FASB: the People, the Process, and the Politics
5th Edition

Here's a glimpse into this book –

EXCITEMENT — most people don't think accounting can be exciting. Truth is, though, it involves complicated human communication about complex economic conditions and events. Because financial information affects how wealth is accumulated, everyone has a vested interest in accounting's messages and how it is conducted. The politics make it even more exciting.

EXPLANATION — the first three chapters explain why financial reporting exists, why it's regulated, and why FASB was created while also describing how FASB really works. Despite the importance of the Board's output, most people don't know that it doesn't work the way they think it does, much less the way it ought to.

EXPLORATION — the last three chapters take readers deep into FASB's territory, including its conceptual framework, a history of major issues that just won't go away, and the Board's future. The framework is useful but politically compromised, incomplete, and not up to its billing. Those issues remain unresolved because many managers don't seem to realize that telling the truth is essential for satisfying the capital markets' hunger for information. FASB's future is hopeful because it can focus on serving financial statement users like never before.

EXPLOSION — with an analysis not found elsewhere, the final chapter explodes the false myth of the early 21st century that uniform global accounting standards automatically lead to comparability and greater capital market efficiency. Although these benefits were believed to be obvious, they just don't exist. For example, financial reporting is only one of at least ten key factors that must fall into place to create efficiency. Further, many advocates for replacing FASB with IASB were actually promoting their own interest over the public interest. Simply put, the SEC cannot put IASB in charge and, even if it could, that board could not meet its needs.

EXHORTATION — throughout, the authors exhort everyone involved in financial reporting to grasp that the status quo system is inadequate for communicating useful information because of its ineffective practices, such as using cost-based measures, relying on assumptions instead of observations, and reporting quarterly, which is much too infrequent. They cast a vision for progress in which managers and others embrace truth-telling with clarity. While change is always hard, reporting greater quantities of more useful financial information will enrich everyone.

Preface

Some words from the authors

This Fifth Edition of *The FASB: The People, the Process, and the Politics* appears more than a decade and a half after the Fourth Edition was published in 1998. We have produced it in response to various inquiries and our desire to provide a book that will be useful to the many different participants in financial reporting and capital markets in the United States and elsewhere.

Prior editions

The book was first published in 1986 and revisions were released in 1988, 1994, and 1998 with a McGraw Hill-Irwin imprint. It was also translated into Japanese in 1989 by Dr. Haruhiko Takahashi of Tokyo Metropolitan University. Our initial objective was to provide a supplemental resource in both undergraduate and graduate accounting courses. While it was successfully marketed to this segment (FASB Member Dr. Tom Linsmeier used it at the University of Illinois, for example), scholars also frequently cited it in the broader accounting literature and the Financial Accounting Standards Board included it among reading materials for new personnel as part of their orientation.

The current edition

The Fifth Edition uses the same Table of Contents in the sense that it has six chapters covering the same general topics. It would be a mistake, though, to think it is the same book as its most recent predecessor. Because both FASB and we have matured over the intervening years, we have re-examined virtually everything and completely rewritten many sections.

As a specific case, we give a great deal more attention to international accounting standards, which were little more than a curiosity in the late 1990s and hardly mentioned in the Fourth Edition. This new version describes the two boards' convergence efforts and thoroughly analyzes the political implications of the controversial issue that asks whether IFRS should replace GAAP or, to be more direct, whether the IASB should replace FASB.

Running throughout the book are our observations related to the apparent fact that many involved with financial reporting, including preparers, auditors, the media, and even standard setters, embrace a time-honored but deeply flawed paradigm that security prices are directly linked to the contents of published financial statements. We find the most obvious evidence of this paradigm's acceptance in the intense controversies that erupt when FASB proposes new standards to change those contents.

To encourage a future better than the present, we describe a new alternative paradigm that is premised on the observation that investors and creditors readily turn to other sources of information if and when public financial statements don't deliver all they need to know. The main implication of our proposal is that substantial benefits will accrue to all concerned parties when managers decide to provide more of the information that financial statement users need and want. For one, financial statement users who turn to alternative sources incur additional high costs for gathering and processing the additional information. This information is often inferior because it comes from secondary (or tertiary) sources that have significant reliability limitations. As a result, users still face substantial risks that compel them to demand higher rates of return as compensation. Of course, if managers were to share greater amounts of more useful information with users, they would incur additional preparation costs. However, by doing so, they would reduce those users' uncertainty and go on to reap huge benefits in the form of lower capital costs (the obverse of investors' rates of return) and higher valuations for their equity and debt securities. In addition, society as a whole would benefit from less friction and greater efficiency in the capital markets and the economy as a whole.

Because the majority of our revisions are in the final three chapters, we now turn to describing more specifically what we have done with them.

