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LETTER OF COMMENT NO. |

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

Proposed Changes to Oversight, Structure, and Operations of the FAF, FASB, and GASB

Dear Ms. Polley:

This letter includes my comments on the Proposed Changes to Oversight, Structure, and Operations of the FAF, FASB, and GASB. By way of introduction to those FAF Trustees with whom I am not acquainted, I served as Chairman of the FASB from 1987 through 1997. For the past ten years I have been an accounting professor at the University of Georgia and I also serve as chairman of the audit committee of three large public companies. Further, I am a member of the SEC Advisory Committee on Improvements to Financial Reporting. However, this letter represents my personal comments and should not be attributed to any of those organizations.

In summary, I support the efforts to improve the oversight, structure, and operations of the FAF, FASB, and GASB, although I have suggestions for refining some of the recommendations. My comments will focus on recommendations relating to the FAF and FASB. However, I also feel that the changes relating to the GASB are needed. For example, some would argue that using FAF reserve funds that mainly have been generated through the excess of support for FASB related activities over costs violates Trustee fiduciary responsibilities. If strong support for the GASB related changes cannot be secured from the state and local governmental communities and others with a specific interest in governmental accounting standard setting, the FAF should consider ending its involvement in this activity and letting it go its own way.

Each of the FAF/FASB related recommendations is listed below with my views on each noted.

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.

I agree. The "FNOs" that have had more or less automatic appointment power to the FAF will continue to be the ones that are most interested in the work of the FAF and they are likely to continue to nominate strong candidates. The fact that their nominees are not automatic selections should encourage these organizations to work even harder to identify outstanding candidates. At the same time, eliminating the automatic selections will allow the FAF to choose the best qualified individuals to serve without as much indication that the selections are "representing" a particular interest group. It also will allow the FAF to select more at large Trustees assuming that well qualified individuals are identified.

Change the term of service for Trustees from two three-year terms to one five-year term.

The proposal states the reasons for this change to be, "The Trustees believe that changing to one five-year term will provide the opportunity for a larger number of qualified Trustees to bring their skills and perspectives to the FAF. The Trustees believe that this change also will reduce the potential for an inherent pitfall in self-perpetuating Boards that results in near automatic reappointment." In addition, longer initial terms may provide greater continuity as there is a learning process involved in becoming an FAF Trustee, much the same as in any new position.

Assuming that this recommendation is adopted, and assuming an average size of the FAF Board of 16 (another recommendation is that the size of the Board range from 14 to 18 members), there would be an average of approximately three new members each year (16 divided by 5 equals 3.2). If terms continue to be three years and all Trustees are appointed to a second term, there would still be an average of approximately three new members each year (16 divided by 6 equals 2.7). Thus, the proposal would create only an insignificant amount of "new blood" each year. Also, there apparently is no way to remove a Trustee from office so that a person appointed to a five-year term could continue for that entire period in spite of poor attendance at Board meetings or other substandard performance.

A better approach would be to leave the two three-year terms in place and adopt a more meaningful renomination review process similar to what the Trustees do for FASB and GASB board member reappointments. This most likely would result in somewhat greater turnover among FAF Trustees thus achieving nearly the same amount of "new blood" as in the current proposal. And it would eliminate the notion of near automatic reappointments that apparently is a current problem.

Change the size of the Board of Trustees from sixteen members to a range of fourteen to eighteen members.

Per the proposal, this would enable the FAF Board "to better react to a changing environment by having the ability to add particular experience and expertise as needed." I note, however, that if an individual is added solely because of "particular experience and expertise," he or she would remain on the Board for five years under the preceding

recommendation even if that particular experience or expertise is no longer considered important. This is another reason to stay with the current three-year terms.

On balance, I support this recommendation. The articles of incorporation or by-laws of most corporate or nonprofit boards state only that the number of directors not exceeds a certain number. This gives the entities flexibility in reacting to current conditions including the fact that sufficient outstanding candidates for the board may not be identified in a certain year.

Strengthen and enhance the governance and oversight activities of the Trustees as to the efficiency and effectiveness of the standard-setting process.

This is, by far, the most important proposal and I strongly support it.

The principal responsibilities of the FAF are:

- Appointing members of the FASB, GASB and their Advisory Councils
- Overseeing the finances of the organization, including fund raising as appropriate
- Overseeing the standard-setting process, protecting its independence, and educating the public about accounting standards

In its current committee structure, the Trustees clearly cover the first and second of those responsibilities but not the third. The Trustees apparently conduct occasional reviews, such as the one that resulted in the recommendations in the report to which this letter responds. However, there is no formal, ongoing oversight of the standard-setting process through a standing FAF committee with this responsibility.

