Testimony of Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
Before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises of the Committee on Financial Services
May 14, 2002

Full Text of Testimony

Chairman Baker, Ranking Member Kanjorski, and Members of the Subcommittee:

I am pleased to appear before you today on behalf of the Financial Accounting Standards Board ("FASB" or "Board"). My testimony includes a brief overview of the FASB and our structure and process, a summary of the significant activities that the Board has completed over the past year, and a summary of some of the Board's current projects. My testimony includes a summary of the FASB's responses to the report of the American Institute of Certified Public Accountant's ("AICPA") Special Committee on Financial Reporting. My testimony also includes a brief discussion of Enron Corp.'s ("Enron") failure to comply with existing accounting requirements. Finally, my testimony concludes with some brief comments about the "credibility GAAP."

What Is the FASB, What Does It Do, and What Has It Done Lately?

The FASB is an independent private-sector organization. We are not part of the federal government and receive no federal funding. Our independence from enterprises, auditors, and the federal government is fundamental to achieving our mission—to establish and improve standards of financial accounting and reporting for both public and private enterprises. Those standards are essential to the efficient functioning of the markets because investors, creditors, and other consumers of financial reports rely heavily on credible, transparent, and comparable financial information.

The FASB's authority with respect to public enterprises comes from the US Securities and Exchange Commission ("SEC"). The SEC has the statutory authority to establish financial accounting and reporting standards for publicly held enterprises. For more than

60 years, the SEC has looked to the private sector for leadership in establishing and improving those standards.

The FASB's standards govern only the information contained in enterprises' financial reports—financial statements and accompanying notes. Those reports are only one element of the broader universe of information provided by enterprises to the public. Other important information for consumers includes management's discussion and analysis, information provided in an enterprise's annual report, presentations to analysts, fact books, and information provided on an enterprise's website.

The FASB has no power to enforce its standards. Responsibility for ensuring that financial reports comply with the FASB's standards rests with the officers and directors of an enterprise, the auditors of the statements, and for public enterprises, ultimately with the SEC. Generally, when an enterprise restates its financial reports, it publicly acknowledges that it has failed to comply with existing accounting standards.

The FASB also has no authority or responsibility with respect to auditing, including the independence of auditors and the scope of services of auditors. Rather, our responsibility relates solely to establishing financial accounting and reporting standards.

The focus of the FASB is on consumers—users of financial reports, such as investors, creditors, and others. We attempt to ensure that financial reports give consumers an informative picture of an enterprise's financial condition and activities and do not color the image to influence behavior in any particular direction.

The US capital markets continue to be the deepest, most liquid, and most efficient markets in the world. The unparalleled success and competitive advantage of the US capital markets are due, in no small part, to the high-quality and continually improving US financial accounting and reporting standards. As Federal Reserve System Chairman Alan Greenspan stated:

> Transparent accounting plays an important role in maintaining the vibrancy of our financial markets. . . . An integral part of this process involves the Financial Accounting Standards Board (FASB) working directly with its constituents to develop appropriate accounting standards that reflect the needs of the marketplace.[1]

The FASB has been very active this past year issuing standards and other accounting literature and information to improve the relevance and transparency of financial reports. The Board issued the following standards since June 2001:

- A standard that improves the transparency of business combinations[2]

- A standard that improves the transparency of purchased goodwill and intangible assets[3]

[1] Letter from Federal Reserve System Chairman Alan Greenspan to SEC Chairman Arthur Levitt (June 4, 1998).
[2] See FASB Statement No. 141, *Business Combinations* (June 2001).
[3] See FASB Statement No. 142, *Goodwill and Other Intangible Assets* (June 2001).

- A standard that improves the transparency of asset retirement obligations[4]

- A standard that improves the transparency of impairment or disposal of long-lived assets[5]

- A standard that updates, clarifies, and simplifies several existing accounting requirements.[6]

Other accounting literature and information issued the past year include:

- A video to assist the public in understanding the importance of financial reporting to the US capital markets and to individual investment decisions[7]

- A report that identifies redundancies between generally accepted accounting principles ("GAAP") and SEC disclosure requirements and ways to eliminate them (see below the discussion, "How Has the FASB Responded to the Report of the AICPA's Special Committee on Financial Reporting?")[8]

- A report that encourages enterprises to continue improving their business reporting and to experiment with the types of information disclosed and the manner by which it

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[4] See FASB Statement No. 143, *Accounting for Asset Retirement Obligations* (June 2001).
[5] See FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (August 2001).
[6] See FASB Statement No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections* (April 2002).
[7] See *FASB Presents Financially Correct with Ben Stein* (2001).
[8] See Business Reporting Research Project, Steering Committee Report, *GAAP-SEC Disclosure Requirements* (2001).

is disclosed (see below the discussion, "How Has the FASB Responded to the Report of the AICPA's Special Committee on Financial Reporting?")[9]

- A report that examines the impact of the "new economy" on business and financial reporting.[10]

What Is the Financial Accounting Foundation ("FAF"), and What Is the FAF's Relationship to the FASB?

The FASB is an operating unit of the Financial Accounting Foundation ("FAF"). The FAF is a not-for-profit foundation that was incorporated in 1973 to operate exclusively for charitable, educational, scientific, and literary purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code.

The FAF is separate from all other organizations. Its 16-member Board of Trustees is composed of prominent individuals with a broad range of backgrounds. Each of them shares a common understanding of the importance of independent private-sector accounting standard setting to the efficiency of the US capital markets.[11]

The FAF Trustees have several important responsibilities with respect to the FASB.

[9] See Business Reporting Research Project, Steering Committee Report, *Improving Business Reporting: Insights into Enhancing Voluntary Disclosures* (2001).
[10] See FASB Special Report, *Business and Financial Reporting, Challenges from the New Economy* (April 2001).
[11] See Attachment 1 for a list of the current FAF Trustees.

Those responsibilities include:

1. Oversight of the FASB's process to ensure that the FASB is fulfilling its stated mission (see below the discussion, "What Process Does the FASB Follow in Developing Accounting Standards?")

2. Selection of the FASB Board members

3. Arranging for the financing of the FASB.

FAF Trustees select the FASB Board members based on their technical expertise in financial accounting and reporting. Board members, however, have diverse backgrounds. Of the seven current members of the Board, three are from the accounting profession, two from the business community, one from the analyst community, and one from the academic community.

Each of the Board members is a full-time employee of the FAF and is required to be independent of all other business and professional organizations. Thus, upon joining the FASB, Board members are required to sever all financial ties with former employers. Board members can serve no more than two full five-year terms.

Approximately two-thirds ($15 million in 2001) of the FASB's financing results from the public sale and licensing of the FASB's publications. The remaining one-third ($6 million in 2001) results from the fundraising efforts of the FAF Trustees who solicit donations from a broad range of consumers, preparers, and auditors of financial reports.

To ensure the independence and objectivity of the FASB, the Board members are prohibited from participating in the FAF Trustee's fundraising efforts, and the FAF Trustees are prohibited from participating in the Board members' technical decisions on establishing and improving accounting standards.

What Process Does the FASB Follow in Developing Accounting Standards?

Because the actions of the FASB affect so many organizations and are so important to the efficient functioning of the US capital markets, its decision-making process must be open and thorough. An open and thorough process is essential to ensuring the credibility and quality of the resulting standards. An open and thorough process also reduces the possibility that standards will create unintended consequences inconsistent with transparent financial reporting.

Our Rules of Procedure require an extensive and public due process that is broader and more open in several ways than the Federal Administrative Procedure Act, on which it was modeled. The FASB process involves public meetings, public hearings, field tests, and exposure of our proposed standards to external scrutiny and public comment. The Board makes final decisions only after carefully considering and understanding the views of all parties, including consumers, preparers, and auditors of financial information.

The FASB and the FAF, in consultation with the Board's constituents, periodically review the FASB's due process to ensure that the process is working efficiently and effectively. Beginning in January of this year, in response to constituent requests, including requests from our Financial Accounting Standards Advisory Council,[12] the FAF and FASB have undertaken several actions to improve the Board's due process procedures, as well as improve the ease of access to our standards and related accounting literature, reduce the complexity of our standards, and modernize financial accounting and reporting. Those actions include the following:

- Reducing the Board voting requirement from a 5-to-2 supermajority to a 4-to-3 majority to make the process more efficient without compromising the quality of the FASB's standard-setting process.

- Reorganizing the FASB's research and technical activities staff by reallocating the staff functions across three distinct areas versus one that had been in place previously. The reorganization is designed to address increasing demands on staff and other resources of the FASB.

- Implementing an improved approach to determining what new major topics should be added to the FASB's technical agenda. That approach involves issuing a proposal for public comment before the Board decides whether to add a particular project to its agenda. The proposal discusses the problem to be addressed (that is, the reason for the project), the proposed scope, relationship to the conceptual framework and relevant research, the main issues and alternatives the Board expects to consider, and how practice might be affected. The proposal also explicitly reviews the Board's agenda decision criteria.[13] The Board believes this improved approach provides

[12] See Attachment 2 for information about the Financial Accounting Standards Advisory Council.
[13] See Attachment 1 for information about the Board's agenda criteria.

additional discipline to the Board's project management capabilities, particularly in the area of defining and refining the scope of a new agenda project. Scope expansion during the life of a project has sometimes been a significant impediment to the timeliness of the Board's standard setting.

- Implementing a more rigorous project planning and management process, which requires the establishment of clear project milestones and plans for meeting them, resource budgets, and status reporting in terms of previously established milestones.

- Working with the Emerging Issues Task Force ("EITF"),[14] the AICPA, and the SEC to more clearly define and coordinate their accounting-standard-setting roles with those of the FASB with an eye toward streamlining certain activities.

- Making it easier for constituents to find all of the appropriate accounting requirements for a particular topic by including references to all applicable US accounting literature in the FASB's future standards and in the FASB's *Current Text,* a compilation of all FASB accounting standards categorized by subject. In addition, the FASB is seeking to partner with others in developing an online database that will include all of the US accounting literature.

- Reducing the complexity of accounting literature by (1) seeking to determine if the FASB can issue standards that are less detailed and have few, if any, exceptions or alternatives and (2) more actively engaging FASB constituents in discussions about the cost-benefit relationship of proposed standards.

[14] See Attachment 1 for information about the EITF.

- Working with the SEC in its initiative to modernize financial reporting and disclosure.

What Are the Board's Current Projects to Improve the Relevance and the Transparency of Financial Reports?

The FASB has 18 current agenda projects (and 1 proposed agenda project) designed to improve the relevance and transparency of financial reports.[15] A brief description of four of the more significant of those projects (and the proposed project) follows:

Interpretative Guidance on Consolidation of Special-Purpose Entities

As evidenced by Enron, transactions involving special-purpose entities ("SPEs") are becoming increasingly prevalent and complex. The complexity of their structure makes it difficult to determine if another enterprise has a controlling financial interest in the SPEs that would result, under existing accounting requirements, in that other enterprise consolidating (reporting the assets and liabilities of) the SPEs. Preparers of financial reports, their auditors, and analysts and other users of financial reports have indicated that additional guidance is needed for determining when SPEs should be consolidated by another enterprise.

Since November 2001, the Board has been working with constituents to develop, at public meetings, interpretative guidance that would require that many nonsubstantive SPEs that are currently not consolidated, be consolidated by the enterprise they support. The interpretative guidance would result in a more representationally faithful depiction of enterprises' assets and liabilities.

[15] See Attachment 3 for a list and detailed description of the FASB's agenda projects.

The Board plans to issue proposed interpretative guidance before the end of June.

Interpretative Guidance on Guarantees

The FASB has observed that there are differing practices about the need for disclosures by enterprises that guarantee the debt and other obligations of SPEs and other enterprises. The FASB has also observed that there are differing practices about the need for the guarantor enterprise to recognize an initial liability for its obligation under the guarantee.

Since February 2002, the Board has been working with constituents to develop, at public meetings, interpretative guidance that would require that enterprises recognize a liability at fair value for the obligations they undertake when issuing a guarantee and that they provide additional disclosures about the guarantee. The interpretative guidance would result in a more representationally faithful depiction of enterprises' assets and liabilities and improved transparency of enterprises' obligations and liquidity risks related to guarantees issued.

The Board plans to issue proposed interpretative guidance within the next 30 days.

Disclosures about Intangible Assets

For many enterprises, the amounts of intangible assets reflected in their financial reports are very small. In a recent article in *Financial Executive* (March/April 2002, p. 35), a prominent researcher indicated that ". . . in the late 1990s, the annual U.S. investment in intangible assets—R&D, business processes and software, brand enhancement, employee training, etc.—was roughly $1.0 trillion, almost equal to the $1.2 trillion total investment of the manufacturing sector in physical assets. Further, intangible capital currently constitutes between one-half and two-thirds of corporate market value. . . ." The FASB has observed that there is very little information—quantitative or qualitative—about those intangible assets in financial reports.

In January 2002, the Board added a project to its agenda to expand the disclosures required about intangible assets. The FASB Board and staff are currently gathering additional information from constituents to determine, at public meetings, what qualitative and quantitative disclosures about intangible assets would be most relevant for consumers.

The Board plans to issue a proposed standard in the fourth quarter of this year.

Financial Performance Reporting by Business Enterprises

The FASB has observed that increased reporting of numerous and inconsistent alternative (pro forma) financial measures has heightened investor confusion and has raised significant questions about the credibility of financial reporting.

In October 2001, the Board added a project to its agenda to (1) improve the quality of information displayed in financial reports so that consumers can better evaluate an enterprise's financial performance and (2) ascertain that sufficient information is contained in the financial reports to permit calculation of key financial measures used by investors and creditors.

Since adding the project to the Board's agenda, the Board and its staff have conducted a series of interviews with 56 individuals who use financial reports—investors, creditors, and their advisors (equity and credit analysts)—to assist the FASB in identifying key financial measures that they use in evaluating the performance of an enterprise. A summary of the findings resulting from those interviews is available on the FASB website. The FASB has discussed the results of the user interviews with its project task force of constituents.

