

**1994 VALUATION ACTUARY
SYMPOSIUM PROCEEDINGS**

SESSION 6

Luncheon Presentation: FASB: Past, Present and Future

Glen M. Gammill

Robert H. Northcutt

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FASB Past, Present and Future

MR. GLEN M. GAMMILL: Bob Northcutt is a former Vice President and Comptroller of Lockheed Corporation. He was appointed to the Financial Accounting Standards Board effective March 1, 1992. In addition to his previous responsibilities at Lockheed, Bob has served as a member of FASB's Advisory Council, a member of the Financial Executives Institute and its Committee on Corporate Reporting, and served as a member of that committee's SEC Committee. Additionally, Bob's a member of the Board of Advisors to the University of Southern California's School of Accounting.

Bob is also acting as a board liaison to the American Academy of Actuaries. When the American Academy, through its Financial Reporting Steering Committee meets with the board, Bob is the one that helps coordinate and organize that effort. I am pleased to introduce Bob Northcutt.



LUNCHEON PRESENTATION
FASB: Past, Present and Future

MR. ROBERT H. NORTHCUTT: Just who is the FASB anyway? Where does it get its clout? How does its process work? What are we as FASB members up to now? And why should actuaries care?

Since 1973, the FASB has been the designated organization in the private sector for establishing standards of financial reporting and accounting. From its inception, the FASB has been our country's chief accounting rulemaker. The mission of the FASB is to establish and improve standards of financial accounting and reporting, and that includes not only issuing new standards wherever necessary, but also keeping existing standards up-to-date, for example, to reflect changes in the methods of doing business and changes in economic environments. We are the source of GAAP. If you want or need a GAAP opinion on your financial statements, you have to follow our standards. The FASB's rules of procedure require that the FASB follow open decision making in its processes. All its activities, and all its meetings are open for public observation and are announced in advance. We are prohibited from getting together in private and talking about technical issues. In addition, we're charged with trying to be objective in our decision making and to carefully consider the views of our many constituents. Standards should only be issued when the expected benefits exceed the perceived cost, and that's a tricky one. In bringing about changes the FASB is required to try to do so in ways that minimize the disruption to the continuity of reporting practice. These types of guidelines and our overall rules of procedure have been established primarily because the actions of the FASB have an impact on so many organizations, and it's so essential that the FASB's decisions be evenhanded.

One myth about the FASB that some of you may have heard is that we are part of the American Institute of Certified Public Accountants (AICPA). Another myth is that we are an arm of the federal government. In fact, every so often I receive

1994 VALUATION ACTUARY SYMPOSIUM

letters or read news stories where we're referred to as the Federal Accounting Standards Board. Actually we are a private independent organization that is overseen by a board of trustees. The board of trustees, the Financial Accounting Foundation, oversees us. The trustees' role (and there are 16 trustees from our various constituencies) is to appoint board members, to raise the money to fund the operation, and to provide nontechnical oversight. That is, the trustees are prohibited from getting involved in our technical decisions, but they oversee us to make sure we're following our procedures and processes correctly. The foundation does have some staff and provides the administrative activities of accounting and human resources and that kind of thing. In addition they administer quite an extensive publication operation for the FASB.

Under the Financial Accounting Foundation is another organization called the Government Accounting Standards Board (GASB). Both boards are under the foundation and operate in a somewhat similar manner. The GASB is responsible for setting standards for state and local government accounting. Both the FASB and the GASB have advisory committees. The Financial Accounting Standards Advisory Council (FASAC) comprises between 30 and 40 people from diverse parts of our constituency. Its members meet quarterly, and they advise us on technical issues. They provide feedback on what the world's thinking about where we are in various technical matters.

The FASB has essentially what we call five constituent groups. The first is users: investors and creditors. A big focus of our attention is trying to satisfy the needs of users. Second is the preparer group. That's, of course, the companies that must prepare the financial statements. The auditors are third, government regulators are fourth, and fifth is the academic world, instructors in accounting. The users are represented by the Association of Financial Analysts, and the Securities Industrial Association and Robert Morris Associates, which deals with credit grantors. Preparers have representatives, as well. We have a lot of interface with the Financial

LUNCHEON PRESENTATION

Executive Institute's committee that deals with us, the Institute of Management Accountants, various corporations, and we also deal with a lot of associations. We have a lot of liaison activities, among which are those with the American Academy and with the steering committee. We meet annually with that group as a board. Of course, the auditors are represented by the AICPA and state societies. We see the Big Six accounting firms a lot, but we also have many opportunities to talk with the smaller accounting firms, too. The regulators obviously include the SEC, and the instructors or professors of accounting, the American Accounting Association.

