The Impact of the SEC on the First 100 Statements of the FASB[*]

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[*] Working Paper: This paper was originally written in the mid-1980's, and covered the FASB's first 100 statements. It is now in the process of being updated to include all FASB statements to date. This will give depth to the paper's historical perspective.

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1. Introduction

One major conclusion of the Metcalf Committee in its study "The Accounting Establishment" (1976) is that the Big Eight accounting firms dominate the FASB and its pronouncements while the SEC plays only a passive role.

> *The FASB organizational separation from the private interest groups sponsoring it is the basis for the claim that it establishes accounting standards in- dependently. However, the separation is one in name only. The study finds that the Big Eight accounting firms, the AICPA and, to a lesser extent, the other sponsoring groups have control over the operation of the FASB. (p.15)*
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> *In effect, the SEC had delegated the establishment of accounting standards which are binding on all publicly-owned corporations to the special interest groups which control the FASB, and has reserved* <u>*a mere oversight role for itself.*</u> *(Emphasis added) (p.18)*

Hussein and Ketz (1980) cast doubt on the allegation regarding the dominance of the Big Eight accounting firms. This study examines the other allegation by the other allegation by the Metcalf Report, that the SEC plays a peripheral role in the setting of accounting standards by describing the actual role played by the SEC in the early years of the FASB's existence. Understanding the relationship between the FASB and the SEC is important since the SEC is often criticized for not fulfilling its obligation.

> *Critics take the SEC to task for allowing standard setting to remain in the private sector, whether at the AICPA or the FASB. In the Securities Act of 1933 and the Securities Exchange Act of 1934, Congress directed the SEC to protect investors from misleading financial reports. From this came the authority to establish accounting and reporting standards.*
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> *Instead of setting its own standards, however, the SEC has relied on the rules established by the profession, except in those cases where it finds the AICPA or the FASB to be derelict in its duties. (Stevens, 1981, p.227)*

Nevertheless the .SEC is often criticized for exerting pressure on the FASB (see for example Sunder, Wall Street Journal April 27, 1981; page 30), suggesting that the SEC has some involvement in the standard setting process. Examination of the nature of the SEC's involvement should help determine which of the following descriptions of the SEC's role is more appropriate: (1) Weak SEC input to the standard setting process, as alleged by the Metcalf Report; (2)

Significant SEC input to the standard setting process. If the SEC has had substantive involvement with the FASB in setting accounting standards, the Metcalf allegation has little basis in fact. If not, perhaps the SEC should be reprimanded and the standard-setting process restructured.

In this paper we examine the influence of the SEC on the FASB as evidenced by the first one-hundred statements issued by the FASB. The politicization of the accounting standards setting body -the FASB – has been recognized in the literature, e.g., Chatov .(1975), Gerboth (1973), Horngren (1973), Kirk (1981), May and Sundem (1976), Solomon (1978), Watts and Zimmerman (1978), and Zeff (1978). As pointed out by Kirk (1981) the FASB perceives the SEC as the major political force:

> *Behind the FASB's car are several very impatient drivers - would be standard setters - who are honking their horns and frantically gesturing that we should forge ahead in the direction they want to go. The noisiest car is a black limousine with the Washington D.C. license plate 'SEC' (p.84).*

Sections two and three describe the data sources and the FASB's rules of procedure, respectively; each of the major first one hundred statements is examined in section four and section five provides a summary and conclusions.

2. Data and Methodology

To determine the extent of the interaction between the SEC and the FASB on the first one hundred statements, we first examined the FASB public file for each of these statements. The files contain minutes from FASB meetings, discussion memoranda, exposure drafts, letters of comment and records of public hearings; we extracted all evidence of FASB/SEC interaction. Furthermore, we checked the Wall Street Journal Index, New York Times Index, and the Business Periodicals Index for articles addressing the topics covered in Statements 1-100 and articles dealing with the SEC or the FASB. We also reviewed the newsletters published by the Big Eight firms and the "News Report" section in the Journal of Accountancy to check the current developments on accounting issues during 1972-1989.

The question of whether or not the FASB is subject to the SEC's pressure does not lend itself to quantitative methodology. Accordingly, we used the following indicators which suggest the existence of SEC pressure: 1) the degree of SEC involvement in the initial selection of the topics underlying FASB Statements; 2) deviations from the FASB's rules of procedure and the timing of FASB actions in order Co accommodate the SEC; 3) similarity between positions taken by the FASB to those sought by the SEC.

3. Rules of Procedure

A brief outline of the FASB's rules of procedure, presented next, is necessary if we are to identify deviations from these rules.

1. An item seen as a potential problem area as a result of input from the Advisory Council, Accounting Standards Executive Committee of the AICPA or public accounting firms is defined. There is a Committee on Emerging Problems intended as a vehicle for recognizing and initiating action on public issues.
2. The item is formally placed on the Board's technical agenda.
3. A task force is appointed by the Board. Task forces include members from the Advisory Council and are responsible for refining the definition of a problem, recommending the nature and extent of the research to be performed.
4. The task force, normally prepares a discussion memorandum (which typically takes six months) and upon its issue, comments are solicited.
5. A public hearing is held within 30-90 days after the discussion memorandum is issued.
6. An exposure draft of the proposed standard is issued, usually within 10 months of the public hearing.

A final standard is issued between 30 and 90 days after the close of the comment period. An analysis of the political environment associated with the development of each statement follows in the next section. The analysis focuses 1) on the positions of and interactions between the FASB and SEC regarding the specific accounting issue at hand throughout the seven-step process and 2) the extent to which the FASB deviated from its rules, because-such deviations might stem from political pressure.

4. The SEC-FASB Relationship as Evidenced by the First One Hundred Statements

Our analysis of the first one hundred FASB statements reveals several modes of SEC involvement in the accounting standards setting process. These modes, which are not mutually exclusive, are described in Table I and include:

- FASB acts right after a related disclosure requirement is issued by the SEC. The action of the FASB is consistent with the disclosure requirements of the SEC.
- The subject matter is initiated by the SEC.
- The SEC threatens to act if the FASB does not.
- The FASB acts hastily as a result of SEC pressure.
- The FASB changes its rules of procedures in order to accommodate the SEC.
- The SEC intervenes on the behalf of the FASB.