The Board has begun its public discussions of the project issues and plans to issue a proposed standard next year.

Liabilities and Revenues

The FASB has observed that enterprises and auditors have continually received and raised questions about revenue (and related liability) recognition issues. In addition, recent studies on financial reporting indicate that revenue recognition is the largest category of fraudulent financial reporting and restatements of financial reports.

In January 2002, the Board issued a proposal on a potential major project on the recognition of liabilities and revenues in financial reports. The Board has received approximately 30 comment letters from constituents in response to the proposal. The Board plans to discuss those comments at a public meeting on May 15 and determine whether a project on liabilities and revenues should be added to the Board's agenda.

How Has the FASB Responded to the Report of the AICPA's Special Committee on Financial Reporting?

In 1991, the AICPA formed a Special Committee on Financial Reporting ("Special Committee"), which I chaired, to address questions about the relevance and usefulness of "business reporting."[16] The Special Committee's 1994 report ("AICPA Report") contained 20 recommendations to the AICPA, the auditing profession, lawmakers, regulators, and standard setters.[17] Six of those recommendations were directed at financial statements and related disclosures.[18]

Responding to the AICPA Report, in February 1996, the FASB issued an Invitation to Comment, *Recommendations of the AICPA Special Committee on Financial Reporting and the Association for Investment Management and Research,* to solicit views on the Special Committee's recommendations made to standard setters and the recommendations contained in a similar paper published by the Association for Investment Management and Research.[19] Issue 1 of the Invitation to Comment asked: "Should the FASB broaden its activities beyond financial statements and related

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[16] Business reporting was defined broadly to include "the information a company provides to help users with capital-allocation decisions about a company. It includes a number of different elements, with financial statements as one of those elements." See AICPA, *Improving Business Reporting—A Customer Focus* (1994), page 2.
[17] Ibid., pages 121–127.
[18] Ibid., pages 123-124. See Attachment 4 for a list of the recommendations.
[19] Association for Investment Management and Research, *Financial Reporting in the 1990s and Beyond* (1993).

disclosures to also address the types of nonfinancial information that would be included in a comprehensive business reporting model?"

Overall, respondents had mixed views about the Board's involvement with nonfinancial information. Some respondents opposed FASB standard setting for the disclosure of nonfinancial information. Other respondents suggested that the Board be selective and initially limit its efforts to focusing on operating data and performance measures and reasons for changes in such data and key trends. Others suggested that the Board take a primary leadership role in developing a comprehensive business-reporting model similar to the one developed by the Special Committee.

At a public Board meeting on January 29, 1998, the Board decided, as a first step, to undertake a research project on business reporting. The Board formed a Steering Committee to conduct the project and instructed the Steering Committee to:

- Study present practices for the voluntary disclosure of certain types of business information that users of business reporting might find helpful in making investment decisions.

- Develop recommendations for ways to coordinate GAAP and SEC disclosure requirements and to reduce redundancies.

- Study present systems for the electronic delivery of business information and consider the implications of technology for business reporting in the future.

The work of the Steering Committee resulted in a three-volume research report.[20] The first volume, issued in 2000, identifies present practices for the electronic distribution of business information. Among the report's highlights is identification of:

- Leading-edge technologies as well as core features of corporate web sites;
- Divergent corporate strategic objectives and uses of the Internet;
- Notable present practices in terms of content and presentation; and
- Legal issues and questions related to website practices.

The second volume, issued in 2001, identifies redundancies between GAAP and SEC disclosure requirements and ways to eliminate them. The report also includes observations that the SEC is encouraged to consider in future rule-making activities.

The third volume, also issued in 2001, identifies extensive voluntary disclosures that many leading enterprises are making and provides findings and recommendations on how enterprises can better describe and explain their investment potential to investors. The report *encourages* enterprises to continue improving their business reporting and to experiment with the types of information disclosed and the manner by which it is disclosed.

In addition to the three-volume research report, the FASB has issued a number of standards, proposals, and other documents (and is actively working on some current projects) that are responsive, in whole or in part, to the specific recommendations on

[20] The entire three-volume research report is available, at no cost, on the FASB website.

financial statements and related disclosures contained in the AICPA Report. Attachment 4 to this testimony contains a listing of those recommendations and the relevant FASB responses.

Did Enron's Financial Statements Comply with Existing GAAP?

Enron publicly acknowledged in its November 8, 2001, Form 8-K and November 19, 2001, Form 10-Q filings with the SEC that it had failed to comply with existing accounting requirements in at least two areas. First, Enron indicated that with respect to four SPEs that it created during 2000, it issued Enron common stock to the SPEs in exchange for notes receivable from the SPEs. At the time, Enron reported an increase in assets and shareholder's equity to reflect those transactions. Longstanding accounting requirements, however, provide that notes receivable arising from transactions involving an entity's own capital stock are generally required to be reported as deductions from stockholders' equity and not as assets.[21]

As a result of this error, Enron indicated that it had overstated both total assets and shareholders' equity in its financial statements for the second and third quarters of 2000, and its annual financial statements for 2000, by $172 million. It also indicated that it had overstated both total assets and shareholders' equity in its financial statements for the first and second quarters of 2001 by $1.0 billion.

Second, Enron indicated that the assets, liabilities, gains, and losses of three previously unconsolidated SPEs should have been included in Enron's financial statements under existing accounting requirements. As a result of that error, Enron indicated that it had overstated reported net income by approximately $96 million in 1997, $113 million in 1998, $250 million in 1999, and $132 million in 2000. It also indicated that it had understated net income by $17 million and $5 million in the first and second quarters of 2001, respectively, and overstated net income by $17 million in the third quarter of 2001. Finally, Enron indicated that as a result of this error, it also had understated debt (or liabilities) by approximately $711 million in 1997, $561 million in 1998, $685 million in 1999, and $628 million in 2000.

In commenting on Enron's restatements in testimony before Congress, former SEC Chief Accountant Lynn Turner stated:

> New accounting rules were not needed to prevent the restatements of Enron's financial statements or improve the quality of some of its disclosures. Compliance with and enforcement of the accounting rules that have been on the books for years would have given investors a timely and more transparent picture of the trouble the company was in.[22]

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[21] See EITF Issue No. 85-1, "Classifying Notes Received for Capital Stock," and SEC Staff Accounting Bulletin No. 40, Topic 4-E, *Receivables from Sale of Stock*.
[22] Written statement by Lynn Turner in testimony before the Committee on Governmental Affairs, United States Senate (January 24, 2002), page 3.

In February 2002, a committee of three outside members of Enron's own board of directors filed a public report ("Powers Report") that stated that its investigation "identified significant problems beyond those Enron has already disclosed."[23]

Those further problems included entering into transactions that Enron

> could not, or would not, do with unrelated commercial entities. Many of the most significant transactions apparently were designed to accomplish favorable financial statement results, not to achieve *bona fide* economic objectives or to transfer risk. Some transactions were designed so that, had they followed applicable accounting rules, Enron could have kept assets and liabilities (especially debt) off its balance sheet; but the transactions did not follow those rules.[24]

The Powers Report suggests that "other transactions" resulted in "Enron reporting earnings from the third quarter of 2000 through the third quarter of 2001 that were almost $1 billion higher than should have been reported."[25]

The Powers Report also states that Enron's disclosures about its transactions with the partnerships were "obtuse, did not communicate the essence of the transactions

[23] William C. Powers, Jr., Chair, Raymond S. Troubh, and Herbert S. Winokur, Jr., Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp. (February 1, 2002), page 3.
[24] Ibid., page 4.
[25] Ibid.

completely or clearly, and failed to convey the substance of what was going on between Enron and the partnerships."[26]

More recently, Enron publicly acknowledged in its April 22, 2002, Form 8-K with the SEC that it may have failed to comply with existing accounting requirements relating to the "valuations of several assets the historical carrying value of which current management believes may have been overstated due to possible accounting errors or irregularities."[27] The 8-K indicates that the amount of the overstatement may be in the billions of dollars.

In addition, at the ongoing trial of Andersen in Houston, Texas, two partners from Andersen's professional standards group testified on May 9, 2002, that "seriously flawed accounting methods and misleading documentation [was] prepared by the Enron team to justify the accounting."[28] They also testified that the Enron audit team "disregarded and misrepresented" the professional standards group's advice about the appropriate accounting required.[29]

Conclusion

The title of this hearing "Corporate Accounting Practices: Is There a Credibility GAAP?" might be read to imply that GAAP is the main contributor to what many perceive to be the growing lack of credibility of corporate financial reports. I strongly disagree. US GAAP, when properly applied, produces the most transparent financial

[26] Ibid., page 17. See Attachment 5 for additional excerpts from the Powers Report on Enron's failure to follow existing accounting requirements.
[27] Enron Corp., Form 8-K (April 22, 2002), page 2.
[28] Susan Schmidt, "Tensions Flare at Trial of Andersen: Enron Auditors Said to Have Ignored Advice," *The Washington Post* (May 10, 2002), page E4.

reports in the world—financial reports that are an essential element of an efficient capital market.

Should US GAAP be improved? Without question. As part of the Board's ongoing process, the FASB is actively working with our constituents, including the SEC, to continue to make necessary improvements to GAAP. In addition, the FASB (and the FAF) is reviewing and modifying our due process procedures and taking other steps to improve the efficiency and effectiveness of the standard-setting process. Those actions are described in detail above.

In my opinion, the most efficient and effective accounting standard setter imaginable, and the highest quality accounting standards conceivable, could not have prevented the Enron bankruptcy, could not have prevented the many corporate restatements of recent years, and could not alone improve the credibility of financial reports. (Remember, restatements, including Enron's restatements, bring financial statements into compliance with existing accounting standards.)

By working together, standard setters, reporting enterprises, auditors, and regulators share the responsibility of supporting a credible and transparent financial reporting system. Each party must carry out its responsibilities in the public interest.

Reporting enterprises seeking to access the capital markets for financing are responsible for preparing the financial reports and presenting those reports to investors. Those enterprises must apply GAAP in a way that is faithful to the intent of the standards. Unfortunately, the far too common practice of seeking loopholes to find ways around the

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[29] Ibid., page E1.

intent of the standards obfuscates reporting and does not result in a transparent and true reflection of the economics of the underlying transactions. That practice must end.

Auditors examine the financial reports of enterprises to determine that GAAP has been fairly applied. Auditors also must assure that the stated intent of the standards are followed and not accept facile arguments that the reporting is acceptable because the standard does not explicitly say that the reporting is unacceptable. Auditors have primary responsibility to the public, since investors and other users do not have the same access to the underlying facts about enterprises' operations and transactions. Auditors must end the practice of accepting "show me where it says I can't do this" accounting.

Finally, regulators, principally the SEC, are responsible for protecting the investor. Through their oversight and enforcement activities, regulators ensure that enterprises report their financial information based on GAAP and that auditors are independent and examine financial statements using accepted auditing standards. The SEC must have the resources it needs to fulfill that important role.

Thank you, Mr. Chairman. I very much appreciate this opportunity, and I would be pleased to respond to any questions.

Facts about FASB 2002

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Since 1973, the Financial Accounting Standards Board (FASB) has been the designated organization in the private sector for establishing standards of financial accounting and reporting. Those standards govern the preparation of financial reports. They are officially recognized as authoritative by the Securities and Exchange Commission (Financial Reporting Release No. 1, Section 101) and the American Institute of Certified Public Accountants (Rule 203, Rules of Professional Conduct, as amended May 1973 and May 1979). Such standards are essential to the efficient functioning of the economy because investors, creditors, auditors and others rely on credible, transparent and comparable financial information.

The Securities and Exchange Commission (SEC) has statutory authority to establish financial accounting and reporting standards for publicly held companies under the Securities Exchange Act of 1934. Throughout its history, however, the Commission's policy has been to rely on the private sector for this function to the extent that the private sector demonstrates ability to fulfill the responsibility in the public interest.

THE MISSION OF THE FINANCIAL ACCOUNTING STANDARDS BOARD (FASB)

The mission of the Financial Accounting Standards Board (FASB) is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors and users of financial information.

Accounting standards are essential to the efficient functioning of the economy because decisions about the allocation of resources rely heavily on credible, concise, transparent and understandable financial information. Financial information about the operations and financial position of individual entities also is used by the public in making various other kinds of decisions.

To accomplish its mission, the FASB acts to:

- Improve the usefulness of financial reporting by focusing on the primary characteristics of relevance and reliability and on the qualities of comparability and consistency;

- Keep standards current to reflect changes in methods of doing business and changes in the economic environment;

- Consider promptly any significant areas of deficiency in financial reporting that might be improved through the standard-setting process;

- Promote the international convergence of accounting standards concurrent with improving the quality of financial reporting; and

- Improve the common understanding of the nature and purposes of information contained in financial reports.

The FASB develops broad accounting concepts as well as standards for financial reporting. It also provides guidance on implementation of standards. Concepts are useful in guiding the Board in establishing standards and in providing a frame of reference, or conceptual framework, for resolving accounting issues. The framework will help to establish reasonable bounds for judgment in preparing financial information and to increase understanding of, and confidence in, financial information on the part of users of financial reports. It also will help the public to understand the nature and limitations of information supplied by financial reporting.

The Board's work on both concepts and standards is based on research aimed at gaining new insights and ideas. Research is conducted by the FASB staff and others, including foreign national and international accounting standard-setting bodies. The Board's activities are open to public participation and observation under the "due process" mandated by formal Rules of Procedure. The FASB actively solicits the views of its various constituencies on accounting issues.

The Board follows certain precepts in the conduct of its activities. They are:

 To be objective in its decision making and to ensure, insofar as possible, the neutrality of information resulting from its standards. To be neutral, information must report economic activity as faithfully as possible without coloring the image it communicates for the purpose of influencing behavior in any particular direction.

 To weigh carefully the views of its constituents in developing concepts and standards. However, the ultimate determinant of concepts and standards must be the Board's judgment, based on research, public input and careful deliberation about the usefulness of the resulting information.