Our budget is about \$16 million a year. About one third of that comes from contributions, and the other two thirds, believe it or not, comes from the sale of our publications. We are in the publishing business. Of the contributions, about half comes from the accounting profession and about half from business corporations.

Where does the FASB get its clout? Standards and other pronouncements issued by the FASB are officially recognized as authoritative by both the SEC and the AICPA, but we are not part of either organization. As you know, the SEC does have statutory authority to establish financial accounting and reporting standards for publicly held companies. However, they have historically delegated that operation to the private sector. Prior to the FASB, the AICPA was the major standard setter in the U.S. Its committee on accounting procedure was in operation from 1936 to 1959, and the AICPA issued Accounting Research Bulletins (ARBs). From 1959 to 1973 the AICPA established accounting rules through the Accounting Principles Board (APB) which issued APB opinions. In 1973 the AICPA ceded its standard setting authority to the FASB which made the FASB the chief accounting rulemaker in the U.S.

We hear the view that the FASB actually consists of a bunch of academics who sit around a table and discuss issues on a very esoteric level. Well, I don't think that's quite true. The FASB itself consists of seven members who serve full time and are

1994 VALUATION ACTUARY SYMPOSIUM

required to sever all their ties with organizations they served prior to their appointment. Each FASB member serves one five-year term and is eligible to serve one additional term of five years. While the occupational make-up of the board is intentionally diverse, they each must have a knowledge of accounting, finance, and business and a concern for the public interest in matters of financial accounting and reporting. In addition, none of the board members are allowed to represent the interests of any particular segment of the FASB's constituency. The current FASB is comprised of three individuals from public accounting, two from industry, one academic, and one former securities analyst. We have no direct staff. Our technical staff is organized by major project effort, and there are about 45 people on our technical staff.

How does the process work? Perhaps the most important part in our process is really the agenda decision -- what goes on our technical agenda for us to work on. In order for the FASB to place a project on its agenda, there are four factors that must be considered. First is the pervasiveness of the problem; that is, to what extent is the issue troublesome to users, preparers, auditors, or others and to what extent is there diversity in practice? Second is the likely duration of the problem. For example, is the problem merely transitory or will it persist? Postretirement benefits other than pension or 106 or retiree medical are good examples of things that weren't transitory but would persist because of factors such as rising health care costs, increased longevity, and early retirements.

Third, the FASB also has to consider whether there are alternative solutions. Basically that consideration involves assessing to what extent one or more alternate solutions could be developed that would serve to improve financial reporting in terms of relevance, reliability, and comparability. Another factor we have to consider is whether the solution is technically feasible. In other words, can a technically sound solution be developed or should the project under consideration wait perhaps until another project is completed? Our stock compensation project is a good example.

LUNCHEON PRESENTATION

The FASB first added stock compensation to its agenda in 1984, but decided it needed to resolve some fundamental issues in defining liabilities and equity before it could resolve the accounting for stock compensation. Since the issues were being addressed as part of the FASB's project on financial instruments, the stock compensation project was put on hold pending further progress on the financial instruments project.

A fourth consideration involves assessing the practical consequences of adding a project to the agenda. For example, the FASB has to consider the extent to which an improved accounting solution is likely to be accepted, and it also has to consider the extent to which addressing a particular subject or not addressing it might cause others to act, for example the SEC or Congress. While it's not possible to evaluate all of these factors in precisely the same way and to the same extent in every instance, identifying these factors does help to bring about consistent decisions regarding the FASB's technical agenda.

Agenda decisions are dependent upon advice from a lot of different sources. Those sources generally include all the organizations that comprise our fairly diverse constituency. Contrary to some perceptions, the FASB doesn't need to seek out topics to add to its agenda. This group provides us with quite a few suggestions, and the FASB actually ends up rejecting many more of the proposed topics than it accepts.