The most common sequence of events surrounding the issuance of an FASB statement would have the FASB acting immediately after a related disclosure requirement is made by the SEC and taking a position consistent with the SEC. This relationship was found in 9 of the first 16 statements. The events surrounding Statement No. 14 can be used as an illustration.

In April 1974, the SEC issued ASR No. 154 which required segment reporting. One month later the FASB issued a discussion memorandum on the very same topic which culminated in Statement No. 14, Financial Reporting for Segments of a Business Enterprise, (December 1976), a statement fully consistent with ASR No. 154. Wagner in a 1976 article appearing in Management' Accounting argues that the fact the discussion memorandum was issued one month after the ASR was not coincidental and describes ASR No. 154 as a "subtle hint" from the SEC to the FASB.

The statements where it was noticeable that the SEC initiated the subject matter are Nos. 1, 4, 8, 13, 16, 19, 33, 34, 86, 89, and 95. For example, evidence that Statement No. 13 was initiated by the SEC can be found in a speech made by former Chairman of the SEC, G. Bradford Cook: "The accounting profession has probably failed to keep up with the phenomenal growth and complexity of lease arrangements." (Journal of Accounting, July 1973, p. 10). Furthermore, a speech made by L. Rosen, Associate Director of SEC, San Francisco Office, with regard to this issue, states that the “accounting profession should be concentrating on building new principles while reinforcing old bridges with additional disclosure” (ibid. p. 12).

In Statement Nos. 1, No. 4 and No. 13 we observe that the SEC not only initiated the particular accounting issue but rather threatened to act itself if the FASB would not. For example, with regard to Statement No. 4: (Reporting Gains and Losses from Extinguishment of Debt) a February 3, 1973 Wall Street Journal article states that in addition to open admission by the Board that the topic was placed on its agenda at the urging of the SEC, the SEC threatened to issue the proposed rule itself if the FASB would not.

Examination of Statement No. 1 and No. 4 also show that the FASB acted hastily as a result of SEC pressure. This hasty action is apparent by the omission of the discussion memorandum and public hearings and the use of the minimum 30-day exposure period for Statement No, 1: Disclosures of Foreign Currency Translation Information.

There is evidence that this hasty action was motivated by SEC pressure. A letter from DeSota, Inc. (dated October 24, 1973), commenting on the exposure draft states that the chief accountant of the SEC threatened that the SEC would act and issue its own pronouncement if the FASB did not. A December 14, 1973 article in the New York Times corroborated the DeSota letter.

Evidence of the unexpectedly early release of Statement No. 1 can also be found in a Status Report issued by the FASB on September 28, 1973. In the report, Chairman Armstrong suggested that a final statement could not be issued before mid-1974. The statement was actually issued in December 1973.

A unique case regarding the SEC-FASB relationship was observed in Statement No. 16. At its first attempt, the FASB was unable to issue Statement No. 16 because only a simple majority, rather than the necessary five votes, supported the issuance of the statement. A short time after this unsuccessful attempt, the trustees of the Financial Accounting Foundation approved a proposal of their Structure Committee to change the FASB's voting requirements to simple majority. This change enabled the FASB to issue Statement No. 16 as sought by the SEC.

Another dimension of the harmony between the SEC and the FASB can be found in the history of Statement Nos. 2, 3, 5, and 8 where the SEC intervened on behalf of the FASB and supported the FASB's position when the latter was criticized by outside groups such as Congress, IRS, and industry.

For example, in the issuance of Statement No. 3, a conflict developed between the requirements of the statement and the Internal Revenue Service. The IRS viewed FASB Statement No. 3 as a circumvention of its regulation prohibiting companies who choose the LIFO method for tax purposes from using a non-LIFO method for external reporting and threatened to eliminate the LIFO tax advantage for those companies switching to LIFO and reporting according to Statement No. 3 and ASR 159. The SEC in ASR 169 (January 1975) interceded on behalf of the FASB in opposition to the IRS, by requiring corporations changing to LIFO to disclose the effect of the change.

While in most cases the FASB took a position which was consistent with the SEC, there are statements (Nos. 13, 15, and 6) where one may perceive an existence of conflict between the two organizations. The most noticeable conflict occurred with the issuance of Statement No. 13 where the issue of retroactive application developed. In the analysis of the events surrounding this statement we found that the FASB delayed the issuance of the statement and issued a second exposure draft which was a compromise with the SEC view. Thus the final statement was satisfactory to the SEC.

Another perceived inconsistency existed with Statement No. 15 where the final statement differs from the SEC position favoring present value accounting for banks. In depth analysis of the events leading up to the issuance of the statement indicate complete harmony between the SEC and FASB. The discussion memorandum which did favor present value accounting was vehemently opposed by the strong banking industry. The joint forces of the SEC and the FASB were not strong enough to resist the banks and thus the exposure draft and final statement exclude present value accounting.

A similar case occurred later with the oil and gas industry, in Statement No. 19. The SEC overruled FASB Statement No. 19 in spite of the fact that they initially supported this statement; this change in position, however, was due to its inability to resist the industry pressure. SFAS 19, Financial Accounting and Reporting by Oil and Gas producing companies, is a classic example the political interaction in the standard setting process. The 1975 Energy Policy and Conservation Act required the SEC to develop either internally or through the FASB financial accounting and reporting standards for the oil and gas companies. The SEC delegated the responsibility to the FASB and the FASB concluded that only the successful effort method should be followed. As is evidenced by SAR No. 5861, initially, the SEC agreed with FASB. However, due to industry pressure, the SEC rejected FASB's statement and set out to develop its own standard.

In SFAS 34, "Capitalization of Interest Cost," and SFAS 86, "Accounting for the Costs of Computer Software," the SEC, clearly initiated the subject matter. In both instances, the SEC acted by issuing a moratorium, pending FASB's decision.