 To promulgate standards only when the expected benefits exceed the perceived costs. While reliable quantitative cost-benefit calculations are seldom possible, the Board strives to determine that a proposed standard will meet a significant need and that the costs it imposes, compared with possible alternatives, are justified in relation to the overall benefits.

 To bring about needed changes in ways that minimize disruption to the continuity of reporting practice. Reasonable effective dates and transition provisions are established when new standards are introduced. The Board considers it desirable that change be evolutionary to the extent that it can be accommodated by the need for relevance, reliability, comparability and consistency.

 To review the effects of past decisions and interpret, amend or replace standards in a timely fashion when such action is indicated.

The FASB is committed to following an open, orderly process for standard setting that precludes placing any particular interest above the interests of the many who rely on financial information. The Board believes that this broad public interest is best served by developing neutral standards that result in accounting for similar transactions and circumstances in a like manner and different transactions and circumstances should be accounted for in a different manner.

AN INDEPENDENT STRUCTURE

Financial Accounting Standards Board (FASB)

The FASB is part of a structure that is independent of all other business and professional organizations. Before the present structure was created, financial accounting and reporting standards were established first by the Committee on Accounting Procedure of the American Institute of Certified Public Accountants (1936–59) and then by the Accounting Principles Board, also a part of the AICPA (1959–73). Pronouncements of those predecessor bodies remain in force unless amended or superseded by the FASB.

Financial Accounting Standards Advisory Council (FASAC)

The Financial Accounting Standards Advisory Council (FASAC) has responsibility for consulting with the FASB as to technical issues on the Board's agenda, project priorities, matters likely to require the attention of the FASB, selection and organization of task forces and such other matters as may be requested by the FASB or its Chairman. At present, the Council has more than 30 members who are broadly representative of preparers, auditors and users of financial information.

Financial Accounting Foundation (FAF)

The Financial Accounting Foundation (FAF), which was incorporated to operate exclusively for charitable, educational, scientific and literary purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code, is responsible for selecting the members of the FASB and its advisory council, funding their activities and for exercising general oversight with the exception of the FASB's resolution of technical issues.

In 1984, the Foundation established a Governmental Accounting Standards Board (GASB) to set standards of financial accounting and reporting for state and local governmental units. As with the FASB, the Foundation is responsible for selecting its members, funding and exercising general oversight. The Foundation also receives contributions and approves the FASB budget. More than half the funds contributed are from the public accounting profession, with the remainder coming from industry and the financial community.

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

- American Accounting Association
- American Institute of Certified Public Accountants
- Association for Investment Management and Research
- Financial Executives International
- Government Finance Officers Association

- Institute of Management Accountants
- National Association of State Auditors, Comptrollers and Treasurers
- Securities Industry Association

The members of the FAF Board of Trustees include:

- Manuel H. Johnson (Chairman of the Board and President, FAF), Co-Chairman, Johnson Smick International,
- Stephen C. Patrick (Vice President , FAF), Chief Financial Officer, Colgate-Palmolive Company,
- Judith H. O'Dell (Secretary and Treasurer, FAF), Managing Shareholder, Beucler, Kelly & Irwin, Ltd.,
- John J. Brennan, Chairman and Chief Executive Officer, The Vanguard Group, Inc.,
- Samuel A. DiPiazza, Jr., Chief Executive Officer, PricewaterhouseCoopers,
- Douglas R. Ellsworth, Director of Finance, Village of Mount Prospect, Illinois,
- Peter C. Goldmark, Jr., Chairman and Chief Executive Officer, International Herald Tribune,
- William H. Hansell, Executive Director, International City/County Management Association,
- Richard D. Johnson, Auditor of State, Iowa,
- Duncan M. McFarland, President, Chief Executive Officer and Managing Partner, Wellington Management Company,
- Frank C. Minter, Retired Vice President and Chief Financial Officer, AT&T International,
- Lee N. Price, President and Chief Executive Officer, Price Performance Measurement Systems, Inc.,
- David S. Ruder, William W. Gurley Memorial Professor of Law, Northwestern University School of Law,
- Steve M. Samek, Partner, Andersen,
- David A. Viniar, Chief Financial Officer, Goldman, Sachs & Co., and
- Jerry J. Weygandt, Andersen Alumni Professor of Accounting, University of Wisconsin-Madison.

AN OPEN DECISION-MAKING PROCESS

Actions of the Financial Accounting Standards Board (FASB) have an impact on many organizations within the Board's large and diverse constituency. It is essential that the Board's decision-making process be evenhanded. Accordingly, the FASB follows an extensive "due process" that is open to public observation and participation. This process was modeled on the Federal Administrative Procedure Act and, in several respects, is more demanding.

HOW TOPICS ARE ADDED TO THE FASB'S TECHNICAL AGENDA

The FASB receives many requests for action on various financial accounting and reporting topics from all segments of a diverse constituency, including the SEC. The auditing profession is sensitive to emerging trends in practice and, consequently, it is a frequent source of requests. Requests for action include both new topics and suggested review or reconsideration of existing pronouncements.

The FASB is alert to trends in financial reporting through observation of published reports, liaison with interested organizations and discussions with the Emerging Issues Task Force (EITF)—see page x. In addition, the staff receives many technical inquiries by letter and telephone, which may provide evidence that a particular topic, or aspect of an existing pronouncement, has become a problem. The FASB also is alert to changes in the financial reporting environment that may be brought about by new legislation or regulatory decisions.

The Board turns to many other organizations and groups for advice and information on various matters, including its agenda. Among the groups with which liaison is maintained are the Accounting Standards Executive Committee and Auditing Standards Board of the AICPA (AcSEC), the International Accounting Standards Board (IASB), and the appropriate committees of such organizations as the Association for Investment Management and Research (AIMR), Financial Executives International (FEI) and Institute of Management Accountants (IMA). As part of the agenda process, the Board may make available for public comment agenda proposals that concisely describe the scope of potential projects. The Financial Accounting Standards Advisory Council (FASAC) regularly reviews the Board's agenda priorities and consults on all major projects added to the technical agenda.

After receiving input from the constituency, the Board must make its own decisions regarding its technical agenda. To aid in the decision-making process, the Board has developed a list of factors to which it refers in evaluating proposed topics.

Those factors include consideration of:

- *Pervasiveness of the issue*—the extent to which an issue is troublesome to users, preparers, auditors or others; the extent to which there is diversity of practice; and the likely duration of the issue (i.e., whether transitory or likely to persist);

- *Alternative solutions*—the extent to which one or more alternative solutions that will improve financial reporting in terms of relevance, reliability and comparability are likely to be developed;

- *Technical feasibility*—the extent to which a technically sound solution can be developed or whether the project under consideration should await completion of other projects;

- *Practical consequences*—the extent to which an improved accounting solution is likely to be acceptable generally, and the extent to which addressing a particular subject (or not addressing it) might cause others to act, e.g., the SEC or Congress;

- *Convergence possibilities*—the extent to which there is an opportunity to eliminate significant differences in standards or practices between the U.S. and other countries with a resulting improvement in the quality of U.S. standards; the extent to which it is likely that a common solution can be reached; and the extent to which any significant impediments to convergence can be identified;

- *Cooperative opportunities*—the extent to which there is international support by one or more other standard setters for undertaking the project jointly or through other cooperative means with the FASB; and

- *Resources*—the extent to which there are adequate resources and expertise available from the FASB, the IASB or another standard setter to complete the project; and whether the FASB can leverage off the resources of another standard setter in addressing the issue (and perhaps thereby add the project at a relatively low incremental cost).

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

Board Meetings

The core of the Board's due process is open decision-making meetings and exposure of proposed standards for public comment. Every technical project involves a number of Board meetings. The Board meets as many times as necessary to resolve the issues. A major project generally includes dozens of meetings over several years. All meetings are open to public observers, although observers do not participate in the discussions. The agenda for each meeting is announced in advance.

The staff presents written material, including analysis and recommendations, to the Board members in advance as the basis for discussion in a Board meeting. The meeting format calls for oral presentation of a summary of the written materials by the staff, followed by Board discussion of each issue presented and questioning of the staff on the points raised.

The Exposure Draft

When the Board has reached conclusions on the issues, the staff is directed to prepare a proposed Exposure Draft for consideration by the Board. After further discussion and revisions, Board members vote by written ballot to issue the Exposure Draft. Five votes of the seven-member Board are required to approve a document. Dissents, if any, are explained in the document.

The Exposure Draft sets forth the proposed standards of financial accounting and reporting, the proposed effective date and method of transition, background information and an explanation of the basis for the Board's conclusions.

At the end of the exposure period, generally 60 days or more, all comment letters and position papers are analyzed by the staff. This is a search for information and persuasive arguments regarding the issues; it is not intended to be simply a “nose count” of how many support or oppose a given point of view. In addition to studying this analysis, Board members review the comment letters to help them in reaching conclusions.

Further Deliberation of the Board

After the comments have been analyzed and studied, the Board redeliberates the issues. As in earlier stages of the process, all Board meetings are open to public observation. The Board considers comments received on the Exposure Draft, and often incorporates suggested changes in the final document. If substantial modifications appear to be necessary, the Board may decide to issue a revised Exposure Draft for additional public comment. When the Board is satisfied that all reasonable alternatives have been considered adequately, the staff is directed to prepare a draft of a final document for consideration by the Board. A vote is taken on the final document, again by written ballot. Five votes are required for adoption of a pronouncement.

Statements of Financial Accounting Standards

The final product of most technical projects is a Statement of Financial Accounting Standards (SFAS). Like the Exposure Draft, the Statement sets forth the actual standards, the effective date and method of transition, background information, a brief summary of research done on the project and the basis for the Board’s conclusions, including the reasons for rejecting significant alternative solutions. It also identifies members of the Board voting for and against its issuance and includes reasons for any dissents.

Additional Due Process

For major projects, the Board generally goes significantly beyond the core due process described above. Soon after a major project is placed on the Board’s technical agenda, a task force or working group usually is appointed, including preparers, auditors and users of financial information who are knowledgeable about the subject matter. Experts from other disciplines also may be appointed. Care is taken to ensure that various points of view on the issues involved are represented.

The task force meets with and advises the Board and staff on the definition and scope of the project, the nature and extent of any additional research that may be needed and the preparation of a discussion document and related material as a basis for public comment. Task force meetings are open to public observers. Task forces and working groups play an important role in the standard-setting process by providing expertise, a diversity of viewpoints and a mechanism for communication with those who may be affected by proposed standards.

Before it begins deliberations on a new major project, the Board often asks the FASB staff to prepare a Discussion Memorandum or other discussion document. The task force provides significant assistance and advice in this effort. The discussion document generally sets forth the definition of the problem, the scope of the project and the financial accounting and reporting issues; discusses research findings and relevant literature; and presents alternative solutions to the issues under consideration and arguments and implications relative to each. The discussion document is published to invite constituents to comment on the project before the Board begins deliberations.

After a discussion document or an Exposure Draft is issued for comment, the Board may decide to hold a public hearing or a public roundtable meeting. These meetings provide an opportunity for the Board and staff to ask questions about information and viewpoints offered by constituents who participated in the comment process. Any individual or organization may request to be heard at a public hearing, and the FASB attempts to accommodate all such requests. Public observers are welcome.

Statements of Concepts

In addition to Statements of Financial Accounting Standards (SFAS), the FASB also issues Statements of Concepts. Those do not establish new standards or require any change in the application of existing accounting principles; instead, they are intended to provide the Board and constituents with a foundation for setting standards and concepts useful as tools for solving problems. The framework defined in the Statements of Concepts helps the Board identify the right questions to ask in structuring technical projects and contributes to a consistent approach over time. Because of their long-range importance, Statements of Concepts are developed under the same extensive due process the FASB follows in developing Statements of Financial Accounting Standards on major topics.

Other Documents

In addition to broad issues of financial accounting and reporting, the Board considers narrower issues related to implementation of existing standards and other problems arising in practice. Depending on their nature, implementation and practice problems may be dealt with by the Board in Statements or Interpretations, by the staff in Technical Bulletins or in Implementation Guidance in question and answer form. All of those are subject to discussion at public Board meetings and to exposure for comment, although Technical Bulletins and Implementation Guidance are exposed more narrowly.

Emerging Issues Task Force (EITF)

The Emerging Issues Task Force (EITF) was formed in 1984 in response to the recommendations of the FASB's task force on timely financial reporting guidance and an FASB Invitation to Comment on those recommendations. EITF members are drawn primarily from public accounting firms but also include representatives of large companies. The Chief Accountant of the Securities and Exchange Commission attends EITF meetings regularly as an observer with the privilege of the floor. Timothy S. Lucas, FASB Director of Research and Technical Activities, is Chairman of the Emerging Issues Task Force.

Composition of the EITF is designed to include persons in a position to be aware of emerging issues before they become widespread and before divergent practices regarding them become entrenched. Therefore, if the group can reach a consensus on an issue, usually that consensus is taken by the FASB as an indication that no Board action is needed. A consensus is defined as an agreement, provided that no more than two of the thirteen voting members object. Consensus positions of the EITF are considered part of GAAP. If consensus is not possible, it may be an indication that action by the FASB is necessary.

The EITF meets six times a year. Meetings are open to the public and, generally, are attended by substantial numbers of observers. Because interest in the EITF is high, the FASB has separate subscription plans for keeping up-to-date on the issues.

Availability of Publications

To encourage public comment, Discussion Memorandums and Exposure Drafts are distributed widely through the FASB's established mailing plans. Single copies are available without charge to all who request them during the comment period and Exposure Drafts generally can be accessed from the website at www.fasb.org.

Statements of Standards, Statements of Concepts and Interpretations also are distributed broadly when published through FASB subscription plans and may be purchased separately by placing an order at the FASB website, www.fasb.org.

The FASB strives to keep the public informed of developments on its projects through a monthly newsletter, *Status Report,* and a weekly notice, *Action Alert,* which provides notice of upcoming Board meetings and their agendas with brief summaries of actions taken at previous meetings. *Action Alert* is available by e-mail subscription at the FASB website, www.fasb.org.

