

COUNCIL OF INSTITUTIONAL INVESTORS

Suite 500 • 888 17th Street, NW • Washington, DC 20006 • (202) 822-0800 • Fax (202) 822-0801 • www.cii.org

Via Email

February 11, 2008

Ms. Teresa S. Polley
Chief Operating Officer
Financial Accounting Foundation
401 Merritt 7
Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 42

Re: Request for Comments on Proposed Changes to Oversight, Structure, and Operations of the FAF, FASB, and GASB¹

Dear Ms. Polley:

The Council of Institutional Investors (“Council”) appreciates the opportunity to provide our input on the Financial Accounting Foundation’s (“FAF”) Request for Comments on Proposed Changes to Oversight, Structure, and Operations of the FAF, FASB, and GASB (“RFC”). The Council is an association of more than 130 U.S. public, corporate and union pension funds with combined assets of over \$3 trillion.

As a leading voice for long-term patient capital, the Council strongly believes that independent private sector accounting standard setting is critical to the integrity of the capital markets. Last year, after months of research and deliberations by the Council’s staff, policies committee, and board of directors, the Council’s general members unanimously approved the following policy regarding the independence of accounting and auditing standard setting:

. . . [F]inancial statements and their related disclosures are a critical source of information to institutional investors making investment decisions. The well-being of the financial markets—and the investors who entrust their financial present and future to those markets—depends directly on the quality of the information audited financial statements and disclosures provide. The quality of that information, in turn, depends directly on the quality of the standards that: (1) preparers use to recognize and measure their economic activities and events The result should be accurate, transparent, and understandable financial reporting.

¹ Financial Accounting Foundation (“FAF”), Request for Comments on Proposed Changes to Oversight, Structure, and Operations of the FAF, FASB, and GASB (2008), <http://www.fasb.org/FAF%20Proposed%20Changes.pdf>.

The responsibility to issue and develop accounting . . . standards should reside with independent private sector organizations with an appropriate level of government input and oversight. Those organizations should possess adequate resources and the technical expertise necessary to fulfill this important role. Those organizations should also include significant representation from investors and other users of audited financial reports on the organizations' boards and advisory groups. Finally, those organizations should employ a thorough public due process that includes solicitation of public input on proposals and consideration of user views before issuing final standards. The United States Congress, the Securities and Exchange Commission ("SEC"), and other federal agencies and departments should respect and support the independence of the designated accounting . . . standard setting organizations and refrain from interfering with or overriding the decisions and judgments of those bodies.²

Consistent with the Council's conclusion that high quality accounting standards can best be achieved by an independent private sector organization, we would like to offer the following specific comments in response to several of the proposed actions raised in the RFC:

Proposed Action: Expand the breadth of individuals and organizations that are invited to submit nominations for the FAF Board of Trustees with the understanding that final authority for all appointments rests solely with the Board of Trustees.

As indicated by the Council's policy, we believe that having significant investor representation in the private sector accounting standard setting process is critical to producing high quality accounting standards.³ We, therefore, generally support reducing reliance on the non-user Financial Nominating Organizations ("FNOs") and Governmental Nominating Organizations ("GNOs") as the main source of nominations for the FAF Board of Trustees.

It is our understanding that the origin of the FNOs and GNOs involvement in the selection of the Board of Trustees appears to have been based, in part, on a commitment by those organizations to participate in the raising of funds required for the operation of the Financial Accounting Standards Board ("FASB") and the Governmental Accounting Standards Board ("GASB"), respectively.⁴ That purpose is now less relevant (at least for the FASB) as a result of the accounting support fee requirements included in the Sarbanes-Oxley Act of 2002.⁵

² Council of Institutional Investors ("Council") Policies, Pension Fund Issues, I. Independence of Accounting and Auditing Standard Setting (Mar. 20, 2007), <http://www.cii.org/policies/Redesigned%20CII%20Policies%20on%20Other%20Governance%20Issues%201-29-08.pdf>.

³ Of note, the Council's policy supporting significant representation from investors and other users of financial reports on the boards and advisory groups of the organizations that establish accounting standards appears to have been adopted by the Advisory Committee on Improvements to Financial Reporting ("CIFiR"). CIFiR, Progress Report 37-38 (draft Feb. 11, 2008), <http://www.sec.gov/about/offices/oca/acifr/acifr-dpr-021108.pdf>.

⁴ See American Institute of Certified Public Accountants ("AICPA"), Report of the Study on Establishment of Accounting Principles, Establishing Financial Accounting Standards 9 (Mar. 1972) (on file with the Council) (The original financial nomination organizations were the Financial Executives Institute, the National Association of Accountants, the Financial Analysts Federation, and the American Accounting Association).

⁵ See Sarbanes-Oxley Act of 2002, Section 109(e) (2002), <http://f11.findlaw.com/news.findlaw.com/hdocs/docs/gwbush/sarbanesoxley072302.pdf>.

Our general support for the proposed action, however, is contingent on the expansion focusing on increasing the investor representation on the FAF. As the key customers of financial accounting and reporting, qualified investors should be offered a much greater role in the boards and advisory groups of those organizations that establish accounting standards.

Proposed Action: Reduce the size of the FASB from seven members to five.