The subject matter of SFAS 33, Financial Reporting and Changing Prices, was also initiated by the SEC. In 1976, the SEC adopted a replacement cost rule that required certain large public companies to calculate in annual reports to the commission what it would cost in current dollars to replace existing "productive capacity." As a result of this disclosure requirement, the FASB began its work on financial reporting and changing prices and issued SFAS 33 which required constant dollar accounting and current cost accounting. Evidence exists that most FASB members were reluctant to include current cost accounting in SFAS 33, but nonetheless included it to satisfy the SEC (Bartlett and Kelly, 1980, p.13). In light of this fact, it seems ironic that the Board eliminated the CDA and while retaining CCA in SFAS 70 and SFAS 82.

Although we found no direct evidence of FASB-SEC interaction in accounting for pension costs, it is interesting to note FASB's cautionary stance. FASB, aware of the need for reform as well as of the pressures from industry for status quo, decided to use the "foot in the door" technique. It first established guidelines for accounting for "pension plan" (rather than the Employer). Next, it asked the companies to disclose the information about the plan in notes. Finally, it required the companies to record a liability if accumulated benefit obligations exceeded fair value of plan assets. Also worth noting is that the FASB deviated slightly from its regular "due process" by its issuance of Preliminary Views, which was an intermediate step between Discussion Memorandum and Exposure Draft. The Board issued it to obtain comments on its tentative conclusions.

The third statement which is somewhat inconsistent with the initial position of the SEC is Statement No. 6. This statement softens certain SEC requirements that proved to be unworkable. Thus, out of the three statements in which a conflict between the FASB and SEC might be perceived, only in one (Statement No. 13) is the conflict of substance and ended in a compromise.

A detailed statement by statement analysis showing the SEC involvement in the first sixteen statements is provided in the appendix.

5. Concluding Remarks

The relationship between the SEC and the FASB as described above indicates that the SEC has put pressure on the FASB (the "noisiest car" in the analogy of Kirk (1981)) in the standard setting process and has not adopted a position of benign neglect. The issues addressed by the FASB, the speed at which the FASB responds, and even its position on certain issues can at times be solely attributed to SEC pressure. In some cases we even witness the FASB's protection from criticism of outside groups by the SEC.

Our analysis strongly suggests that the SEC is quite active in the standard setting process and not nearly as passive as appears on the surface. We conclude that the second Metcalf allegation has little basis in fact. Indeed, the SEC involvement is strong and intense and goes beyond "occasional creative stimulation" as concluded by Burton (1981).

Nevertheless, the FASB plays an important role both in the setting of accounting standards and in the life of SEC. Kirk (1981b) argued that the existence of the FASB is particularly important to the SEC because it removes by one step the inevitable temptation of Congress to let politics influence the setting of financial reporting standards. Since the SEC has the ultimate power of dismantling the FASB and therefore can greatly influence its decisions, the SEC might prefer to have the standards set by the FASB thus minimizing its own (SEC) exposure to political pressures.

6. Appendix

The Sec Involvement in Accounting Standard Setting Statement by Statement

<u>Statement 1: Disclosures of Foreign Currency Translation Information (December 1973)</u>

The FASB acted hastily in the preparation of this first statement. This is apparent by the omission of the discussion memorandum and public hearings, and the use of minimum 30-day exposure period.

There is evidence that this hasty action was motivated by SEC pressure. A letter from DeSota, Inc. (dated October 24, 1973), commenting on the exposure draft stated that the chief accountant of the SEC threatened that the SEC would act and issue its own pronouncement if the

FASB did not. A December 14, 1973 article in the New York Times corroborated the DeSota letter.

Evidence of the unexpectedly early release of Statement Number 1 can also be found in a Status Report issued by the FASB on September 28, 1973. In the report, Chairman Armstrong suggested that a final statement could not be issued before mid-1974. However, the statement was actually issued in December, 1973.

<u>Statement 2: Accounting for Research and Development Costs (October 1974)</u>

Prior to the issuance of Statement Number 2, most companies expensed their research and development costs in the period incurred. In Statement Number 2, the FASB gave official sanction to this practice and therefore was not subject to much dissent or criticism.

However, some companies particularly in the aerospace and high technology areas had been capitalizing research and development costs. Prominent among these were Lockheed and McDonnell-Douglas. It was estimated that Lockheed's deferred costs on the Tri-star amounted to $500 million; write-off of this amount would almost eliminate Lockheed's stockholders' equity. Similarly McDonnell-Douglas' deferred cost on the DC-10 equaled 75% of its stockholders' equity (Anderer, 1974). Congress was unhappy with the practice of capitalizing research and development costs, and made the SEC aware of this. (Ripley, 1972)

On May 6, 1974 the SEC issued Securities Act Release (SAR) No. 5492 which called for defense and long-term contractors to disclose the amount of research and development costs charged to inventory. Thus the SEC responded to the pressure from Congress and indicated its support of expensing research and development costs, the method later selected later by the FASB in the exposure draft (June, 1974) and the final statement (October, 1974).

<u>Statement 3: Reporting changes in interim Financial Statements (December 1974)</u>

The SEC position on this topic prior to the issuance of the FASB exposure draft (November, 1974) is stated in ASR 159 (August, 1974) which required corporations changing to

LIFO to disclose the impact on reported interim income. The FASB exposure draft and the final statement (December 1974) are fully consistent with the position of the SEC. Other than the fact that the exposure draft was issued after the ASR, there is no evidence of SEC involvement.

A conflict, however, developed between the requirement of this statement and the IRS. The IRS viewed FASB Statement No. 3 as a circumvention of its regulation prohibiting companies who choose the LIFO method for tax purposes from using a non-LIFO method for external reporting and threatened to eliminate the LIFO tax advantage for those companies switching to LIFO and reporting according to Statement No. 3 and ASR 159. The SEC in ASR 169 (January, 1975) interceded on behalf of the FASB in opposition to the IRS, by requiring corporations changing to LIFO to disclose the effect of the change.

<u>Statement 4: Reporting Gains and Losses from Extinguishments of Debt (March 1975)</u>

In December, 1974, the SEC referred the problem of reporting gains and losses from the early extinguishment of debt, to the FASB with a request for prompt action.

A February 3, 1975, Wall Street Journal article states that in addition to open admission by the Board that the topic was placed on its agenda at the urging of the SEC, the SEC threatened to issue the proposed rule itself if the FASB would not. The lack of a discussion memorandum and the shortened exposure period indicate that the FASB acted hastily in order to please the SEC.