FASB Website

The FASB website includes general information about the Board and its activities, information on upcoming public meetings, announcements of Board actions, summaries and status of all active technical agenda projects, summaries of previously issued FASB Statements and Interpretations, the quarterly plan for FASB projects and information about membership in the Foundation, as well as information on how to order publications online, by phone or mail.

The website can be accessed at http://www.fasb.org.

The Public Record

Transcripts of public hearings, letters of comment and position papers, research reports and other relevant materials on projects leading to issuance of pronouncements become part of the Board's public record. The public records on all projects are available for inspection in the public reference room at FASB headquarters in Norwalk, Connecticut. Copies of public records also may be purchased at prices that vary according to the volume of material that has to be copied by accessing the FASB website at www.fasb.org, or contact Records Retention at (203) 847-0700, ext. 270, for more information.

MEMBERS OF THE FASB

The seven members of the FASB serve full time and are required to sever all connections with the firms or institutions they served prior to joining the Board. While collectively they represent diverse backgrounds, they also must possess "knowledge of accounting, finance and business, and a concern for the public interest in matters of financial accounting and reporting."

Board members are appointed for five-year terms and are eligible for reappointment to one additional five-year term. Expiration dates (at June 30) of current terms are indicated in captions beneath the members' photographs.

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

G. Michael Crooch *was a partner with Arthur Andersen and Director of the firm's International Professional Standards Group before joining the FASB on July 1, 2000. Mr. Crooch was the American Institute of Certified Public Accountants' (AICPA) delegate to the International Accounting Standards Committee (IASC) and served on the IASC's Executive Committee. He also served on the Institute's Accounting Standards Executive Committee, including three years as the Committee Chairman. He earned bachelor's and master's degrees from Oklahoma State University and a Ph.D. from Michigan State University.*

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

Edward W. Trott *was appointed as a member of the FASB, effective October 1, 1999. Since 1992, he headed the Accounting Group of KPMG's Department of Professional Practice. Before joining the Board, he was a member of the FASB's Emerging Issues Task Force, the Financial Reporting Committee of the Institute of Management Accountants, the FASB's Advisory Council and the Accounting Standards Executive Committee and Auditing Standards Board of the AICPA. He holds a bachelor's degree from the University of North Carolina and an M.B.A. degree from the University of Texas.*

Katherine Schipper *was appointed to the FASB, effective September 2001. Prior to joining the FASB, she was the L. Palmer Fox Professor of Business Administration at Duke University's Fuqua School of Business. She has served the American Accounting Association (AAA) as President and as Director of Research. She was a member of the FASB's Advisory Council (FASAC) from 1996 to 1999. Ms. Schipper holds a B.A. degree from the University of Dayton and M.B.A., M.A. and Ph.D. degrees from the University of Chicago.*

Gary S. Schieneman *was appointed to the FASB, effective July 1, 2001. Prior to joining the FASB, Mr. Schieneman served as Director, Comparative Global Equity Analysis, of Merrill Lynch. He is a member of the American Institute of Certified Public Accountants (AICPA), the New York Society of Security Analysts and the Association for Investment Management and Research (AIMR). He received a bachelor's degree in accounting from the University of Illinois and earned an MBA degree from New York University.*

John K. Wulff *was appointed to the FASB, effective July 1, 2001. Prior to joining the FASB, he was Chief Financial Officer of Union Carbide Corporation where he directed the company's global financial operations, including its internal and external audits, treasury, control, financial analysis and corporate financial reporting. He is a past Chairman of the Financial Executive Institute's Committee on Corporate Reporting and is a member of the American Institute of Certified Public Accountants. He is a graduate of the Wharton School of the University of Pennsylvania.*

FASB Staff

The Board is assisted by a staff of approximately 40 professionals drawn from public accounting, industry, academe and government, plus support personnel. The staff works directly with the Board and task forces, conducts research, participates in public hearings, analyzes oral and written comments received from the public and prepares recommendations and drafts of documents for consideration by the Board.

FASB Fellows are an integral part of the research and technical activities staff. The Fellowship program provides the Board the benefit of current experience in industry, academe and public accounting and offers the Fellows first-hand experience in the accounting standard-setting process. Fellows take a leave of absence from their firms or universities and serve as project managers or consultants on a variety of projects.

Timothy S. Lucas *is Director of Research and Technical Activities, a position equal to that of a Board member. Mr. Lucas was a Project Manager on the FASB staff from 1979 to 1986, and later joined Gordon Capital, an investment-banking firm. Before joining the FASB staff in 1979, Mr. Lucas was an Audit Manager with Deloitte, Haskins & Sells and was a lecturer at the Jesse H. Jones Graduate School of Administration at Rice University. He holds B.A., B.S. and master's degrees from Rice University and is a certified public accountant.*

Suzanne Q. Bielstein *was named Assistant Director of Research and Technical Activities in July of 2001. In this position, she is responsible for supporting the FASB staff activities involving the Emerging Issues Task Force (EITF) and the technical inquiry program. Ms. Bielstein joined the FASB in March 1999, as a member of the research and activities staff and, prior to her current position, was a Project Manager on the Board's projects on business combinations and combinations for not-for-profit organizations. Ms. Bielstein earned a B.B.A. degree in accounting from the University of Notre Dame.*

ADDITIONAL INFORMATION

General Information

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

To Order Publications

Statements, Interpretations, Exposure Drafts and other documents published by the FASB may be obtained by placing an order on the FASB website, www.fasb.org, or by contacting the FASB Order Department at (203) 847-0700.

Public Hearings and Comment Letters

For information about submitting written comments on documents or about public hearings, access the FASB website at www.fasb.org, or contact the FASB Project Administration Department at (203) 847-0700, ext. 389.

Public Reference Room and Files

The FASB maintains a public reference room open during office hours, Monday through Friday. The public reference room contains all FASB publications, comment letters on documents and transcripts of public hearings. Copies of this material may be obtained for a specified charge by accessing the FASB website at www.fasb.org, or by contacting Records Retention at (203) 847-0700, ext. 270, for an appointment.

Fax-on-Demand

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

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To order additional copies of *FACTS about FASB* without charge, contact Public Relations at (203) 847-0700, ext. 252, or telefax a request to (203) 849-9714.

Financial Accounting Standards Board

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

No. 231-A   April 19, 2002
(The FABB Report No. 347)

THE ***FASB*** *REPORT*

Technical Plan

First Quarter Action

Project-Related Activities

Rescission of Statement 4. *On February 14, 2002, we issued a limited revised Exposure Draft,* Rescission of FASB Statements No. 4, 44, and 64 and Technical Corrections—Amendment of FASB Statement No. 13. *We requested comments by March 18. The Exposure Draft was distributed primarily through the FASB website* *(see page x)**.*

Liabilities and Revenues. *We requested comments by March 29, 2002, on a proposal for a potential project on issues related to the recognition of revenues and liabilities. That proposal was distributed primarily through the FASB website* *(see page x)**.*

Financial Performance Reporting by Business Enterprises. *In February 2002, members of the Board and staff completed a series of interviews of 56 individuals who use financial statements. Those individuals were investors, creditors, and their advisors (equity and credit analysts). A summary of the findings resulting from those interviews is available on the FASB website. On February 26, the Board discussed the results of its user interviews with its project task force as well as their implications for the issues to be addressed by the project* *(see page x)**.*

Agenda Decisions. *The Board added the following two projects to its technical agenda:*

- ***Disclosures about Intangible Assets.*** *On January 9, 2002, the Board added a project on disclosure of information about intangible assets not recognized in financial statements (see page x).*

- ***Guarantor's Accounting and Disclosure Requirements for Guarantees.*** *On February 13, 2002, the Board added a project to address guarantor's accounting and disclosure requirements for guarantees (see page x).*

Other Activities

Emerging Issues Task Force (EITF). *The Task Force met twice and discussed 14 issues. The next EITF meeting is scheduled for June 19 and 20, 2002. That one-and-one-half day June meeting replaces both the May and July meetings (see page x).*

Liaison Meeting. *In March 2002, the Board met with representatives of the Executive Committee of Financial Executives International.*

FASB Website. *We post detailed summaries of most of the Board agenda projects and other Board activities on the FASB website at www.fasb.org. We update those summaries often, and we encourage constituents to visit our website for timely and detailed information concerning Board decisions on specific projects.*

IASB News

The International Accounting Standards Board (IASB) has completed deliberations on a number of its initial agenda projects and is expected to issue for public comment several Exposure Drafts in the second quarter. Those Exposure Drafts relate to the following topics:

- *First-time application of International Financial Reporting Standards (IFRS)*
- *Improvements to existing IFRS (amendments to 13 existing standards)*
- *Amendments to IAS 39,* Financial Instruments: Recognition and Measurement, *and IAS 32,* Financial Instruments: Disclosure and Presentation
- *Business combinations, Phase I.*

The IASB will post its Exposure Drafts to its website (www.iasb.org.uk). Those interested in commenting on the IASB's proposals can download them as they become available or contact the IASB for more information.

Board Agenda Projects

As of April 1, 2002	2002 2Q	2002 3Q	2002 4Q	2003 1Q
Business Combinations: (page x)				
Purchase Method Procedures (page x)*			**E**	
Combinations of Not-for-Profit Organizations (page x)*			**E**	
Combinations of Mutual Enterprises (page x)*		**E**		
Fresh-Start (New Basis) Issues (page x) *See Discussion**				
Reconsideration of Statement 72 (page x)*	**E**			
Certain Costs and Activities Related to Property, Plant, and Equipment (page x) *See Discussion*				
Consolidations and Related Matters: (page x)				
Interpretive Guidance for Certain Situations (page x)*	**E**			
Comprehensive Policy Guidance (page x) *See Discussion**				
Procedures (page x) *See Discussion**				
Unconsolidated Entities (page x) *See Discussion*				
Disclosures about Intangible Assets (page x)*			**E**	
Financial Instruments: (page x)				
Measuring at Fair Value (page x) *See Discussion**				
Replacement of Statement 107 (page x) *See Discussion*				
Liabilities and Equity including Amendment to Concepts Statement 6 (page x)*			**F**	
Amendment to Statement 133 (page x)*	**E**			
Financial Performance Reporting by Business Enterprises (page x) *See Discussion**				
Guarantor's Accounting and Disclosure Requirements for Guarantees (page x)*	**E**			
Obligations Associated with Disposal Activities (page x)*		**F**		
Rescission of Statement 4 (page x)	**F**			
Potential Agenda Projects and Other Potential Initiatives				
Liabilities and Revenues (page x) *See Discussion*				

Codes: E - *Exposure Document* **F -** *Final Statement or Other Final Document*
**Current updates of these projects are maintained on the FASB website, www.fasb.org.*

Discussion of Board Projects Agenda

The project summaries in this quarterly technical plan are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions are included in an Exposure Draft for formal comment only after a formal written ballot. Decisions in an Exposure Draft may be (and often are) changed in redeliberations based on information provided to the Board in comment letters, at public hearings, and through other communication channels. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Business Combinations

Background. In June 2001, the Board issued FASB Statements No. 141, *Business Combinations,* and No. 142, *Goodwill and Other Intangible Assets.* The Board currently has on its agenda four projects related to the business combinations project. Those projects include (1) purchase method procedures, (2) combinations of not-for-profit (NFP) organizations and combinations of mutual enterprises, (3) fresh-start (new basis) issues, and (4) a limited-scope project to reconsider the accounting requirements of FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions.*

Purchase Method Procedures

Background and recent developments. In September 2001, the FASB and the International Accounting Standards Board (IASB) agreed to work together to address issues related to the application of the purchase method of accounting for business combinations. In October 2001, the staffs of the FASB and the IASB met to discuss plans for coordinating their approach to the joint project.

Additionally, the FASB and the IASB tentatively agreed to the following working principle for recording a business combination:

- The accounting for a business combination is based on the assumption that the transaction is an exchange of equal values; the total amount to be recognized should be measured based on the fair value of the consideration paid or the fair value of the net assets acquired, whichever is more clearly evident.

1. If the consideration paid is cash or other assets (or liabilities incurred) of the acquiring entity, the fair value of the consideration paid determines the total amount to be recognized in the financial statements of the acquiring entity.

2. If the consideration is in the form of equity instruments, the fair value of the equity instruments ordinarily is more clearly evident than the fair value of the net assets acquired and, thus, will determine the total amount to be recognized by the acquiring entity.

- In a business combination, the acquiring entity obtains control over the acquired entity and therefore is responsible for the assets and liabilities of the acquired entity. An amount equal to the fair value, on the date control is obtained, should be assigned to the identifiable assets acquired and liabilities assumed.

1. If the total fair value exchanged in the purchase transaction exceeds the amounts recognized for identifiable net assets, that amount is the implied fair value of goodwill.

2. If the total fair value exchanged in the purchase transaction is less than the amounts recognized for identifiable net assets, that amount should be recognized as a gain in the income statement.

At the end of the first quarter of 2002, the Board completed its deliberations on the working principle and preacquisition contingencies.

The Board also completed a substantial portion of its deliberations on measuring the value of a business combination. The Board reached the following decisions in the first quarter of 2002:

- The description of the acquisition date in Statement 141 would be modified to clarify that the acquisition date is the date that the acquirer gains control of the acquired entity.
- The fair value equity securities issued as consideration in a business combination would be measured on the acquisition date.
- Contingent consideration issued in a business combination is an obligation of the acquirer as of the acquisition date and, therefore, would be recognized as part of the

purchase price on that date. Consistent with the working principle, the initial measurement of contingent consideration should be at fair value.

- Some contingent consideration arrangements obligate the acquirer to deliver its equity securities if specified future events occur. Presuming that the Board issues a standard on accounting for financial instruments with the characteristics of liabilities, equity, or both prior to the issuance of guidance in this project, the guidance in that standard would apply to contingent consideration arrangements.
- The exception in paragraph 11(c) of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* would be eliminated so that contingent consideration arrangements that otherwise meet the definition of a derivative would be subject to the requirements of Statement 133.
- Subsequent remeasurement (after the acquisition date) of contingent consideration liabilities does not result in a change to the purchase price of the business combination. Those amounts therefore should be recognized in the income statement.

