge the project only with direct costs and not with a part of the overhead that would be incurred in any event. A company that has more frequent self-construction activities will usually have assigned to such work more or less continuously a certain number of people from the overhead pool—engineers, draftsmen, etc.—and may assign a portion of the overhead to the construction project. (Method No. 2).

Finally, the "full costing" of construction projects (Method 3) exists largely in the area of regulated utilities where regulatory commissions prescribe accounting methods and permit such costs to be included in the utility's rate base.

The practice of capitalizing interest during construction is one of general concern within the profession and is currently one of the topics on the FASB's technical agenda. Pending resolution of this issue by the FASB, the SEC, in its Accounting Series Release 163, prohibited the use of this method to those who had not used it consistently in the past.

12. *Development costs in extractive industries*

Grady cited in 1965 three methods of accounting for the development costs of extractive industries:

1. capitalized and allocated to future production through depletion charges
2. capitalized but not charged to future income statements (certain mining enterprises)
3. capitalized in part and the remaining part charged to expense currently; the portion capitalized is allocated to future production through depletion charges.

Accounting for exploration and development costs in the extractive industries is on the FASB's technical agenda. In this regard, the FASB recently issued a Discussion Memorandum (December 23, 1976), "Analysis of Issues Related to Financial Accounting and Reporting in the Extractive Industries", specifically addressing this and other problems relating to accounting for extractive enterprises.

THE STUDY'S "42 ALTERNATIVES" IN 1977

The following table summarizes the current status of the "42 alternatives" tabulated in the Study:

Grady's Issue No.:	1	2	3	·4	5	6	7	8	9	10	11	12
Different Circumstances or Wholly Different Transactions (14)	3	2		2		2				3	1	1
Eliminated (4)			1	1		1				1		
Sole Practice (1)			1									
Not Accounting Method (1)								1				
Immaterial (10)					8				2			
Rare and Disappearing (2)							1	1				
Alternatives (10)							3	3			2	2
Total (42)	3	2	2	3	8	3	4	5	2	4	3	3

In summary, if current accounting principles are applied to the Study's 1965 table, it is apparent that, on an issue by issue basis, only 10 may be alternative practices. Of these, 2 are currently under study by the FASB in its Extractive Industries project, and of the remaining 8, the 6 dealing with depreciation and inventories are accepted for government contract costing purposes by the Cost Accounting Standards Board.

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