<u>Statement 5: Accounting for Contingencies (March 1975)</u>

Prior to the issuance of FASB Statement No. 5 (March 1975), large insurance companies accrued catastrophe losses, and many large industrial companies accrued self-insurance charges. This practice was no longer permitted under FASB No. 5 which followed the disclosure rules of ASR 134 (January 1973) and ASR 145 (August 1973).

Examination of the FASB public file indicates that the large insurance companies expressed their opposition to the proposed rule through letters of comment to the FA6 . Their effort was unsuccessful and they appealed to the SEC. This effort also proved to be unsuccessful causing them to approach certain members of Congress, including Senator Hubert Humphrey. Senator Humphrey sent a letter of comment to the FASB stressing the negative economic effects the proposed standard would have on the insurance industry. Even so, the FASB did not yield and with the support of the SEC, Statement No. 5 prevailed.

Statement 6: Classification of Short-Term Obligations Expected to be Refinanced (May 1975)

In the early 1970s, there had been a considerable increase in the amount of short term debt on many companies' balance sheets. Responding to the lack of rules regarding debt classification, the SEC issued ASR 148 (November, 1973) which specified certain criteria for the classification of commercial paper and short term debt expected to be refinanced.

In its exposure draft (November 1974) the FASB proposed that all obligations due within the year should be reported as long-term liabilities if there is evidence that these obligations are to be refinanced. Statement No. 6 generally conformed to practice under similar rules adopted in 1973 by the SEC, in ASR 148.

Statement 7: Accounting and Reporting by Development Stag.e Enterprises (June 1975)

Statement No. 7 did not present any novel accounting concepts. It required development stage companies to present financial statements in conformity with existing generally accepted accounting principles for established operating companies.

This statement is consistent with the SEC's preference for uniform accounting standards. With a few exceptions (extractive, real estate, and cable television industries) Statement No. 7 emphasized that generally accepted accounting principles apply to all companies regardless of their age or size. The SEC endorsed this statement with the release of ASR 181 (November, 1975).

Statement 8: Accounting fc'r the Translation of Foreigp Currency Transactions and Foreign Currency Financial Statements (October 1975)

As, was seen in our discussion of Statement No. 1, the SEC has exerted pressure on the FASB with respect to foreign currency translation. However, the SEC recognized that Statement No. 1 11 was just a first step in the process of developing accounting standards in this area. This is evident by a letter dated November 20, 1973 in which Burton, the chief accountant of the SEC comments on the exposure draft of FASB Statement No. 1. "... Such disclosure appears to the staff to be a useful interim step since final measurement standards in the area cannot be established by year end." The requirements of Statement No. 8 (October, 1975) are in tune with the position of the SEC as apparent by its reaction to the critics of FASB Statement No. 8:

> *Some critics have asked the Securities and Exchange Commission to intercede with the FASB in an attempt to get the rule modified, but the SEC has so far refused the request. SEC Chief Accountant John C. (Sandy) Burton admits that: 'in any particular quarter, the new accounting treatment might produce numbers that show a greater impact on earnings than the economic conditions warrant.' But, he contends, the new rule is justified because it shows the risks that exist in a world of floating exchange rates. Recent changes in the values of certain currencies underline his attitude... "it is not the accounting treatment that is at fault," says Burton. "The fluctuations are occurring." (Hershman, 1976, p. 69)*

Most of the political developments surrounding FASB No. 8 occurred after the issuance of the statement, particularly the opposition from multinational companies which later forced the FASB to issue the exposure draft which ultimately culminated in Statement No. 52.

Statement 9 Accounting for Income Taxes - Oil and Gas Producing Companies (October 1975)

While the position of the SEC with respect to this issue is unknown, there is some evidence of a relationship between the SEC and oil and gas industry. The proposed SAR No. 5343 (December 1972) implied that full cost companies would be required to disclose the net income of their company had they used successful efforts accounting. This proposal was shelved by the SEC apparently as a result of objections by the industry. In addition, modified guidelines proposed in October 1973 by the SEC were also rejected because of opposition by the industry. Clearly, if the SEC was unable to wrestle with such a powerful industry, it seemed unlikely the FASB would try.

Indeed, the final statement (October 1975) was a complete reversal of the position taken by the FASB in the exposure draft (April 1975). A study of letters of comment and the transcripts of the public hearings reveals that this reversal represents a total surrender by the FASB to the industry.

The final statement adopts the alternatives as suggested by the industry and rejected the alternative required by the exposure draft.

The political implications of FASB No. 9 should not be overstated. The Board was aware that the more volatile aspects of oil accounting (full cost vs. successful efforts) would have to be faced shortly; perhaps the FASB did not want to start a battle over the relatively smaller matter of deferred taxes and thus yielded to industry pressure.

<u>Statement 10: Extension of "Grandfather" Provisions for Business Combinations</u>

Statement of Financial Accounting Standards No. 10 was adopted in October 1975 as a result of an individual petition. It was neither controversial nor was its effect widespread. The statement left the status quo intact. This was not an objectionable course of action even for the opponents of the pooling-of-interests method. Further, the great merger craze of the 1960s had subsided. The statement eliminates the five year limitation in the grandfather provisions contained in APB Opinion No. 16. There appeared to be no SEC involvement in this issue.

<u>Statement 11: Accounting for Contingencies - Transactions Method, an Amendment of FASB Statement No. 5</u>

This statement, issued December 1975, is of minor importance and was initiated by individual petition. There appeared to be no SEC involvement.

<u>Statement 12: Accounting for Certain Marketable Securities (December 1975)</u>

The SEC position prior to the issuance of Statement No. 12 is reflected in ASR No. 166 (December 1974) which states that if the market value of marketable securities falls below their cost, the unrealized losses should be either recognized in the income statement or at least disclosed in a note.