During my first few years at the FASB I identified the absence of an Oversight Committee as an important omission from the Trustees' activities. I recommended the establishment of such a Committee and the Trustees agreed. However, sometime after I left the Board, the Trustees must have discontinued the Oversight Committee as the current list of committees on the FASB/FAF website lists no such committee. As part of strengthening and enhancing the governance and oversight activities of the Trustees as to the efficiency and effectiveness of the standard-setting process, I urge the FAF to reestablish an ongoing Oversight Committee.

As noted in the proposal, oversight should include review of such matters as due process, agenda setting, solicitation of public comment, consideration of comments, and the retrospective evaluation of the effectiveness and efficiency of standards. Based on my experience at the FASB and my familiarity with the current system, I am confident that the Trustees will find all of the above processes to be working reasonably well, except for the last one. To the best of my knowledge, the FASB has not conducted retrospective evaluations of its standards for at least 25 years and I agree that this is something that should be done on a regular basis.

To be clear, FAF oversight means that it should review what the FASB has done and is doing, and it does not mean that the Trustees should conduct those activities themselves. So, for example, a retrospective review process should be initiated by the FASB and the Trustees should review the process and evaluate whether it is being conducted appropriately. The purpose of oversight is to ensure that the standard setting bodies are "doing what they are supposed to be doing." And, as noted in the proposal, it is critically important that Trustees do not insert themselves into substantive deliberations on technical matters. Oversight vs. interference may be a fine line in some cases but an effective standard-setting process demands appropriate oversight.

One of the most important things the Trustees should be actively overseeing at present is the move toward internationalization of accounting standards. Much of the FASB's present agenda deals with so-called convergence topics for which the IASB has similar projects on its agenda. Over time it is possible that there may be a single international accounting standard setting group and that the FASB may have only a subsidiary role or perhaps even no role at all. While planning needs to take place for a possible eventual change in the FASB's role, for the immediate future the FASB needs to concentrate on its current mission relating to United States accounting standards.

With respect to the ongoing convergence relationship between the FASB and IASB, I note that in testimony before the United States Senate Subcommittee on Securities, Insurance, and Investment on October 24, 2007, IASB Chairman David Tweedie stated the following:

"Going forward, we [the IASB and FASB] will <u>demand</u> that a good principle-based standard <u>must</u> pass four tests:

- (i) Is the standard written in plain English? (This is also important to allow easy translation of our standards.)
- (ii) Can the standard be explained simply in a matter of a minute or so? If not, why does it take longer? (Put another way, can only specialists understand it or can most accountants use it?)
- (iii) Does it make intuitive sense?
- (iv) Do managements believe that it helps them to understand and describe the underlying economic activity? (emphasis added)"

Frankly, I think these are excellent tests for accounting standards and the FASB's work would be more generally supported if these tests were actually met. However, even though FASB Chairman Bob Herz testified at the same hearing and apparently did not disagree with Mr. Tweedie's comments, I suspect that the FASB does not officially endorse these tests. Clearly, for example, recent standards 141R and 160 could not meet most of the tests enumerated by Mr. Tweedie. This is the type of thing that the Trustees need to be aware of and to question as part of an effective oversight program.

In formalizing and carrying out its oversight responsibilities, I believe the FAF Trustees should work with the FASB to develop performance metrics that can be used to analyze

and measure the effectiveness of the FASB in the future. Perhaps something can be learned in this regard from the GASB's extensive project on service efforts and accomplishments.

Reduce the size of the FASB from seven members to five.

I agree that reducing the size of the FASB will result in a more efficient process. In my experience, neither due process procedures nor any other process related factors are the root causes of an overly slow standard-setting process. Rather, the reason for delay most often is the inability of Board members to agree on the solution to a financial reporting issue. It is obviously easier for three Board members (see next recommendation) to agree than four. So things should move somewhat faster with a smaller number of FASB Board members.

In addition to improved efficiency, the Trustees assert that a smaller Board size will result in improved effectiveness. I don't know how that can be proven or even evaluated in advance. Effectiveness is more of an "in the eyes of the beholder" type of matter. For example, I would agree that the Board is operating more effectively if it reaches solutions that are consistent with the way I would have resolved technical issues. But if the solutions are not ones I favor, I might not consider the process to be effective.

Notwithstanding my reservations about effectiveness, I support the recommendation to reduce the size of the Board. I observe, however, that this change means that the appointment process will become even more critical as a poor choice for the Board will have much greater consequences in the future.

If the reduction of FASB Board size is formally adopted by the FAF after considering the comments it receives on the proposal, I suggest that the Trustees formally commit to reevaluate the new approach after two or three years. It would be relatively easy to increase the FASB Board size if five members prove ineffective for any reason.