Immediate plans. In the second quarter of 2002, we expect to complete the issues of measuring the fair value of a business combination and begin drafting an Exposure Draft for the decisions reached to date. The FASB staff will begin work on issues related to the recognition of assets acquired and liabilities assumed. We expect to issue an Exposure Draft in the fourth quarter of 2002.

Combinations of Not-for-Profit Organizations

Background. In this project, the Board will develop guidance on the accounting for combinations between two or more NFP organizations and the accounting for the acquisition of a for-profit entity by an NFP organization. By early 2001, the Board had made decisions on several key issues, including the method of accounting for combinations of NFP organizations and the criteria to be used to identify the acquiring organization. Deliberations on this project were temporarily suspended in early 2001 while the Board completed its work on Statements 141 and 142. With the issuance of those Statements, the Board recommenced deliberations of the issues remaining in this project, reaching decisions on the (1) accounting for collection items acquired in a combination and (2) initial recognition of intangible assets acquired in a combination.

Decisions in current phase. The Board has made the following decisions to date in this project. A more detailed discussion of these decisions is available on the FASB website.

Project Approach

- The project approach presumes that Statement 141 (which supersedes Opinion 16) would apply to combinations of NFP organizations unless a circumstance unique to those combinations is identified that would justify a different accounting treatment.

Project Scope

- The definition of an NFP organization in FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made,* will be used for this project.

- The project's scope includes the accounting for (1) combinations between NFP organizations and (2) the acquisition of a for-profit business enterprise by an NFP organization.

Method of Accounting for a Combination of NFP Organizations

- The facts and circumstances of each combination of two or more NFP organizations should be reviewed to determine the extent to which the combination is a contribution or a bargained exchange. The proposed Statement should include guidance describing the types of facts and circumstances that should be considered in making that determination. A combination of NFP organizations in which no consideration is exchanged should be presumed to be a nonreciprocal transfer and accounted for in a manner similar to a contribution under Statement 116. A combination that includes the exchange of consideration should be presumed to be a bargained exchange and accounted for in accordance with Statement 141. When the facts and circumstances provide evidence that the combination is in part an exchange and in part a contribution, the contribution inherent in that transaction should be recognized by the acquiring organization in accordance with Statement 116.

- If the acquired entity is an NFP organization, the contribution recognized by the acquiring organization would be measured as the excess of the sum of the fair values of the identifiable assets and the liabilities assumed over the fair value of the assets transferred as consideration (if any). In those rare cases in which the sum of the fair values of the liabilities assumed exceeds the sum of the fair values of the identifiable assets acquired, the acquiring NFP organization should initially recognize that excess as an unidentifiable intangible asset (goodwill). The Board has decided that it will reconsider this tentative decision.

- If the acquired entity is a business enterprise, the contribution inherent in a combination should be measured as the excess of the fair value of the acquired business enterprise over the cost of that business enterprise.
- Communities neither own nor control NFP organizations and, therefore, a community's relationship with an NFP organization has no effect on the accounting for a combination of NFP organizations.

Consideration Exchanged in a Combination of NFP Organizations

- Generally, assets transferred (or liabilities incurred or assumed) by the acquiring organization as a requirement of a combination should be accounted for as consideration paid for the acquired entity, even if the asset transfer is a requirement imposed by a regulatory body. If the acquiring organization retains control over the future economic benefits of the transferred assets, however, the asset transfer should be reported by the acquiring organization as an asset-for-asset exchange. The proposed Statement should provide examples of the types of conditions that indicate that the acquiring organization has retained control over the future economic benefit of the transferred assets.
- Contingent consideration in a combination of NFP organizations should be accounted for in accordance with the guidance in Statement 141.

Identifying the Acquirer in a Combination of NFP Organizations

- In determining the acquiring organization, all pertinent facts and circumstances surrounding the combination should be considered, in particular whether one of the combining organizations has the ability to dominate the process of selecting a voting majority of the combined organization's governing body. Implementation guidance should be provided that would include a list of factors that should be considered when determining the identity of the acquiring organization.

Collection Acquired in a Combination of NFP Organizations

- The Board decided that when the assets acquired in a combination include collection items (as defined in Statement 116), the acquirer should follow the guidance in Statement 116 to account for the collection items acquired.

Identification of Intangible Assets

- The criteria in paragraph 39 of Statement 141 for recognizing identifiable intangible assets should be applied in the recording of combinations of NFP organizations.

Recent developments and immediate plans. The Board decided that it would revisit its tentative decision that in a combination of NFP organizations, any excess of the fair value of liabilities assumed over the fair value of assets acquired should be considered goodwill. The Board also decided to consider the recognition of goodwill separately for combinations of NFP organizations and combinations of mutual enterprises. The Board will continue its deliberations in the second quarter. We expect to issue an Exposure Draft in the fourth quarter of 2002.

Combinations of Mutual Enterprises

Background. The effective date of Statements 141 and 142 is deferred for combinations between two or more mutual enterprises to allow the Board time to consider whether there are any unique attributes of mutual enterprises to justify an accounting treatment different from that provided in those Statements.

Decisions in current phase. The Board has made the following decisions to date in this project. A more detailed discussion of the Board's decisions is available on the FASB website.

Approach and Scope

- The project approach presumes that Statement 141 (which supersedes Opinion 16) would apply to combinations of mutual enterprises unless a circumstance unique to those combinations is identified that would justify a different accounting treatment.
- The project's scope includes the accounting for combinations between two or more mutual enterprises.

Method of Accounting for a Combination of Mutual Enterprises

- The criteria in Statement 141 should be used to identify the acquiring enterprise in a combination of mutual enterprises.
- The criteria in paragraph 39 of Statement 141 should be used to recognize identifiable intangible assets acquired in a combination of mutual enterprises.

Recent developments and immediate plans. The combinations of mutual enterprises project likely will become a joint effort between the Canadian Institute of Chartered Accountants Accounting Standards Board (AcSB) and the FASB. The FASB staff intends to accelerate FASB's consideration of the issues associated with combinations of mutual enterprises in an effort to converge with the AcSB project, which has already deliberated several issues that the FASB has not addressed. Based on potential convergence, the FASB intends to issue an Exposure Draft on this project in the third quarter of 2002.

Fresh-Start (New Basis) Issues

Background. The fresh-start (new basis) project is a joint project of the IASB and the FASB. This project focuses on those situations in which fresh-start (a new basis at fair value) recognition and measurement of all of an entity's assets and liabilities would be appropriate. One commonly identified candidate for application of this approach would be a multiparty business combination or other new entity formation in which no single preexisting entity obtains majority ownership and control of the resulting new entity. Similarly, joint venture formations also are candidates for this accounting treatment. Related issues include the recognition and measurement of goodwill and other intangible assets in combinations or other transactions accounted for by the fresh-start method.

In September 2000, prior to this project being designated as a potential IASB-FASB joint project, the Board approved a draft working principle to be utilized in determining the appropriateness of recognizing a new basis of accounting. The Board also decided that the scope of the project should include the issue of gain recognition in the financial statements of an entity that has transferred control over net assets to a joint venture.

During the fourth quarter of 2000, the Board discussed recognition of fresh-start accounting in connection with the formation of a joint venture. The Board decided that a change in control over net assets from unilateral control by one entity to joint or shared control by that entity and one or more other entities should result in fresh-start accounting for those net assets in the financial statements of the jointly controlled entity. The Board also discussed gain recognition, as of the date of formation of a joint venture in the financial statements of an investor that transfers an appreciated (or previously unrecognized) asset to the joint venture. The Board decided that an entity that exchanges appreciated (or previously unrecognized) assets for an equity interest in a joint venture should recognize a gain on the assets exchanged.

Immediate plans. The FASB staff has had initial discussions with the IASB staff principally concerning the background of the project and preliminary development of a joint scope for the project. Because of the pressures of other priorities for both Boards, this project temporarily is on hold.

Reconsideration of Statement 72

Background. Paragraphs 5–7 of Statement 72, which apply only to certain acquisitions of financial institutions (or branches thereof), require that the excess of the fair value of the liabilities assumed over the fair value of tangible and identifiable intangible assets acquired ("the excess") be recognized as an unidentifiable intangible asset. Statement 72 also requires that the unidentifiable intangible asset be amortized over a specified period. Following the issuance of Statement 142, constituents asked the Board to consider whether the unidentifiable intangible asset should be accounted for differently than goodwill. In response to those questions, the Board decided in the fourth quarter of 2001 to undertake a limited scope project to reconsider the guidance in paragraphs 5–7 of Statement 72.

Decisions in current phase and recent developments. The Board decided to reconsider application of the guidance in Statement 72 to combinations between mutual enterprises as part of its separate project addressing those transactions (page x). With respect to the acquisition of a stockholder-owned financial institution (or a branch(es) thereof) that are business combinations (as defined in Statement 141), the Board decided that the amount of the excess should be recognized as goodwill and accounted for in accordance with Statement 142. The Board decided that acquisitions that do not meet the definition of a business combination should be accounted for as asset acquisitions as described in paragraph 9 of Statement 142.

The Board also decided that the scope of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* should be amended to include long-term customer relationship intangible assets of financial institutions (including depositor relationship assets, sometimes referred to as core deposit intangible assets, and credit cardholder intangible assets). That means that those intangible assets will be subject to the same undiscounted cash flow recoverability tests and impairment loss recognition and measurement provisions that Statement 144 requires for long-term tangible assets and other finite-lived intangible assets held and used.

With respect to transition, the Board decided that the unidentifiable intangible asset recognized in past transactions should continue to be amortized unless all of the following conditions are met: (1) the unidentifiable intangible asset was initially recognized in connection with a business combination, (2) when the business combination was initially recorded, the acquiring enterprise recognized the acquired customer relationship intangible assets separately from goodwill, and (3) subsequent to their initial recognition, the customer relationship intangible assets were accounted for separately from goodwill. The Board decided that when those three conditions are met, the carrying amount of the unidentifiable intangible asset would be reclassified as goodwill at the effective date of the proposed Statement, and subsequently accounted for in accordance with the provisions of Statement 142.

Immediate plans. We plan to issue an Exposure Draft in April 2002 with a 45-day comment period. That Exposure Draft will be distributed primarily through the FASB website.

Project chronology. Added to agenda—August 1996. Special Report—June 1997. *Methods of Accounting for Business Combinations: Recommendations of the G4+1 for Achieving Convergence:* Invitation to Comment—December 1998. *Business Combinations:* Statement 141—June 2001. *Goodwill and Other Intangible Assets:* Statement 142—June 2001.

Consolidations and Related Matters

Background. This group of related projects is intended to cover all aspects of accounting for affiliations between entities along with several other matters that raise similar or potentially related issues about financial statements. The Board is reconsidering issues relating to Accounting Research Bulletin No. 51, *Consolidated Financial Statements,* and APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock.* The project on consolidation policy and procedures is considering both business enterprises and not-for-profit organizations and presently is focusing on the area of consolidation policy. The unconsolidated entities project is intended to address presentation in the investor's financial statements and other issues related to investments in noncontrolled corporations and partnerships, including joint ventures and undivided interests.

Comprehensive Policy Guidance

Background. In February 1999, we issued a revised FASB Exposure Draft, *Consolidated Financial Statements: Purpose and Policy.* We received comments from 113 respondents. The proposed Statement would require business enterprises and not-for-profit organizations that control other entities to include those subsidiaries in their consolidated financial statements. *Control* would be defined as the nonshared decision-making ability of one entity to direct the policies and management that guide the ongoing activities of another entity so as to increase its benefits and limit its losses from that other entity's activities. In July 1999, the Board began a series of meetings to consider comments received on the Exposure Draft and to redeliberate conclusions reached in the Exposure Draft.

In January 2001, the Board determined that there was not sufficient Board member support to proceed to a final Statement on consolidation policy. The Board is concerned about the appropriateness of determining that nonshared decision-making ability can exist based on the anticipated nonaction by other holders of voting rights. The Board also is concerned about the effectiveness of the proposed treatment of convertible and option instruments that give the ability to obtain voting rights as well as the operationality of certain other provisions. However, the Board believes its effort to deal with consolidation policy issues should continue. Those efforts should include the need to develop effective guidance for special-purpose entities (SPEs), to deal with situations where control exists but is not apparent based on the form of the arrangement, and to provide guidance on partnership and other noncorporate structures. It also believes that the work to define *control* has been useful and that this effort should continue.

Interpretive Guidance for Certain Situations

Background and plans. In November 2001, the Board discussed its assessment of the consolidation project and how to proceed with it. The Board decided to first concentrate on developing guidance for dealing with the following situations under the current consolidation approach:

- So-called strawman situations
- Entities that lack sufficient independent economic substance
- Convertible instruments and other contractual arrangements that involve latent control
- The distinction between participating rights and protective rights.

Effective guidance for those situations would resolve many problems encountered in present practice including some of the ones related to SPEs. We plan to issue an Exposure Draft of proposed guidance for dealing with entities that lack sufficient economic substance in the second quarter of 2002 and the other situations thereafter. The Board then will continue its consideration of the proposals in the 1999 Exposure Draft.

Decisions in current phase. In the first quarter of 2002, the Board discussed and resolved most aspects of a draft of the first of those Exposure Drafts of a proposed Interpretation of FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries,* and ARB 51. The Board decided that an SPE should be consolidated by its Primary Beneficiary when the SPE lacks sufficient independent economic substance. An SPE is an entity that supports the activities of a Primary Beneficiary. A Primary Beneficiary is the entity that retains or obtains principal economic benefits and risks that arise from the activities of the SPE. An SPE has sufficient independent economic substance if, at all times during its life, it has the ability to fund or finance its operations without assistance from or reliance on the Primary Beneficiary or a related party of the Primary Beneficiary. An SPE is considered to have that ability if its owner(s) is an independent third party that has:

- A substantive equity investment at risk in the SPE
- Substantive risks of variable returns that are generally characteristics of equity ownership
- The ability to make decisions about and manage the SPE's activities to the extent those decisions have not been predetermined for the SPE.