This issue was placed on the technical agenda of the FASB on September 8, 1975. The exposure draft (November 1975) called for companies to carry marketable equity securities at the lower of cost or market. The final statement (December 1975) is similar to the exposure draft but with one very important modification and that is that marketable securities must be classified into two portfolios, current and non-current. While unrealized losses on the current portfolio must be charged against current earnings, unrealized losses on noncurrent portfolios are charged to a contra account in the stockholders' equity section of the balance sheet. Companies wishing to avoid current recognition of these losses would not classify any marketable securities as current. Analysis of the letters of comment suggests that the FASB modified the exposure draft to accommodate the needs of companies with large investment portfolios, particularly insurance companies. This conclusion is also supported by an article in Forbes (February 1, 1976) entitled "Much Ado About Nothing".

Statement 13: Accounting for Leases (November 1976)

The SEC felt that the accounting rules with regard to leases were outdated. This feeling was expressed in a speech made by former Chairman of the SEC, G. Bradford Cook: "The accounting profession has probably failed to keep up with the phenomenal growth and complexity of lease arrangements". (Journal of Accountancy, July 1973, p. 10). Furthermore, a speech made by L. Rosen, Associate Director of the SEC, San Francisco Office, with regard to this issue, states that the "accounting profession should be concentrating on building new principles while reinforcing old bridges with additional disclosure." (Ibid p. 12)

The SEC issued ASR No. 147 (October 5, 1973) requiring mandatory footnote disclosure by lessees of the present value of noncapitalized financing leases and the impact on net income if these leases had been capitalized. The FASB appointed a task force to study the issue shortly thereafter (October 17, 1973) which then led to a discussion memorandum (July 19, 1974). Failure of the FASB to issue an exposure draft by January 1975 prompted Burton to remark on behalf of the SEC, "...If the FASB fails to act the SEC will. At a minimum capitalization of leases that are primarily financing devices to permit acquisition should be required and retroactively. (Forbes, January 1975)

The first FASB exposure draft (August, 1975) did not apply to leases entered into before January 1, 1976. The SEC claimed that this exempted billions of dollars of existing leases and affected the comparability of financial statements until these leases expired. (Barrons, September 15, 1975 p.14).

In November 1975 the FASB announced postponement of the issuance of the final statement. The official explanation given was the need to analyze the two hundred forty letters of comment and the general complexity of the leasing issue. However, the delay might be attributed to attempts to find a compromise between the FASB and the SEC on the retroactive application issue.

The second exposure draft (July. 22, 1976) included a compromise with the SEC on the retroactive application issue. It allowed for a four year transition period, justifying this grace period as necessary to give time for companies to change their indenture agreements. There were some other minor changes between the first and second exposure drafts but it is important to note that the second exposure draft reflected the major provisions of ASR 147. The final statement (November 1976) was basically the same as the second exposure draft.

Statement 14: Financial Reporting for Segments of a Business Enterprise

ASR No. 154 (April 1974) required that companies disclose appropriate condensed information about consolidated subsidiaries as supplementary financial statements or as lines of business disclosure. Following the discussion memorandum (May 1974), the exposure draft

(September 1975) and the final statement (December 1976) provide guidelines for segmentation which are fully consistent and even go beyond the scope of the SEC ruling in ASR 154.

Examination of the chronology of the events suggests that the SEC pressured the FASB to deal with this issue. Indeed, Wagner (1976) states that the fact that the discussion memorandum was issued one month after the ASR was not coincidental Wagner describes ASR No. 154 as a "subtle hint" from the SEC to the FASB.

Statement 15: Accounting by Debtors and Creditors for Troubled Debt Restructuring

The financial crisis of New York City and the debt restructuring arrangement on New York City bonds caused the SEC to issue ASR No. 188 (January 7, 1976) requiring all registrants holding New York City securities to make certain disclosures but no particular accounting method was required. ASR No. 188 states that the FASB agreed to undertake a study of the issue with the objective of developing standards which would be applied to 1976 financial statements.

The FASB discussion memorandum (May 11, 1976) proposed several accounting methods, including present value accounting, but excluded the status quo of historical accounting with no income statement recognition of troubled loans. Stabler (July 23, 1976 Wall Street Journal) called the discussion memorandum an outgrowth of ASR No.188. The banks vehemently opposed the present value approach and indicated their opposition through letters of comment. Due to the strength of the banking industry, the FASB position, even with the support of the SEC, could not prevail. Lee J Seidler, pointed out in a Bear Stearns Industry Report (November 1976) that:

> *Unless the F'ASB has an overriding suicidal impulse, it will tone down the proposals to something considerably more acceptable to the banking industry than as they now stand...*
>
> *I think the FASB, being alerted to the enormous opposition to this discussion memorandum, will come out with an exposure draft which will be substantially less onerous than the proposals.*

In issuing the exposure draft (December 1976) and the final statement (June 1977) the Board backed off its original platform and proposed a draft which was quite satisfactory to the bankers because it waived recognition of losses in many restructuring situations.

Statement 16: Prior Period Adjustments (June 1977)

APB Opinion No. 9 was expected to eliminate almost all prior period adjustments. Instead many companies and their accountants interpreted the Opinion in such a way as to allow prior period adjustments for most litigation settlements, income tax assessments, and other recurring items. During 1975, the SEC interpreted APB Opinion No. 9 in a manner which resulted in a change in the existing accounting practice for the outcome of prior year litigation.

In Staff Accounting Bulletin (SAB) No. 8 (June 4, 1976) the SEC stated that out-of-court litigation settlements do not meet the criteria of APB Opinion No. 9 and must be recorded as a charge to current income rather than a prior period adjustment. Therefore, the SEC would not accept the accounting treatment of litigation settlements as prior period adjustments. This necessitated action by the FASB and on July 29, 1976 the FASB issued an exposure draft which eliminated all prior period adjustments except for (1) the correction of an error of a prior period and (2) the adjustment that results from realization of income tax benefits of pre-acquisition operating loss carry forwards of purchased subsidiaries.

On April 12, 1977 the FASB announced its inability to issue a final statement on prior period adjustments because it was unable to obtain the necessary five affirmative votes. Subsequently, June 21, 1977 the trustees of the Financial Accounting Foundation announced that they had approved several recommendations proposed by their structure committee including the amending of their by-laws to change the FASB's voting requirements from five assenting votes to a simple majority. On June 30, 1977, a new vote on the statement was the same as the earlier vote, (4 to 3), but the change in the voting requirements allowed the statement to pass. Although the final statement was more restrictive it was consistent with the position of the SEC.