In Chapter 4 on FASB's conceptual framework project, we added new material because the Board has issued two new concepts statements since 1998. In addition, we provided new insights that have come clear to us as time has passed. The chapter now describes not only the framework's structure and contributions but also what we see to be its significant limitations, especially with regard to its incomplete guidance for measuring assets, liabilities, and income. We also elaborate on the asset/liability theory that served as the initial basis for FASB's framework.

In Chapter 5, we enhanced the discussion and analysis of recurring accounting controversies to incorporate events and developments that have occurred since the Fourth Edition. While the chapter follows the same general outline, its contents now include more in-depth conceptual analysis and expanded discussions of measurement issues triggered by the Board's 30-year-old political choice to not resolve the pivotal relevant attribute question in *Statement of Financial Accounting Concepts No. 5* on recognition and measurement. That unmade decision continues to negatively affect virtually every project FASB has addressed since then.

Chapter 6 is completely different from the Fourth Edition because it addresses FASB's new future that starts now. One new feature is our opening analysis of the Board's first forty years, focusing on key political events that impacted its independence from the people and organizations it is charged with regulating. We identify five phases, starting with the time in which FASB operated under the auditing profession's umbrella. Those relatively few formative years were then followed by more than two decades in which many vocal members of the preparer constituency frequently criticized essentially everything it did. Indeed, some of them actually tried to usurp control over such things as board member appointments, the agenda, the due process, and even the staff. We also describe in detail how Securities and Exchange Commission Chairmen David Ruder and Arthur Levitt protected FASB during this era. The third phase began when Congress enacted the Sarbanes-Oxley legislation in July 2002. Specifically, it required the SEC to formally designate an agency (obviously intended to be FASB) as the source of authoritative accounting standards and then imposed an "accounting support fee" on public companies in order to eliminate the Board's financial dependence on corporate contributions. This phase ended very prematurely only 50 days later when FASB and the IASB signed the Norwalk Agreement that bound them to cooperatively converge existing and new standards.

Unfortunately, this arrangement put the Board back into the position of having to develop new consensuses with the IASB that did then and still does depend on contributions from U.S. corporations and accounting firms. Although cooperation between the boards and progress initially marked this fourth phase, both seemed to diminish when many, including SEC Chairman Christopher Cox and IASB Chairmen David Tweedie, advocated for replacing U.S. GAAP with International Financial Reporting Standards, a move that would surely lead to replacing FASB with the IASB. Chapter 6 explains not only why those replacements didn't occur but also why they weren't very good ideas in the first place. In our view, this challenging phase finally ended in 2014.

Thus, we believe FASB is now in its fifth phase in which it is finally and truly independent. Among other points, the chapter discusses the Board's current efforts to shape financial statements issued by private companies, an activity that the IASB would not have been as strongly inclined to do if it had replaced FASB. We conclude the chapter, and the book, with a list of thirty questions about financial reporting that we believe the Board needs to answer as it moves ahead.

On the whole

To help readers understand what they will encounter in this book, we consider ourselves to be among the most ardent and vocal supporters of FASB, its people, and its results. However, we also reckon this status entitles us to be ardent and vocal critics as well, especially when we see what else it can do to come closer to completing its crucial high mission of making the capital markets more efficient by promoting the availability of greater amounts of more useful information.

As we believed in the beginning with the First Edition in 1986, so we still believe that accomplishing this mission involves the Board's talented and dedicated PEOPLE using its due PROCESS in an environment laden with POLITICS that produces immense challenges, mountains of frustration, and slow but sure progress. It's unlikely we will be around to observe firsthand but we fervently hope FASB is still leading the way with many more significant accomplishments after its next four decades.

Acknowledgements

We are indebted to many people and organizations for their help and assistance in publishing this book.

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We especially acknowledge FAF Chief Executive Officer and President Teresa (Teri) Polley for her initial encouragement and for mobilizing the resources of the Foundation and the Board to help bring it about.

Next on the list for our thanks are the Board and staff members of FASB for their cooperation in submitting to interviews and countless questions as they updated us on what had changed since 1998. We extend a very special thanks to those who gave our first manuscript a very intense and thorough review. To be clear, any errors in this work are strictly our responsibility.

We also want to express deep appreciation to all the people at the Foundation and the Board for their seemingly inexhaustible personal commitments to serving the public interest in having better informed and therefore more efficient capital markets, not just in the United States but around the globe. For many of them, their time at the FAF and FASB interrupts a very promising career in the public or private accounting professions. On the other hand, we know from our own past experiences on the Board's staff that they are developing in many ways that will pay future dividends. We also understand firsthand that working at the Board brings extreme challenge, excitement, satisfaction, and frustration, along with no small amount of accounting fun.

We extend our gratitude to Dr. Julie Suh, Assistant Clinical Professor of Accounting at the University of Southern California for using our manuscript in her Accounting Theory class.

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Last, but most importantly, we thank our families for putting up with grumpiness and more than occasional inattention to various responsibilities around the house as we once again plunged into the obsessive activity of producing yet another book.