In March, the Board decided that the proposed Interpretation should provide guidance for identification of and accounting by the Primary Beneficiary of multi-seller/multi-lease conduits. The guidance for those conduits would include a provision for separation into separate SPEs if the transferors or lessees have the same risks and rewards they would have had if they were dealing with a single seller/lease SPE. Additionally, the proposed Interpretation would provide guidance for identification of and accounting by the Primary Beneficiary for other conduit structures.

Procedures

Certain issues related to consolidation procedures are being addressed in the projects on ***Business Combinations—Purchase Method Procedures*** (page x) and ***Financial Instruments—Liabilities and Equity*** (page x). The Board will consider resuming its discussions of other consolidation procedures issues after completion of its work on consolidation policy.

Unconsolidated Entities

We participated with the G4+1 to develop a Special Report, *Reporting Interests in Joint Ventures and Similar Arrangements.* That Special Report was issued in September 1999. The project is currently inactive.

Consolidations projects chronology. Projects added to agenda—January 1982. *Consolidation of All Majority-Owned Subsidiaries:* Statement 94—October 1987. *Consolidation Policy and Procedures:* Discussion Memorandum—September 1991. *New Basis Accounting*: Discussion Memorandum—December 1991. Completed consideration of issues related to disaggregated disclosures (segments)—June 1994. *Consolidation Policy:* Preliminary Views—August 1994. *Consolidated Financial Statements: Policy and Procedures:* Exposure Draft—October 16, 1995. Discontinued consideration of new basis issues as part of project—August 1996. *Disclosures about Segments of an Enterprise and Related Information:* Statement 131—June 1997. *Consolidated Financial Statements: Purpose and Policy:* Revised Exposure Draft—February 23, 1999.

Certain Costs and Activities Related to Property, Plant, and Equipment

Background. In April 2001, the Board agreed to issue an Exposure Draft of a proposed Statement that would amend certain APB Opinions and FASB Statements to incorporate changes that would result from issuance of a final AICPA Statement of Position (SOP), *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment.* The Board also agreed that the Exposure Draft would propose to amend APB Opinion No. 28, *Interim Financial Reporting,* so that the provisions of the proposed SOP that would require certain costs to be charged to expense as incurred would apply also to interim periods. In June 2001, the Board approved for issuance FASB Exposure Draft, *Accounting in Interim and Annual Financial Statements for Certain Costs and Activities Related to Property, Plant, and Equipment,* which was issued contemporaneously with the issuance of the proposed SOP by AcSEC. We requested comments on the Exposure Draft by November 15, 2001. Similarly, the AICPA requested comments on the proposed SOP by November 15, 2001.

Plans. In the second quarter, AcSEC will begin to address the comment letters received on its Exposure Draft. The timing of the FASB's final document is dependent on the timing of AcSEC's final document, which is uncertain at this time.

Project chronology. Added to agenda—April 2001. Exposure Draft—June 29, 2001.

Disclosures about Intangible Assets

Background. On January 9, 2002, the Board added to its agenda this project on disclosure of information about intangible assets. That decision was the result of a process including significant input from constituents, including 63 letters commenting on a proposal issued in August, 2001, and consideration of the available research findings and the resources needed for this and other present and proposed FASB projects.

Today, intangible assets that are generated internally, and some acquired intangible assets (those that are written off immediately) are not recognized in financial statements. This project aims to establish standards that will improve disclosure of information about those intangible assets. Intangible assets include brand names, customer relationships, artistic works, advantageous contracts, and patent rights, among others.

For many entities, the amounts of intangible assets not reflected in financial statements are very large. In a recent article in *Financial Executive* (March/April 2002, p. 35), a prominent researcher indicated that "in the late 1990s, the annual U.S. investment in intangible assets—R&D, business processes and software, brand enhancement, employee training, etc.—was roughly \$1.0 trillion, almost equal to the \$1.2 trillion total investment of the manufacturing sector in physical assets. Further, intangible capital currently constitutes between one-half and two-thirds of corporate market value." Generally, there is very little information—quantitative or qualitative—about those intangible assets in financial reports. This project would expand that information.

Decisions in current phase and recent developments. The Board refined the project scope initially established as part of the agenda decision. The refined scope calls for disclosure about intangible assets that would have been recognized if acquired in a business combination under Statement 141. That decision limits the scope to intangible assets that are either grounded in contracts or other legal rights or are separable from the enterprise. The scope also includes in-process research and development assets that, under FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method,* are written off to expense on the day they are acquired. That scope has the important practical advantage of relying on the definitions and scope recently set forth in Statements 141 and 142 and on the implementation guidance and practice that are being developed for those Statements. For constituents, this scope will result in one set of definitional standards and guidance to apply and learn to use, not two.

The Board also decided that the qualitative and quantitative information still to be specified in later meetings should be reported by classes determined using the principles of Statement 142. Statement 142 calls for disclosures about recognized intangible assets subdivided by intangible asset class, defined therein as "a group of intangible assets that are similar, either by their nature or by their use in the operations of an entity." The Board also decided to work toward required disclosures about intangible assets, rather than voluntary disclosures.

The Board began its consideration of whether to call for quantitative disclosures about intangible assets and, if so, what kind of quantitative information to call for. The Board considered several fair-value-based and cost-based approaches to disclosing quantitative information. Pending additional information, the Board decided to narrow the project's focus to possible disclosure of (1) the fair values of all intangible assets (both recognized and unrecognized that fall within the scope) at the end of the current year(s), (2) disclosing expenditures in the current year(s) without distinguishing successful from unsuccessful efforts, or (3) both.

Immediate plans. The Board and staff are gathering additional information from constituents before making a final decision about which, if any, quantitative disclosures to require. The staff also is continuing to research, with the assistance of a working group of constituents, what other "qualitative" disclosures to consider. The Board plans to resolve those and other remaining issues at meetings during the second and third quarters and to issue an Exposure Draft in the fourth quarter of 2002.

Project chronology. Added to agenda—January 9, 2002.

Financial Instruments

The Board added this group of projects to its agenda in 1986 at the request of many constituents, including the auditing profession, the SEC, bank regulators, and some preparers. Those constituents expressed concerns about the lack of accounting guidance and the resulting inconsistencies in practice in accounting for financial instruments and transactions, especially for innovative and complex financial instruments, created during the preceding decade. Since 1986, the Board has completed several of the financial instruments projects. In later years, other projects were added to the group of financial instrument projects and are still active. Those active projects on measuring at fair value, liabilities and equity, and amending Statement 133 are discussed below.

Measuring All Financial Assets and Liabilities at Fair Value

Background. The objective of this project is to provide guidance for reporting financial assets and liabilities at fair value. The Board has made a fundamental decision that fair value is the most relevant attribute for financial instruments. That decision was incorporated into FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* which states in paragraph 334:

> *The Board is committed to work diligently toward resolving, in a timely manner, the conceptual and practical issues related to determining the fair values of financial instruments and portfolios of financial instruments. Techniques for refining the measurement of the fair values of all financial instruments continue to develop at a rapid pace, and the Board believes that all financial instruments should be carried in the statement of financial position at fair value when the conceptual and measurement issues are resolved.*

Although measurement at fair value has conceptual advantages, not all issues have been resolved, and the Board has not yet decided when, if ever, it will be feasible to require essentially all financial instruments to be reported at fair value in the basic financial statements. Constituents have suggested several means of providing information about fair values of financial instruments other than recognition and measurement in the basic financial statements. One alternative is to require presentation of a separate set of fair value financial statements. Another possibility is to enhance the disclosures currently required in notes to the financial statements.

The Board also participated in an international effort to develop a set of standards for reporting financial instruments at fair value. That effort was undertaken by an ad hoc international group called the Financial Instruments Joint Working Group of standard setters (JWG). In December 2000, we published the Draft Standard, Application Supplement, and Basis for Conclusions prepared by the JWG in the form of an FASB Special Report, *Financial Instruments and Similar Items.* The FASB and standard setters in other jurisdictions represented by JWG members have shared the comments each received, and each will use those comments in its own separate project on financial instruments.

Decisions in current phase and recent developments. We issued an FASB Preliminary Views, *Reporting Financial Instruments and Certain Related Assets and Liabilities at Fair Value,* on December 14, 1999. That Preliminary Views discusses the following three questions:

- What should be reported at fair value?
- What does fair value mean?
- How should changes in fair value be reported?

The Preliminary Views also requested comments on two other issues—whether to include in the project scope items that are similar to financial instruments and how to determine fair value if observable market prices include compensation for expected cash flows that are not contractually required.

The Board reaffirmed its ultimate goal of requiring essentially all financial instruments to be measured at fair value in the basic financial statements. The Board also reaffirmed the intermediate objective it established in February 2001, which is to work toward an Exposure Draft that would replace FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments.* The intention is to provide more specific guidance on how to determine fair value for financial instruments, improve the form of the disclosures (possibly by requiring a financial statement format), and to add information about the changes in fair values.

In the first quarter of 2002, the Board continued to discuss measurement issues and made decisions about how to measure fair value for financial instruments.

Plans for the replacement of Statement 107. When the Board continues its redeliberations of the planned replacement for Statement 107, it will begin discussing the scope of the proposed Statement. The scope issues include:

- The definition of financial instruments
- Nonfinancial instruments that may be included in the scope
- Financial instruments that may be excluded from the scope
- Contracts that are very similar to specific financial instruments.
- Other issues that will be addressed in the proposed Exposure Draft are:
- Form and content of the required disclosure including presentation of changes in fair value
- Disclosure of other matters, for example, risk exposures, measurement sensitivity, and valuation policies and methods.

Liabilities and Equity

Background. In 1997, the Board decided to resume deliberations on issues raised in the 1990 FASB Discussion Memorandum, *Distinguishing between Liability and Equity Instruments and Accounting for Instruments with Characteristics of Both.* The objective of the project is to improve the transparency of the accounting for financial instruments that contain characteristics of liabilities, equity, or both.

Decisions in current phase and recent developments. In December 2001, the Board began redeliberations of issues in the FASB Exposure Drafts, *Accounting for Financial*

Instruments with Characteristics of Liabilities, Equity, or Both, and Proposed Amendment to FASB Concepts Statement No. 6 to Revise the Definition of Liabilities. (Copies of both Exposure Drafts are available from the FASB website.) The Board discussed certain questions relating to the issue of separating a compound financial instrument with characteristics of liabilities and equity. The Board decided that an entity that issues a financial instrument that contains characteristics of both liabilities and equity should identify and report those components separately. That decision reaffirms the guidance in the Exposure Draft requiring separation of financial instruments with characteristics of liabilities and equity and represents a change from current generally accepted accounting principles that require classification of the entire instrument based on the governing-characteristics approach. The Board also decided that an issuer of a financial instrument that contains components that, if freestanding, would be classified as assets should not report the asset component separately. In February 2002, the Board decided that the with-and-without method should be used for measuring components under certain models.

Immediate plans. Below is a list of major issues that the Board will redeliberate and resolve. Those issues were addressed by respondents to the two Exposure Drafts. The redeliberation of some of the issues listed is dependent upon the conclusions reached by the Board on preceding issues. A more detailed discussion of the Board's redeliberation plan is available on the FASB website.

- Separating a compound financial instrument with characteristics of liabilities and equity into its individual liability and equity components
- The framework for the classification of financial instruments with characteristics of liabilities, equity, or both (definition of liability)

- Disclosures
- Earnings per share
- Transition and effective date
- Balance sheet classification of the noncontrolling interest in a consolidated subsidiary.

The Board will continue redeliberations of those issues in the second quarter of 2002 with a goal of issuing a final Statement in the fourth quarter of 2002.

Amendment to Statement 133—Beneficial Interests Arising from Securitization Transactions

Background. This project is considering various approaches for resolving questions raised in Statement 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets," which addresses the application of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* to beneficial interests issued in securitization transactions subject to FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* In addition, it also is considering the application of Statement 133 to instruments involving leverage. The staff is working with a task force of individuals associated with the Derivatives Implementation Group.

Decisions in current phase and recent developments. In the first quarter, the Board took the following actions:

- Discussed comments received on the guidance included in the following five implementation issues, which were initially posted for comment in October 2001, regarding Statement 133:

Issue A20 Application of Paragraph 6(b) Regarding Initial Net Investment

Issue B12 Embedded Derivatives in Beneficial Interests Issued by Qualifying Special-Purpose Entities

Issue C17 Application of the Exception in Paragraph 14 to Beneficial Interests That Arise in a Securitization

Issue D2 Applying Statement 133 to Beneficial Interests in Securitized Financial Assets

Issue E21 Continuing the Shortcut Method after a Purchase Business Combination.

- Decided to proceed with the issuance of an Exposure Draft to amend Statement 133 that would incorporate amendments arising from various Statement 133 Implementation Issues.

- Did not object to the staff's posting on the FASB website, concurrent with the Exposure Draft, the five related Statement 133 Implementation Issues noted above, as well as new Statement 133 Implementation Issue No. BX, "Bifurcation of Embedded Credit Derivatives."

- Did not object to the staff's posting the draft questions and answers related to the application of certain provisions of Statement 140 on the FASB website.

Effective Date

- Decided that the final Statement to amend Statement 133 should be effective beginning on the first day of the first fiscal quarter beginning after November 15, 2002, except in the following situations:

1. Entities should continue to apply the amendments that resulted from the Derivatives Implementation Group process in accordance with their respective effective dates.

2. Qualifying SPEs that are not grandfathered or newly created structures that issue beneficial interests after the issuance of the amendment to Statement 133 must apply the provisions related to the amended definition of a derivative and related bifurcation guidance upon issuance of the final Statement.