FASB Statement No. 19: Financial Accounting and Reporting by Oil and Gas Producing companies.

The FASB placed accounting and reporting for oil and gas producing companies on its technical agenda in October 1975. Initially, the FASB gave accounting and reporting for oil and gas producing companies' high priority, because of the considerable interest generated in the oil and gas industry by the foreign oil embargo and the resulting increases in world oil prices.

In December 1975, President Ford signed the Energy Policy and Conservation Act which empowered the SEC to develop appropriate rules for accounting and reporting by oil and gas producing companies. The Act further stated that the SEC may, at its discretion, either develop the rules internally or delegate the responsibility to the FASB. Thus, apparently with the encouragement of the SEC, the FASB undertook the task of establishing financial accounting and reporting standards for the oil and gas producing concerns.

The Board considered the following four basic methods of accounting for a company's oil and gas producing activities: Full costing, Successful efforts costing, Discovery value accounting, and Current value accounting. In July 1977, after considerable deliberations, the Board issued an exposure draft which required the use of successful efforts method of accounting. The Board decided to recommend the successful effort method of accounting and issued SFAS 19 in December 1977.

As is evidenced by Securities Act Release (SAR) No. 5861, the SEC agreed with the conclusions reached by the Board in its exposure draft, SAR No. 5861, issued on August 31, 1977, indicated the Commission's intent to amend its regulations to incorporate the standards set forth in the exposure draft. The Commission was interested in taking such an action to "beat the December 22, 1977 deadline;" the commission wanted the proposal in place to meet the Energy Policy and Conservation Act's requirements.

FASB Statement No. 25: Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies.

SFAS 25 was issued in response to SFAS 19, Financial Accounting and Reporting by Oil and Gas Producing Companies. Essentially, SFAS 25 rescinds SFAS 19 by suspending the effective date of the statement.

SFAS 19 had met with considerable opposition from the industry which had perceived the change in accounting method to affect their ability to raise capital. The smaller firms, especially, were concerned that writing off the high costs of a dry well may give investors the impression that they are losing money and thus hinder their ability to raise capital also stepped in and asked the SEC to delay its adoption of the accounting standard until the standard's effect on competition had been studied. The cumulative effect of the industry's cry and the interference from other governmental agencies resulted in the SEC overturning FASB's decision.

The SEC concluded that both the full cost method and the successful efforts method provided inadequate information. It was felt that only a new approach, referred to by the SEC as Reserve Recognition Accounting, could adequately communicate information on assets and earnings of oil and gas producers.

Although the SEC overturned FASB's decision, the SEC was careful to point out that the oil and gas accounting situation was unique. Special circumstances had warranted the overturning and that this in no way reflected lack of confidence in the FASB's standard-setting procedures. It reaffirmed its "basic policy of looking to the FASB for the initiative in establishing, and improving accounting standards." (qtd. in Cooper)

FASB Statement No. 33: Financial Reporting and Changing Prices

In 1974 the FASB issued an exposure draft which proposed that information about the effects of changing prices be shown as supplementary data in traditional financial statements.

Action on the draft, however, was deferred until the question of objectives and conceptual framework had been settled.

In 1976, the Securities and Exchange Commission (SEC) adopted a replacement cost rule that required certain large public companies to calculate in annual reports to the commission what it would cost in current dollars to replace existing "productive capacity."

Also in 1976, the American Institute of Certified Public Accountants (AICPA) set up a Task Force to look into the effects of inflation on financial statements. The Task Force was to work out details of an experiment and to co-ordinate with the FASB.

In October, 1979 the FASB issued its statement on financial reporting and changing prices. There was a mixed reaction to the statement. Some felt that it was a long-overdue improvement over traditional accounting procedures while others felt that FAS No. 33 was unnecessarily confusing. One of the major criticisms was that investors will not understand how the company is affected by inflation because of the large amount of inflation-adjusted data required. Cost/Benefit consideration were also mentioned and some felt the additional costs did not justify implementing such disclosure.

In announcing the issuance of FAS No. 33, FASB Chairman Donald Kirk said that he expected the SEC to alter its reporting requirements for the 1,200 major companies that had to report on replacement cost data. A point worth noting is that most FASB members were reluctant to include the current cost requirement in FAS No. 33 because of its subjective nature. However, if CDA had been the only required disclosure, the SEC probably would not have considered withdrawing its replacement cost disclosure requirement (the SEC phased out this requirement in response to FAS No. 33).

Interaction Table: 1; The FASB acts right after a related disclosure is made by the SEC and takes a consistent position.

<u>FASB Statement No. 34: Capitalization of Interest Cost.</u>

In 1979, the Financial Accounting Standards Board (FASB) issued Statement No. 34, Capitalization of Interest Cost. This statement established standards for capitalizing interest costs as part of the historical cost of acquiring certain assets.

Accounting for interest cost generated considerable discussion during the first quarter of this century in the accounting literature, but relatively little attention was given to this subject during the next forty years. The sharp rise in interest rate and increased use of debt financing during the 1970s, however, kindled interest in this subject again.

The Accounting Principles Board (APB) first brought up the issue of accounting for interest cost in 1971. A committee was appointed to study the subject but the APB was dissolved before any pronouncement could be issued.

In 1974, the SEC became concerned with accounting for interest cost when it noted an increase in the number of public companies adopting a policy of capitalizing interest as part of the cost of certain assets. The SEC addressed the issue by suspending, in June 1974, interest capitalization for most publicly held companies; however, the SEC at the time said that it would reconsider its stance after FASB's action.

Three months after the SEC's action, the FASB's Advisory Council agreed that this matter should be considered by the FASB and on November 25, 1974, the Board added the project to its technical agenda. In October 1979, the Board issued SFAS 34.

Thus according to its original stance, the SEC rescinded its memorandum prohibiting capitalization of interest cost in November, 1979 (one month after FAS 34 was issued).