Retain the FASB simple majority voting requirement.

As the proposal notes, the FASB voting requirements have changed several times in the Board's history. In general, the majority requirement has been enacted when there has been pressure on the Trustees for standard setting to move faster. And the super majority requirement has been enacted when there has been pressure on the Trustees for standards to be "more generally accepted." As noted in the preceding section, it is always easier for a smaller number of individuals to agree on a solution than a larger number. However, based on my personal experience for ten and a half years as well as my observations of Board behavior over the remaining 25 or so years of the FASB's existence, I don't think the voting requirement makes a big difference in either the ability to resolve particular issues or in the important aspects of the resulting standards.

Thus, I agree with the proposal to continue the current majority voting requirement in connection with a smaller FASB board size. This is an issue that can be easily revisited

by the Trustees if for any reason experience under the new requirements is considered unsatisfactory. In fact, this is one of the many process issues that the Trustees should be reviewing periodically as part of its oversight duties.

Realign the FASB composition.

"The mission of the 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." All Board members must be committed to that mission regardless of their principal background. That is, I believe all of the FASB Board members should be dedicated to improving the quality and usefulness of financial reports for those who rely on financial statements in making investment and related decisions. However, it is also important that Board members have a reasonable amount of experience with accounting standards and financial reporting to allow them to participate adequately in the debate about new standards.

The FAF proposal recommends that four of the proposed five member FASB come from principal backgrounds of auditor, preparer, academic and financial statement user. And the guidelines for the other Board member would be "to achieve the appropriate balance on the FASB" and selection of the "one at-large, best-qualified member." It isn't clear, however, what the FAF has in mind when it says that the fifth member's role is "to achieve the appropriate balance on the FASB." In fact, this can be a dangerous objective as some Trustees may feel it means that the overall philosophy of the Board needs to be modified to make it more liberal or conservative with respect to issuing new standards. Or it might be read to mean that there should be more or fewer advocates of fair value accounting, for example.

Thus, I suggest that the FAF Trustees reevaluate the guidelines for the fifth FASB Board member. It is probably sufficient to say that this person can come from any primary background and that he or she should simply be the best qualified person that can be found at the time.

I also suggest that the Trustees reconsider whether it is necessary to always have one FASB Board member with a primary background in academe. Auditors, preparers, and users are the constituencies that have the major stakes in the outcome of the standard-setting process and there should always be at least one person from each of those backgrounds, in my view. While it probably is important to have a reasonable amount of academic experience on the FASB's professional staff, I don't think it has to be directly represented on the Board itself. My suggestion is to revise the proposal to state that three of the FASB Board members should come from auditor, preparer, and user backgrounds with the remaining two seats for the best qualified individuals regardless of background. One of these at-large seats might well be filled by an academic but this doesn't need to be a requirement, in my view.

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

There are almost always many more projects that the FASB could add to its agenda than there is time to work on all of them. Usually, there has been reasonable support for new projects among the FASB's constituency and few would argue that the Board is unwilling to deal with issues of importance. However, once projects are added, they often languish for many years of little or no progress. In fact, I recently heard one Board member say for a particular project that the staff would have to reeducate Board members on the basic issues because it had been so long since the Board members last discussed the project.

Taking too long to resolve issues means that improvements to financial reporting are delayed and the Board is not achieving its mission. Perhaps of even more importance, as projects are delayed, constituents often lose interest or even forget why a project was added in the first place. So having a process that keeps projects actively moving through the system is an important objective.

Thus, while concentrating agenda decision setting authority is a positive move, in adopting a final requirement the Trustees should make clear that it is equally important that the Chairman actively review the existing agenda and remove projects that haven't made sufficient process. As the proposal notes, the current process "... at times is inefficient and causes the agenda to become overloaded." I infer from this that the Trustees have in mind that agenda authority runs to both additions and deletions but this should be explicit. As part of its oversight of the process, the FAF Trustees should challenge whether the Board is removing projects in appropriate circumstances.

In revising the agenda process, a final requirement should make clear that the full Board would discuss and advise the Chairman before agenda decisions are made. Also, I believe it is important that the Chairman regularly consult with constituents on agenda matters, particularly with the SEC, PCAOB, accounting firms, corporate executives, and financial statement users. Some sort of agenda committee to formally advise the Chairman would be beneficial.

Conclusion

The changes proposed for the FASB and the non-governmental activities of the FAF are a good step and I generally support the recommendations with the modifications noted above. I would be happy to elaborate on the matters in this letter if you or any of the Trustees would like me to do so

Sincerely,

Dennis R. Beresford