Once an agenda decision has been made and an item is added to the FASB's agenda, the first thing that usually is produced is something we call a discussion memorandum. This is a neutral document that identifies the issues involved in the particular project, all the different alternative solutions to each of those issues, and discusses the pros and cons of each alternative. We publish that memorandum, put it out for comments, and we get comments and input. We hold public hearings where we take testimony on the subject, and with that input the FASB begins to

deliberate the issues. The product of that deliberation is what we call an exposure draft, a proposed standard, and the FASB identifies its preliminary or tentative decisions or solutions or selection of each of the different issues and alternatives that were discussed in the discussion memorandum. At this point we get further input, comments, and most of our comments seem to come at this point because, until we've taken a position, people don't seem to get very excited about the issue. At any rate we get comments, hold public hearings again, usually subject our proposal to a field test. With the input from that process we begin to redeliberate on each of the issues before we end up with a final document, a standard.

There are generally four types of documents that emanate from the FASB. One of them is a concept statement. This is where the FASB has deliberated and tried to develop some general notions so that its decisions can be consistent and follow a consistent pattern. These are things like the characteristics and definitions of assets and liabilities and elements of financial statement. Concept statements aren't required to be implemented by anybody or don't require a change. They're just the guidelines that the FASB uses and are commonly referred to as our conceptual framework. Of course, financial standards of accounting, a second kind of document, do become the rules and have to be followed if your statements are prepared in accordance with GAAP. As of today there are 117 of those standards. The FASB also issues interpretations as a third type of document. These clarify, explain, or elaborate on an existing standard or on a pronouncement issued by our predecessors, the APB or ARB, that are still in force. The FASB also publishes technical bulletins. They're actually developed by the staff and are usually an attempt to provide more detailed guidance on an issue. The staff also produces question and answer books for additional guidance as a fourth type of document.

What are we up to now? I promise not to have a technical discussion here, and in the interest of time, I'm just going to briefly catalog some of the things we're dealing with to see if any of them get your attention. Our biggest project is probably one

LUNCHEON PRESENTATION

called financial instruments. Out of these have flown several disclosure standards and certainly one that I know you're familiar with, 115, or accounting for equity securities and marketable debt securities. We have other parts of that project underway: one on hedging and one on securitizations. This seems to be an unending project. There are lots of pieces to it.

Other major projects we have underway are consolidations, that's divided up into consolidation policy (when should a company consolidate its subsidiaries?) and disaggregated disclosures (what unconsolidated information should you provide to the users?) There's a project that's close to issuing a financial standard on asset impairment. This may involve some of you in the valuation side of things. There are projects on mortgage-servicing rights; one I know you're interested in is GAAP for mutuals. We're working on not-for-profit organizations and right now dealing with accounting for investments of not-for-profits. We have an international project on earnings per share. We actually have a project on present value, dealing with when present values should be used in accounting and how they should be used. We talk about things that are probably scary to you like expected values, so you ought to watch us closely on this one.

We have some esoteric projects, one called nuclear decommissioning, dealing with accounting for nuclear power plants where they have to be decommissioned at the end of their useful life at great expense. Of course, the one that has made, at least for us, a lot of press, trial and tribulation is accounting for stock options.

I guess at this point I'll divert to just ask, why should actuaries care about all of this? I started to think of a list. I imagine we create a lot of business for you. Certainly, retiree medical is an example for some of the actuaries, and I'm sure you can think of some others. As a matter of fact, since this is a valuation symposium, I've got a nifty idea. Why don't we turn over valuing employee stock options to this group?

Another reason I think you should care is to protect your turf. We do get into dealing with a lot of things that I think you're interested in. Certainly we're involved in insurance accounting in a number of ways, and certainly things like 115 had an impact on you. You never know. One of these days the question of discounting loss reserves may come up. It's not on the agenda now, so you better watch us.

We're often dealing with the same basic issues, granted from different viewpoints, but the basic issue is measurement in an uncertain environment. We're right there doing the same things. We need your help and your input in the process. Help us to keep from making mistakes. There's a lot of opportunities in that process that I described for input, and we need it and want it. Most of the issues that we both deal with have no clear right answers. They are dilemmas, if you will.