<u>FASB Statement No. 35: Accounting and Reporting by Defined Benefit Pension Plans.</u>

In March 1980, the FASB issued SFAS 35, "Accounting and Reporting by Defined Benefit Pension Plans." SFAS 35 took great care to separate the "pension plan" from the "sponsoring company." The "pension plan" or the "pension fund" was defined as a distinct reporting entity and SFAS 35 established standards for the measurement and reporting of plan assets and obligations.

SFAS 36, "Disclosure of Pension Information," issued two months after SFAS 35, required disclosure of information about the "pension plan." Thus, the FASB used an indirect approach of reporting the pension obligation of the plan sponsor because of the-controversial nature of the topic.

In 1974, the Employee Retirement Income Security Act (ERISA) established minimum standards for participation, vesting, and funding for employee benefit plans of private enterprises. ERISA also required annual reporting of certain information to particular governmental agencies and summarized information to plan participants. Financial Statements prepared according to Generally Accepted Accounting Principles (GAAP) was one of the reporting requirements for many of the plans.

Also in 1974, the FASB placed accounting and reporting for employee benefits on its technical agenda. Considerable controversy was generated over FASB's proposal to require companies to reflect in their balance sheets pension-related unfunded liabilities, or amounts eventually due to retired employees. Before the issuance of such a requirement, the companies were generally disclosing the liability in footnotes to the financial statements.

FASB Statement No. 36: Disclosure of Pension Information.

In May 1980, the FASB issued SFAS 36, "Disclosure of Pension Information." SFAS 36 was issued two months after SFAS 35 and represented an indirect way of requiring the company to disclose pension information.

SFAS 36 required the companies to disclose the present value of their accumulated plan benefits (both vested and nonvested benefits), as measured under FAS 35, by the plan sponsor. Companies must also disclose net assets of the pension fund available to meet those benefits.

FASB considered this statement to be merely an "interim measure" pending completion of its project on pension accounting.

FASB Statement No. 52: Foreign Currency Translation.

In May 1978, the FASB issued an invitation for public comment on its first twelve statements, each of which had been in existence for at least two years. The Board received more than 200 letters and SFAS 8, Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements, was the subject of most of them. Although most had conflicting views as to what the changes should be, there was an almost unanimous call to change SFAS 8.

Many people were concerned that SFAS 8 did not reflect the underlying economic substance of the foreign operations. Two particular areas criticized were: (a) the volatility of the reported earnings and (b) the abnormality of financial results and relationships.

The Board's decision, however, generated a lot of criticism. Companies charged that certain provisions of SFAS 8 misled investors and ignored the way multinational corporations financed their foreign operations. Protestors also claimed that accounting results differed drastically from true-operating results. Another significant complaint against SFAS 8 was that it encouraged the management of multinational corporations to spend money on expensive hedging devices to smooth earning fluctuations due solely to the required accounting method.

Although the SEC did not work closely with the FASB for the issuance of SFAS 52, the SEC chairman, Harold M. Williams, did comment after a meeting with the Board that he was pleased that the FASB is considering revising its controversial rule on foreign exchange.

SFAS 52 was issued in December 1981. Objectives of SFAS 52 included avoiding reporting accounting exchange gains and losses when the opposite has occurred from an economic prospective. It drastically changed the way multinational corporations account for foreign operations. The primary difference was that it adopts a "foreign currency orientation" rather than a U.S. dollar orientation.

FASB Statement No. 86: Accounting for the Costs of Computer Software.

In August 1985, the FASB issued SFAS 86, "Accounting for the costs of computer software to be sold, leased, or otherwise marketed." As the name implies, SFAS 86 provides guidance on accounting for the costs incurred when soft-ware is developed to be sold, leased, or otherwise marketed.

The basic issue that the FASB had to address was which costs in the process of creating a software should be expensed (because they are research and development expenses) and which costs should be capitalized.

The controversy regarding whether any of the costs of developing computer software should be capitalized heated up when the SEC imposed a moratorium that precluded an enterprise from capitalizing the costs of internally developed software if it had not previously disclosed the policy of capitalizing in its financial statements. The moratorium was issued because of SEC's concern over comparability of financial data since different capitalizing and expensing policies were being followed in the software industry.

When imposing the moratorium, the agency officials made it clear that they were not condemning the accounting method of capitalizing costs; their only concern was comparability of the financial data. SEC officials went on to say that once the accounting industry (FASB) established uniform guidelines specifying the circumstances under which the method could be used, the SEC would reconsider its moratorium.

FASB Statement No. 87: Employers' Accounting for Pensions

SFAS 87, "Employers' Accounting for Pensions," was issued in December 1985 and supersedes SFAS 36, "Disclosure of Pension Information." SFAS 87 made essentially three significant changes. First, companies were required to use a standardized method for measuring net periodic pension costs. Second, immediate recognition of a (minimum) liability was required if accumulated benefit obligations exceed fair value of plan assets. Finally, this statement expanded the disclosure requirements.

Considerable controversy was generated over FASB's proposal to require companies to reflect in their balance sheets pension-related unfunded liabilities. Before the issuance of such a requirement, the companies were generally disclosing the liability in footnotes to the financial statements.

Because of the controversy involved in pension costs, FASB deviated slightly from its regular "due process" and issued Preliminary Views in November 1982. Preliminary Views was issued as an intermediate step between the Discussion Memorandum and Exposure Draft so that the Board could obtain comments on its tentative conclusions.

The FASB has been cautious in dealing with pension accounting, The Board felt that although it is heading in the right direction, pension accounting is still in a transitional stage and that gradual changes will be necessary in the future.

FASB Statement No. 88: Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits.

SFAS 88 established standards for an employer's accounting for settlement of defined benefit pension obligations, for curtailment of defined benefit pension plan, and for termination benefits.

Originally, FASB required firms to compute return on a plan's assets, valued at market price, each quarter. This issue that generated considerable opposition because it would cause gains and losses from investment of pension assets to fluctuate more. The practice previously employed by the firms was to use an actuarial method that would even out short-term gains and losses.

Primarily because of the opposition generated by pension accounting rules, FASB eased on its rules. To decrease the volatility of reported profits, the rule permitted companies to measure returns on pension plan assets by using average annual yields rather than calculate return precisely each quarter.

FASB Statement No. 89: Financial Reporting and Changing Prices.