The Council generally does not support reducing the size of the FASB from seven members to five. We note that the RFC suggests that the proposed action will make the FASB “more nimble and responsive to domestic and global demands,” and “more effective and efficient.”⁶ We are not convinced.

We believe that the better argument is that reducing the size of the FASB from seven members to five will make the Board *less* nimble and responsive and *less* effective and efficient for at least two reasons: (1) there will be fewer Board members available to take leadership roles on standard setting projects and related research and technical activities, and (2) there will be fewer Board members to engage in external communications and dialogue with investors and other interested parties—important elements of a high quality standard setting process.

Finally, we understand that in March 2002 the FAF considered a nearly identical proposal to reduce the size of the FASB from seven to five members to improve “the FASB’s efficiency.”⁷ On that occasion the reaction from preparers, auditors, and users of financial reports was generally negative.⁸ In response to those comments the FAF decided to retain a seven-member Board.⁹ In our opinion, the RFC provides no basis for why a different conclusion is now appropriate.

Proposed Action: Realign the FASB composition.

The Council generally supports realignment of the FASB composition. Our support, however, is contingent on the realignment resulting in an increase in the number of qualified investor representatives on the seven-member FASB Board. More specifically, we believe that, consistent with the view expressed in 1992 by then U.S. Securities and Exchange Commission (“SEC”) Chairman Richard C. Breeden, at least two of the seven members of the FASB should be qualified investors or other qualified users of financial reports.¹⁰

⁶ FAF, *supra* note 1, at 5.

⁷ News Release, Financial Accounting Standards Board (“FASB”), Financial Accounting Foundation Considers Changes to Streamline FASB Process; Emphasizes Need for Independent Accounting Standard Setter (Mar. 14, 2002), <http://72.3.243.42/news/nr031402.shtml>.

⁸ *See, e.g.*, Letter from Richard J. Swift, Chairman, Financial Accounting Standards Advisory Council, to Joseph S. LaGambina, Executive Vice President, FAF 1 (Apr. 1, 2002) (on file with the Council) (“The general consensus of the FASAC members is that a reduction in the number of FASB members is not advisable, and they have asked me to express this concern to you.”).

⁹ News Release, FASB, Financial Accounting Foundation Changes Financial Accounting Standards Board’s Voting to Increase Efficiency (Apr. 24, 2002), <http://72.3.243.42/news/nr042402b.shtml>.

¹⁰ Letter from Richard C. Breeden, Chairman, Securities and Exchange Commission, to Shaun O’Malley, President, FAF (Oct. 22, 1992). We also note that CIFIIR has expressed support for “at least two investors” on the FASB Board if the FASB maintains a seven-member Board, CIFIIR, *supra* note 3, at 39.

Proposed Action: Provide the FASB Chair with decision-making authority to set the FASB technical agenda.

The Council generally does not support providing the FASB Chair with the decision-making authority to set the FASB technical agenda. It is our understanding that the proposed action would result in a significant structural change to the FASB's standard setting process. That process was originally designed, in part, to broaden the base and variety of skills involved in standard setting decisions.¹¹ The original design is reflected in the FASB's current rules of procedure which require that the technical agenda be approved by the FASB Board.¹²

We are troubled by the fact that the proposed action would appear to provide the FASB Chair the authority to remove a project from the FASB's agenda even if the project was supported by all of the other Board members or by all investors. Our concern is heightened by the numerous public reports over the past year of efforts by the SEC to exert more control over the FASB.¹³

We, therefore, believe the existing agenda decision-making process should be maintained. We understand that that process includes solicitation of input from investors and other users of financial reports, and requires a majority vote of the Board to add or drop a project from the agenda. In our view, the existing thorough and public agenda process lessens the potential risk that FASB's independence might be impaired by the efforts of self interested special interest groups to the likely detriment of investors and the capital markets.

Proposed Action: Secure a stable mandatory funding source for the GASB.

As indicated by the Council's policy, we believe that independent private sector accounting standard setting organizations should have adequate resources to fulfill their important missions. We, therefore, generally support a stable mandatory funding source for the GASB. Such a funding source, if properly structured, would contribute to the GASB's independence and likely enhance the quality of its standards.

Proposed Action: Retain the current size, term length, and composition of the GASB.

The Council generally supports retaining the current size, term length, and composition of the GASB. To the extent, however, that additional funding sources become available, we generally would support, consistent with the Council's policy, seven full time members of the GASB.

Proposed Action: Provide the GASB Chair with decision-making authority to set the GASB technical agenda.

The Council generally opposes providing the GASB Chair with decision-making authority to set the GASB technical agenda for the same reasons we generally oppose providing such authority to the FASB Chair.

* * * *

¹¹ AICPA, *supra* note 4, at 10-11.

¹² FASB, Rules of Procedure 51 (amended and restated through Dec. 1, 2002).

¹³ See, e.g., Marie Leone & Alan Rappeport, SEC Said No to FASB Raises, CFO.com (Apr. 2, 2007), <http://www.cfo.com/article.cfm/8952913>.

February 11, 2008
Page 5 of 5

The Council appreciates the opportunity to express its views on the RFC. Please do not hesitate to contact me if you have any questions or would like any additional information.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeff Mahoney". The signature is written in a cursive style with a large, stylized initial "J".

Jeff Mahoney
General Counsel
Council of Institutional Investors