Transition

- Decided to require that entities that had not accounted for a contract as a derivative in its entirety or that had not bifurcated an embedded derivative but would be required to do so under the proposed Statement should account for the effects of initially complying with the proposed Statement prospectively for all existing contracts as of the effective date of the proposed Statement and for all future transactions. Also, entities that had previously accounted for a contract as a derivative instrument that would not be accounted for as a derivative instrument under the proposed Statement would not be required to change that accounting treatment.

Disclosures

- Decided to require that SPEs that are considered qualifying under Statement 140 that would no longer be qualifying after applying Statement 133 disclose in financial statements issued after the issuance of the amendment to Statement 133 the amount of assets and liabilities that are currently off-balance-sheet in those structures that would not qualify as qualifying SPEs if both Statements 133 and 140 were applied absent the grandfathering provision.

Immediate plans. We plan to issue an Exposure Draft, primarily through the FASB website, early in the second quarter of 2002 for a 60-day comment period.

Financial instruments projects chronology. Initial project added to agenda—May 1986. Liabilities and equity project separated as next phase—April 1989. *Distinguishing between Liability and Equity Instruments and Accounting for Instruments with Characteristics of Both:* Discussion Memorandum—August 1990. *Recognition and Measurement of Financial Instruments*: Discussion Memorandum—November 1991. Measuring at fair value project separated as next phase—April 1989. *Reporting Financial Instruments and Certain Related Assets and Liabilities at Fair Value:* Preliminary Views—December 14, 1999. *Accounting for Financial Instruments with Characteristics of Liabilities, Equity, or Both:* Exposure Draft—October 27, 2000. *Proposed Amendment to FASB Concepts Statement No. 6 to Revise the Definition of Liabilities:* Exposure Draft—October 27, 2000. Amendment of Statement 133 project added to the agenda—September 2001.

Financial Performance Reporting by Business Enterprises

Background. On October 24, 2001, the Board considered constituents' comments in response to an August 17, 2001 proposal for a potential agenda project on reporting information about the financial performance of business enterprises. The Board decided, consistent with suggestions of its constituents, to add the project to its agenda with the objective and scope described in that proposal.

The primary objective of the project is to (1) improve the quality of information displayed in financial statements so that investors, creditors, and others can better evaluate an enterprise's financial performance and (2) ascertain that sufficient information is contained in the financial statements to permit calculation of key financial measures used by investors and creditors. Several of the respondents to the August proposal suggested that this project, although limited to the display of items and measures in financial statements, is especially timely because the proliferation of alternative and inconsistent financial performance measures is undermining high-quality financial reporting, which is essential to well-informed investment decisions and efficient capital markets.

The project will focus on form and content, classification and aggregation, and display of specified items and summarized amounts on the face of all basic financial statements, interim as well as annual. That includes determining whether to require the display of certain items determined to be key measures or necessary for the calculation of key measures (for example, depreciation and amortization, research and development expense, and income taxes). The project will not address management discussion and analysis or the reporting of so-called pro forma earnings in press releases or other communications outside financial statements and does not include segment information or matters of recognition or measurement of items in financial statements.

The project plan contemplates coordinating, to the extent feasible, the FASB activities and approach for this project with the activities of a similar project being conducted jointly by the IASB and the U.K.'s Accounting Standards Board. That coordination and cooperation with other standard setters is directed at seeking opportunities to resolve issues in ways that also increase convergence of standards worldwide.

Recent developments and immediate plans. In February 2002, members of the FASB and its staff completed a series of interviews of 56 individuals who use financial statements—investors, creditors, and their advisors (equity and credit analysts) to assist the FASB in identifying key financial measures that they use in evaluating the performance of an enterprise. A summary of the findings resulting from those interviews is available on the FASB website. On February 26, the Board discussed the results of its user interviews with its project task force as well as the implications of those results for the project's objectives, plans, and the issues to be addressed. Several task force members suggested that the Board consider addressing certain specific issues on a faster track while the project proceeds with its comprehensive undertaking of the issues.

The Board discussed the project plans, scope, and approach. The Board affirmed the project scope and approved revising the project plan to move to Board deliberations leading to an Exposure Draft of a proposed Statement, rather than a neutral discussion document. The Board also began discussions about addressing certain specific issues on a faster track and sought further advice from members of its advisory council, on March 26, and from other constituents about specific issues for which a fast-track effort might be both desirable and feasible. Those discussions are continuing. The Board plans to begin its discussions of the project issues during the second quarter.

Project chronology. Added to agenda—October 2001.

Guarantor's Accounting and Disclosure Requirements for Guarantees

Background and recent developments. The Board's decision to undertake this project was made in conjunction with its discussion of interpretive consolidation guidance related to identifying and accounting for SPEs. Although guarantees are commonly found in SPE situations, they also are found in non-SPE situations. Accordingly, the Board decided in February 2002 that a separate project is warranted to provide interpretive guidance for the reporting of guarantees by guarantors.

The issuance of a guarantee imposes on the guarantor the following two obligations:

- An obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur
- A contingent obligation to make a future sacrifice (such as future payments) if those triggering events or conditions occur.

The Board decided that at the time a guarantor issues a guarantee, it should recognize a liability at fair value for its obligation to stand ready to perform under the guarantee. However, a guarantor would continue to recognize a liability for its contingent obligation to make a future sacrifice under FASB Statement No. 5, *Accounting for Contingencies.* The Board also decided to require the guarantor to make the following disclosures, even if it is probable that the guarantor will not need to make any payments under the guarantee:

- The nature of the guarantee, including how the guarantee arose and the events or circumstances that would require the guarantor to perform under the guarantee.
- The maximum potential amount of loss under the guarantee (that is, the excess of (1) the maximum amount of future cash payments the guarantor could be required to make over (2) the current carrying amount of the liability for the guarantor's obligations under the guarantee). That maximum potential amount of loss should not be reduced by the effect of any amounts that may possibly be recovered under recourse or collateralization provisions in the guarantee.
- The nature of (1) any recourse provisions that would enable the guarantor to recover from third parties any of the amounts paid under the guarantee and (2) the nature of any

assets held either as collateral or by third parties that, upon the occurrence of any triggering event or condition under the guarantee, the guarantor can obtain and liquidate to recover any of the amounts paid under the guarantee. The guarantor should indicate the approximate extent to which the proceeds from liquidation of those assets would be expected to cover the maximum potential amount of loss under the guarantee.

Regarding the scope of the proposed Interpretation, the Board decided that contracts that meet any of the four following characteristics would be included in the scope of the proposed Interpretation and would be subject to its disclosure requirements and initial recognition and measurement provisions:

- Contracts that contingently require the guarantor to make payments (either in cash or in kind) to the guaranteed party based on changes in an underlying that is related to an asset or liability of the guaranteed party
- Contracts (performance guarantees) that contingently require the guarantor to make payments (either in cash or in kind, including services) to the guaranteed party based on another entity's failure to perform under an obligating agreement
- Indemnification agreements (contracts) that contingently require the indemnifying party (guarantor) to make payments to the indemnified party based on the occurrence of a specified event or circumstance
- Contracts that are indirect guarantees of the indebtedness of others, as that phrase is used in FASB Interpretation No. 34, *Disclosure of Indirect Guarantees of Indebtedness of Others,* even though the payment to the guaranteed party is not based on changes in an underlying that is related to an asset or liability of the guaranteed party.

However, the Board decided that the following three types of guarantees should be excluded from being subject to the proposed Interpretation even though they meet the characteristic-based scope above:

- Product warranties, including separately priced extended warranties and product maintenance contracts
- A guarantee or indemnification contract that is issued by either an insurance company or a reinsurance company and is accounted for under the specialized accounting principles for those companies
- A lessee's guarantee of the residual value of the leased property at the expiration of the lease term, provided the lease is accounted for by the lessee as a capital lease.

Furthermore, the Board decided that guarantees that are accounted for as derivatives and obligations arising from a business combination to pay contingent consideration would be subject only to the disclosure requirements in the proposed Interpretation.

The Board decided that (1) the disclosure requirements in the proposed Interpretation should be effective for financial statements of quarterly or annual periods ending after September 30, 2002, and (2) the initial recognition and initial measurement provisions of the Interpretation should be applied to existing guarantees in the first fiscal year beginning after September 15, 2002, with a cumulative-effect-type adjustment reported in the first interim period of that fiscal year.

Immediate plans. We expect to issue early in the second quarter, primarily through the FASB website, an Exposure Draft of a proposed Interpretation for a 30-day comment period.

Project chronology. Added to agenda—February 13, 2002.

Obligations Associated with Disposal Activities

Background. In August 2001, the Board approved for issuance FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* The Exposure Draft that preceded Statement 144 included issues on the accounting for costs associated with a disposal activity, but in completing Statement 144, the Board decided to deal with those issues separately. The current phase of the project focuses on the accounting for costs associated with a disposal activity. The Board believes that this phase of the project is necessary principally because some liabilities for costs associated with a disposal activity are recognized under current accounting pronouncements, in particular, EITF Issue No.

94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)," that do not meet the definition of liabilities in the Conceptual Framework.

Decisions in current phase. The Board began redeliberations of issues on the accounting for costs associated with a disposal activity during the fourth quarter of 2001. The Board has made the following tentative decisions to date in this phase of the project. A more detailed discussion of the Board's tentative decisions is available on the FASB website.

Scope

- The Board decided to expand the scope of the Exposure Draft to include costs to terminate an obligation under a contract that existed prior to an entity's commitment to a disposal plan and that is not an operating lease. Thus, the project will reconsider all of the guidance in Issue 94-3 as it relates to a disposal activity. A *disposal activity* refers to (1) an exit (restructuring) activity that does not arise from a business combination, (2) the disposal of a long-lived asset or a component of an entity that is a discontinued operation covered by Statement 144, or (3) the termination of employees.

Recognition and Measurement

- The Board reconsidered its decision that a liability for a cost associated with a disposal activity should be recognized and measured based on its fair value when the likelihood of future settlement is *probable,* as that term is used in Statement 5. The Board decided that because the liability is measured based on its fair value, in most cases, the liability should be recognized when it is incurred. Thus, in determining whether to recognize and in measuring the fair value of a liability for a cost associated with a disposal activity, the guidance in Statement 5 and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss,* does not apply. The Board affirmed that a liability is incurred when the definition of a liability is met, thereby eliminating the exit cost notion in Issue 94-3.

- The Board modified the recognition requirements for one-time termination benefits. If the benefit arrangement requires employees to render future service beyond a "minimum retention period," a liability should be recognized as employees render service over the future service period, even if the benefit formula used to calculate an employee's termination benefit is based on length of service. If the benefit arrangement does not require employees to render future service beyond a "minimum retention period," a liability should be recognized at the communication date. The minimum retention period would be based on the legal notification period, or if there is no such requirement, 60 days.

- The Board reconsidered the approach for recognition of costs to terminate an obligation under an operating lease that existed prior to an entity's commitment to a disposal plan. The Board concluded that, conceptually, the liability for those lease termination costs is incurred at the inception of the lease. However, the Board decided for practical rather than conceptual reasons that the liability should be recognized when the leased property ceases to be used in operations, not at the date of an entity's commitment to a disposal plan, as under Issue 94-3. The Board decided that the same approach should apply for other contract termination costs.

Immediate plans. The Board plans to substantially complete its redeliberations of issues addressed in the Exposure Draft during the second quarter of 2002. We expect to issue a final Statement in the third quarter.

Project chronology. Added to agenda—August 1996. Exposure Draft—June 30, 2000. *Accounting for the Impairment or Disposal of Long-Lived Assets:* Statement 144—August 2001.

Rescission of Statement 4

Background. In August 2001, at the request of several constituents, the Board added a project to its agenda to rescind FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt.* When Statement 4 was issued in 1975, the Board indicated that the accounting it would require represented a practical solution and was intended to be temporary. Recently constituents expressed concern that automatically classifying gains and losses associated with the extinguishment of debt as extraordinary items could be misleading to users of financial statements because debt extinguishment is a regular part of their strategy for managing interest rate risk in their debt portfolio. In October 2001, the Board completed its deliberations on the proposed Statement to rescind Statement 4 and FASB Statement No. 44, *Accounting for Intangible Assets of Motor Carriers,* and Statement No. 64, *Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements,* and to make various technical corrections to existing authoritative accounting pronouncements. On November 15, 2001, the Board issued the Exposure Draft*,* *Rescission of FASB Statements No. 4, 44, and 64 and Technical Corrections.*

Recent developments and immediate plans. In February 2002, the Board redeliberated the provisions of the Exposure Draft, and in light of comments received it decided to add a substantive amendment of FASB Statement No. 13, *Accounting for Leases,* to the project. On February 14, 2002, the Board issued a limited revised Exposure Draft through the FASB website to seek comments on that change. We requested comments by March 18, 2002, and we received nine comment letters. We plan to issue a final Statement early in the second quarter of 2002.

Project chronology. Added to agenda—August 2001. Exposure Draft—November 15, 2001. Revised Exposure Draft—February 14, 2002. (Comment deadline—March 18, 2002.)

Other Technical Research Activities

In addition to the formal agenda of technical projects, we have a number of other technical issues that we are studying and developing. Some of these will be developed into future projects for the Board. Others may help us to expand our understanding of financial reporting issues and may affect formal agenda projects indirectly in various ways. Issues currently under consideration are discussed below.

Pre-Agenda Proposal Research—Liabilities and Revenues. At its meeting on January 9, 2002, the Board discussed the objective and scope of a potential major project on the recognition of revenues and liabilities in financial statements. The need for that proposed agenda project arose from difficulties that the Board encountered in addressing issues involving liabilities in three projects (asset impairment and disposal issues, asset retirement obligations, and financial instruments—liabilities and equity) and that the EITF and SEC staff encountered in addressing a variety of issues involving revenues. Because matters of revenue recognition can conflict with liability recognition, that project would lead to a new accounting standard on revenue recognition generally, and it also would involve amending the related guidance on revenues and liabilities in certain of the Board's Concepts Statements. The Board issued that project proposal primarily through the FASB website, for public comment with a 60-day comment period. We requested comments by March 29, 2002. After discussing the letters received, the Board will decide whether to add the project to its agenda. That decision is expected to be made in May.