In 1979, the FASB issued SFAS 33, "Financial Reporting and Changing Prices." This statement established certain criterion for disclosing the effects of price changes on business enterprises as supplementary information in the financial statements. Essentially, it required constant-dollar accounting and current-cost accounting to be disclosed as supplementary information to the basic financial statements. The Board considered the statement to be experimental in nature and committed itself to review the results of the new requirements within five years.

In preparation for that review, the Board encouraged a wide range of research studies to learn about the experiences of those in the financial community. In July 1983, a task force was appointed to assist the FASB in evaluating the merits of its initial requirements. The research studies and responses to the Invitation to Comment indicated that the disclosure required by SFAS 33 was not widely used and that the costs of preparing the disclosure had outweighed the benefits.

The Board concluded that reducing the number of disclosure and simplifying the remaining requirements might enhance the usefulness of the information. The Board felt that the historical cost/constant purchasing power disclosure requirement was less useful than the current cost/constant purchasing power requirement and thus decided to eliminate it.

A point worth noting is that originally most FASB members were reluctant to include the current cost requirement in FAS No. 33 because of its subjective nature. However, it was felt that if constant dollar accounting was the only required disclosure, the SEC probably would not withdraw its replacement cost disclosure requirement (the SEC phased out this requirement in response to FAS No. 33). Thus, we see a shift in the Boards opinion regarding the importance of CDA versus CCA.

In June 1986, the Board decided that the supplementary disclosures required by FAS No. 33, as amended, should not be required. The Board felt that these disclosures should be encouraged, but not required. Although the Board agreed with many of the concerns expressed by respondents who favored supplementary disclosure, the Board nonetheless concluded that due to the general nonuse of data, it could not justify requiring the disclosures.

FASB Statement No. 95: Statement of Cash Flows.

In November 1987, the FASB issued SFAS 95, "Statement of Cash Flows." The Board felt that the cash flow statement should replace the statement of changes in financial position and thus required that a cash flow statement be presented as part of the full set of financial statements.

The Board received widespread support for the change to cash flows approach.

In 1981, the SEC's "integrated disclosures" rules, Accounting Series Release 279 (ASR 279), expanded the reporting of information about cash flows and the related concepts of liquidity and financial flexibility. In the 10-K required to be filed by the management with the SEC, the management was asked to provide an analysis of and discuss its financial condition with specific references to liquidity and financial flexibility. Also required was a discussion of the amounts and certainty of cash flows from operations, external sources, and any material unused sources of liquid assets.

Shortly after the issuance of the proposed concepts statement and ASR 279, the Financial Executives Institute started urging its members "to take a leadership role in encouraging their companies voluntarily to change the format of the funds statement, where applicable, to focus on cash, including short-term investments and the components of cash flow." (qtd. in CPA Journal, June '1982, p. 76)

The FASB issued, in December 1980, a Discussion Memorandum, Reporting Funds Flows, Liquidity, and Financial Flexibility. Later, in November 1981, the Board issued an Exposure Draft of a proposed concepts Statement, Reporting Income, Cash Flows, and Financial Position of

Business Enterprises. This statement was intended to provide guidance on deciding which items in the basic financial statements should be highlighted for the investor and which items should be condensed for ease of understanding.

During its deliberations on the 1981 Exposure Draft, Reporting Income Cash Flows, and Financial Position of Business Enterprises, the Board concluded that the detailed requirements should be addressed at the standards level rather than the conceptual level. The Board, however, decided to defer consideration of the project until the results of a voluntary initiative (see the Financial Executives Institute's section for more information) by the Financial Executives Institute (FEI) was studied,

In November 1987, the Board issued SFAS 95. The, statement received widespread support from accountants, industry, Wall Street, and presumably the SEC.

FASB Statement No. 96: Accounting for Income Taxes.

In December 1987, the FASB issued SFAS 96, Accounting for Income Taxes. This statement established financial accounting and reporting standards for the effects of income taxes on an enterprise's financial statements. SFAS 96 adopted the liability method of accounting for income taxes. The liability method attempts to show the amount of future taxes payable to or due from the government on the balance sheet as a deferred tax liability or as a deferred tax asset. This statement superseded APB Opinion No. 11, Accounting for Income Taxes, and affected numerous other authoritative pronouncements.

In 1967, the Accounting Principles Board (APB) issued APB Opinion No. 11, Accounting for Income Taxes. Since then several authoritative accounting pronouncements have amended, interpreted, or supplemented APB Opinion No. 11. Although some people have supported the accounting and reporting requirements of these pronouncements, others have questioned their underlying concepts and meaningfulness. Some have also complained that the requirements of these pronouncements are inconsistent and that the time devoted to coping with the complexities and ambiguities are not cost-beneficial when compared with the usefulness of the resulting information.

In January 1982, the FASB decided to add to its agenda a project to reconsider accounting for income taxes and a task force was established to assist the Board. Our research did not indicate any direct SEC involvement. The SEC has, however, issued numerous releases regarding accounting for income taxes and thus was certainly involved.

7. Appendix A

	Statement No.																		
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	19	25	33
1. The FASB acts right after a related disclosure requirement is made by the SEC and takes a consistent position.		X	X		X	X						X	X	X	X	X			X
2. Initiation of the subject matter by the SEC.	X			X				X					X			X	X		
3. Threat by the SEC to act if the FASB would not.	X			X									X						
4. The FASB acting hastily as a result of SEC pressure.	X			X															
5. Change in the FASB rule of procedure to accommodate the SEC.																X			
6. The SEC intervening on behalf of the FASB.			X		X			X							X				
7. The SEC overturns FASB’s decision.																		X	
8. No observed interaction.																			

	Statement No.									
	34	35	36	52	86	87	88	89	95	96
1. The FASB acts right after a related disclosure requirement is made by the SEC and takes a consistent position.	X				X				X	
2. Initiation of the subject matter by the SEC.	X				X				X	
3. Threat by the SEC to act if the FASB would not.										
4. The FASB acting hastily as a result of SEC pressure.										
5. Change in the FASB rule of procedure to accommodate the SEC.										
6. The SEC intervening on behalf of the FASB.										
7. The SEC overturns FASB's decision.										
8. No observed interaction.		X	X	X		X	X			X

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