Codification and Simplification. In January, the Board agreed to undertake the following actions in response to concerns raised by constituents about the quantity, complexity, and lack of easy retrievability of the body of U.S. accounting literature including guidance issued by the EITF, AICPA, and SEC. Recent staff activities on the actions are noted below:

Simplification

- Evaluate the feasibility of issuing standards that are less detailed and have few, if any, exceptions or alternatives to the underlying concepts. (This topic was discussed with FASAC at its March 2002 meeting.)
- Work with the EITF, AICPA, and SEC to more clearly define their roles in setting accounting standards with an eye toward streamlining certain activities.
- Improve the quality of the cost-benefit analyses prepared as part of the due process for new standards. (The staff is in the process of developing guidelines to be used in all FASB projects.)

Codification/Retrievability

- Explicitly address all related EITF, AICPA, and SEC literature in new standards. (The staff is in the process of developing guidelines to be used in developing all future FASB standards.)
- Include references to all of the applicable U.S. accounting literature in the FASB's *Current Text* (a compilation of all FASB accounting standards categorized by subject). (The staff currently is working on this effort and hopes to have it completed by the end of this year.)
- Partner with others in developing an online database that will include all of the U.S. accounting literature. (Our publications department is continuing its discussions on this effort.)

Disclosure Overload

- Provide support to the SEC on its initiative to modernize financial reporting and disclosure. (An FASB staff member has been assigned to assist the SEC staff on its initiatives.)

A more detailed discussion of those actions is available on the FASB website.

Financial Instruments—Derivatives Implementation Group (DIG). The objectives of the Implementation Group were to identify issues related to the implementation of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* and to develop recommendations to the Board on how to resolve those issues. The Implementation Group previously met every two or three months with members of the Board and staff to discuss implementation issues related to Statement 133.

We plan to continue working on the various unresolved issues and consulting with individual Board members and DIG members as appropriate. At this time we do not have specific plans for any future DIG meetings. As implementation issues arise, we will assess the alternatives available for resolution of those issues.

A total of 158 issues have been cleared by the Board to date for inclusion in a staff Implementation Guide in a question-and-answer format. Information about DIG issues is available on the FASB website.

Emerging Issues Task Force. The FASB's EITF assists the Board in the early identification of emerging issues affecting financial reporting and of problems in implementing authoritative pronouncements. Additionally, the Task Force's discussion of issues and the relevant accounting pronouncements help us better understand the emerging issues and, when a consensus is reached, may indicate that no immediate action by the FASB is needed because diversity in practice is not likely to evolve.

During the first quarter of 2002, the Task Force met twice and discussed 14 issues. The next EITF meeting is scheduled for June 19 and 20, 2002.

Descriptions of recently discussed EITF issues are posted on the FASB website. A summary of EITF issues and their resolution or other status is published in an FASB loose-leaf subscription service, *EITF Abstracts,* which summarizes the Task Force proceedings. The service includes a summary of each issue discussed by the Task Force and any conclusions reached along with a comprehensive topical index.

Issue summaries and related attachments, which are discussion materials distributed to each EITF member, and the official minutes of each EITF meeting also are available from the FASB order department at 1-800-748-0659.

International. The Board is active in many international accounting activities and participates in meetings of many international accounting organizations, such as the IASB. General information about FASB international activities can be obtained from the

FASB website. A detailed report on the FASB's specific recent international activities is reported in the Chairman's Report on the FASB website.

Information about how to order the FASB Report, *The IASC-U.S. Comparison Project: A Report on the Similarities and Differences between IASC Standards and U.S. GAAP,* is available on the FASB website. Copies of the FASB Report, *International Accounting Standard Setting: A Vision for the Future,* can be downloaded from the FASB website.

AICPA Documents. In the first quarter of 2002, the Board reviewed the following documents and took the action described below:

- Prospectus for a proposed SOP on accounting for risk transfer in mortgage reinsurance arrangements that involve participation of mortgage lenders. The Board did not clear the Prospectus and requested that AcSEC consider increasing the scope of the Prospectus to include the accounting for the arrangements by the mortgage lenders.
- Exposure Draft of a proposed AICPA Statement of Position (SOP), *Clarification of the Scope of Investment Companies Audit and Accounting Guide and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies.* The Board objected to issuance of the Exposure Draft and recommended that AcSEC consider certain changes. Further, the Board expressed its view that an investment company (other than a separate account of an insurance company as defined in the Investment Company Act of 1940) must be a separate legal entity to be within the scope of the Guide. Accordingly, the specialized accounting principles in the Guide should be applied to an investment made after March 27, 2002, only if the investment is held by an investment company that is a separate legal entity. Investments acquired prior to March 28, 2002, or those acquired after March 27, 2002, pursuant to an irrevocable binding commitment that existed prior to March 28, 2002, should continue to be accounted for in accordance with the entity's existing policy for such investments.
- Prospectus for a proposed SOP on reporting the costs of soliciting contributed services that do not meet the recognition criteria for contributions in FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made.* The Board objected to AcSEC's undertaking a project to address the reporting of costs of soliciting contributions of services that do not meet the criteria for recognition as contribution revenue in Statement 116. The Board believes a project is not necessary to clarify the existing GAAP that addresses this issue. The Board believes that paragraphs 26–28 of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations,* require that information about expenses be reported by functional classification and that fund-raising activities include soliciting contributions of services from individuals, regardless

of whether those services meet the recognition criteria for contributions in Statement 116. The Board also observed that the definition of fund-raising activities in paragraph 13.35 of the AICPA Audit and Accounting Guide, *Not-for-Profit Organizations,* conforms to paragraphs 26–28 of Statement 117 and provides that costs of soliciting donors to contribute services (time) should be reported as fund-raising activities regardless of whether those services meet the recognition criteria for contributions in Statement 116. (That conclusion also is articulated in the March 2000 AICPA Technical Practice Aid No. 6140.11, *Costs of Soliciting Contributed Services and Time That Do Not Meet The Recognition Criteria in FASB Statement No. 116.*) The Board suggested that AcSEC consider how best to communicate the final resolution of this issue in the next edition of the Guide.

We expect to address the following documents in the second quarter of 2002:

- Proposed SOP, *Accounting for Derivative Instruments and Hedging Activities by Not-for-Profit Health Care Organizations*
- Prospectus of a proposed SOP on accounting for purchase business combinations involving insurance enterprises including certain reinsurance transactions that are in substance business combinations
- Proposed SOP, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts.*

Effective Dates

FAS 141, *Business Combinations,* effective for all business combinations initiated after June 30, 2001. The provisions also are applicable to all business combinations accounted for by the purchase method (regardless of the date initiated) for which the date of acquisition is July 1, 2001, or later. However, for combinations between two or more mutual enterprises, the effective date is deferred until interpretative guidance related to the application of the purchase method to those transactions is issued.

FAS 142, *Goodwill and Other Intangible Assets,* effective for fiscal years beginning after December 15, 2001, except for mutual enterprises and not-for-profit organizations. However, certain provisions are applicable to goodwill and intangible assets acquired in transactions completed after June 30, 2001.

FAS 143, *Accounting for Asset Retirement Obligations,* effective for financial statements issued for fiscal years beginning after June 15, 2002.

FAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years.

The FASB Report

The FASB welcomes feedback on *The **FASB** Report*
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Statements, Proposals, Other Documents, and Current Projects Responsive to the AICPA Report

Summary of Recommendations

Financial Statements and Related Disclosures (Chapter 6)

Recommendation 1: Improve disclosure of business segment information

Statements

FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information* (June 1997)

Recommendation 2: Address the disclosures and accounting for innovative financial instruments

Statements

FASB Statement No. 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments* (October 1994)

FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (June 1996)

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (June 1998)

FASB Statement No. 134, *Accounting for Mortgage-Backed Securities Retained after the Securitization of Mortgage Loans Held for Sale by a Mortgage Banking Enterprise* (October 1998)

FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements* (February 2000)

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (September 2000)

Outstanding Proposals

Exposure Draft, *Accounting for Financial Instruments with Characteristics of Liabilities, Equity, or Both* (October 2000)

Exposure Draft, *Proposed Amendment to FASB Concepts Statement No. 6 to Revise the Definition of Liabilities* (October 2000)

Other Documents

Preliminary Views, *Reporting Financial Instruments and Certain Related Assets and Liabilities at Fair Value* (December 1999)

Special Report, *Financial Instruments and Similar Items* (December 2000)

Other Current Projects

Guarantor's Accounting and Disclosure Requirements for Guarantees

Recommendation 3: Improve disclosures about the identity, opportunities, and risks of off-balance-sheet financing arrangements and reconsider the accounting for those arrangements

Statements

FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (June 1996)

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (September 2000)

Outstanding Proposals

Exposure Draft, *Consolidated Financial Statements: Policy and Procedures* (October 1995)

Revised Exposure Draft, *Consolidated Financial Statements: Purpose and Policy* (February 1999)

Other Documents

Special Report, *Reporting Interests in Joint Ventures and Similar Arrangements* (September 1999)

Other Current Projects

Consolidations and Related Matters: Interpretative Guidance for Certain Situations

Guarantor's Accounting and Disclosure Requirements for Guarantees

Recommendation 4: Report separately the effect of core and non-core activities and events, and measure at fair value non-core assets and liabilities

Statements

FASB Statement No. 130, *Reporting Comprehensive Income* (June 1997)

FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements* (February 2000)

Other Documents

Preliminary Views, *Reporting Financial Instruments and Certain Related Assets and Liabilities at Fair Value* (December 1999)

Special Report, *Financial Instruments and Similar Items* (December 2000)

Other Current Projects

Financial Performance Reporting by Business Enterprises

Recommendation 5: Improve disclosures about the uncertainty of measurements of certain assets and liabilities

Statements

FASB Statement No. 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments* (October 1994)

AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties* (December 1994)

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (September 2000)

Recommendation 6: Improve quarterly reporting by reporting on the fourth quarter separately and including business segment data

None

Recommendation 7: Standard setters should search for and eliminate less relevant disclosures

Statements

FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities* (December 1996)

FASB Statement No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits* (February 1998)

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (June 1998)

Other Documents

Business Reporting Research Project, Steering Committee Report, *GAAP-SEC Disclosure Requirements* (2001)

Excerpts from the Powers Report

Page 5 "Enron's original accounting treatment of the Chewco and LJM1 transactions that led to Enron's November 2001 restatement was clearly wrong, apparently the result of mistakes either in structuring the transactions or in basic accounting."

Page 15 "Rather than take that loss, Enron 'restructured' the Raptor vehicles by, among other things, transferring more than $800 million of contracts to receive its own stock to them just before quarter-end. This transaction apparently was not disclosed to or authorized by the Board, involved a transfer of very substantial value for insufficient consideration, and appears inconsistent with governing accounting rules. It continued the concealment of the substantial losses in Enron's merchant investments."

Pages 15-16 "As we stated above, in 2001, Enron and Andersen concluded that Chewco lacked sufficient outside equity at risk to qualify for non-consolidation. At the same time, Enron and Andersen also concluded that the LJM1 SPE in the Rhythms transaction failed the same threshold accounting requirement. In recent Congressional testimony, Andersen's CEO explained that the firm had simply been wrong in 1999 when it concluded (and presumably advised Enron) that the LJM1 SPE satisfied the non-consolidation requirements."

Page 58 "Accounting standards for revenue recognition generally require that the services be provided before recording revenue. It seems doubtful that the management services related to the 'required payment' (covering 1998 to 2003) had all been provided at the time Enron recognized the $25.7 million in income. If those services had not been provided by March 1998, Enron's accounting appears to be incorrect."

Pages 97-98 "In three of the four Raptors, the vehicle's financial ability to hedge was created by Enron's transferring its own stock (or contracts to receive Enron stock) to the entity, at a discount to the market price. This 'accounting' hedge would work, and the Raptors would be able to 'pay' Enron on the hedge, as long as Enron's stock price remained strong, and especially if it increased. Thus, the Raptors were designed to make use of forecasted future growth of Enron's stock price to shield Enron's income statement from reflecting future losses incurred on merchant investments. This strategy of using Enron's own stock to offset losses runs counter to a basic principle of accounting and financial reporting: except under limited circumstances, a business may not recognize gains due to the increase in the value of its capital stock on its income statement."

Pages 125-126 "Enron had accounted for the Enron shares sold in April 2000 to Talon (Raptor 1), in exchange for a $172 million promissory note, as an increase to 'notes receivable' and to 'shareholders' equity.'…Enron made similar entries when it sold Enron stock contracts in March 2001 to Timberwolf and Bobcat (Raptors II an IV) for notes totally $828 million. This accounting treatment increased shareholders' equity by a total of $1 billion in Enron's first and second quarter 2001 financial reports.…In September 2001, Andersen and Enron concluded that the prior accounting entries were wrong, and the proper accounting for these transactions would have been to show the notes receivable as a reduction to shareholders' equity.…The correction of the error in Enron's third quarter financial statements resulted in a reduction of $1 billion ($172 million plus $828 million) to its previously overstated equity balance."

Page 129 "Proper financial accounting does not permit this result [Enron's hedging itself through the Raptors]. To reach it, the accountants at Enron and Andersen—including the local engagement team and, apparently, Andersen's national office experts in Chicago—had to surmount numerous obstacles presented by pertinent accounting rules. Although they apparently believed that they had succeeded, a careful review of the transactions shows that they appear to violate or raise serious issues under several accounting rules…."

Pages 197-199 "FAS Statement No. 57 required Enron to provide '[a] description of the transactions,…and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements.' We think that Enron's related-party transaction disclosures fell short of this goal….First, Enron lacked the factual basis required by the accounting literature to make the assertions in each SEC filing concerning how the LJM transactions compared to transactions with unrelated third parties.…Second, the publicly filed financial statement disclosures omitted a number of key details about the transactions."