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Setting Financial Accounting Standards for the Twenty-First Century

A background paper by the University of Southern California Financial Accounting Study Group (Doyle Z. Williams, *Chairman*)[2]

Introduction

This paper was prepared for the purpose of facilitating discussion at the Symposium on Financial Reporting and Standard Setting sponsored by the American Institute of Certified Public Accountants. The authors of the paper believe that the changing environment necessitates a thorough reexamination of financial accounting standard-setting processes in the United States. The following observations underlie the propositions offered in the paper:

- The increasing demand for and availability of alternative information is decreasing the demand for traditional financial accounting information.

- The conventional historical-cost-based accounting model is becoming increasingly inadequate for decision-support purposes.

[2]The USC Financial Accounting Study Group, SEC and Financial Reporting Institute, School of Accounting, University of Southern California, comprised the following members of the faculty: Walter G. Blacconiere, Paul Caster, Charles Chi, Mark DeFond, Dan Elnathan, William W. Holder, E. John Larsen, Daniel E. O'Leary, S.E.C. Purvis, William R. Smith, and Doyle Z. Williams, *Chairman.*

- Users are demanding more timely, relevant, future-oriented data to assist in more effective asset evaluation and risk assessment.

- The U.S. government will become a more important user of accounting information as it relies more heavily on the accounting profession as part of the regulatory process.

- The emergence of the technology-driven information age will challenge the conventional public reporting process, enabling data to be accessed on a user-specific basis.

- Globalization of capital markets requires the United States to take a leadership role in setting international accounting standards.

- It is as important today as it was when the FASB was established that there be one independent standard-setting body for financial accounting in the United States.

- The primacy of the interests of users of public financial reporting suggests that users should play a more dominant role in the standard-setting process.

- The process that governs the deletion of items from the FASB agenda is as important to consider as that which governs the addition of items.

- Providing long-term financial resources for setting accounting standards is an important consideration if the viability and integrity of the process is to be maintained.

The constraints of a paper of this nature do not permit an exploration of all the relevant issues. Therefore, the authors have addressed only those issues they believe to be the most pressing and in need of immediate attention. Of course, those selected for attention are, of necessity, described only briefly.

The presentation of the issues may be viewed as provocative by some readers. However, agreement with the specific propositions offered is not central to the purpose of the paper. If raising these issues leads to a more thorough exploration of the standard-setting process, the paper will have served its purpose.

As faculty members in the School of Accounting at the University of Southern California who believe in the importance of retaining a viable accounting standard-setting process in the private sector, the authors hope this paper will initiate a dialogue that will contribute to that end.

Financial Reporting and Standard-Setting Process at a Crossroads

As we enter the last decade of this millennium and prepare for the twenty-first century, we find financial reporting and the attendant standard-setting process at a crossroads. Continuing on the present course, we believe, will lead to the growing irrelevance of conventional financial reporting in the new age of information. To be responsive in an increasingly competitive market for information, the changing market for financial accounting information and the regulatory processes governing the provision of such information must be carefully examined. The first part of this paper considers the changing financial reporting environment. The second part examines the process for setting standards in this new environment.

The Changing Reporting Environment

Financial reporting must be responsive to four fundamental issues to continue to serve a viable function: (1) the growing irrelevance of the conventional accounting model, (2) the role of conceptual constructs versus practical considerations in rule-making, (3) the impact of technology, and (4) the importance of global financial markets. Although several of these issues are closely intertwined, each one must be considered carefully to understand its unique implications.

The Need for a New Accounting Model

The conventional accounting model is becoming increasingly irrelevant for financial markets. The notions of historical costs and general-purpose financial statements are failing to fulfill users' needs.

Historical-cost accounting has its roots in the need to report on management's stewardship over an entity's resources. Stewardship is becoming a diminishing force in the corporate reporting environment as

entities continue to expand and billions of dollars from non-equity financing sources are both on and off corporate balance sheets.

Increasingly, the U.S. government has become a major stakeholder in the use of financial information. It has begun to focus on the quality and relevance of publicly reported financial information. Regulators and legislators have asked, for example, how a firm can report to the public and regulators that it is solvent and has been recently profitable, yet file for bankruptcy in a matter of weeks.

The focus must shift from reporting on the past to a model that seeks to address prospective events. The primary interests of investors, creditors, and regulators lie not in stewardship but rather in such matters as liquidity, cash flow, return on investment, and (as taxpayers have become painfully aware in the savings and loan bailout) the market value of assets, including related collateral such as real property, that serve as security for many loans and investments.

Users of financial statements are more interested in information that is helpful in evaluating future risks than in a report of the company's past performance. Because of the rapidity of change, a firm's financial history is now less relevant in evaluating its future than it was formerly. Therefore, we offer the following proposition to guide the development of a new accounting model.

PROPOSITION I

> To better serve the needs of users of financial statements in the emerging financial environment, financial reporting should shift its focus from a stewardship emphasis to an asset-valuation and risk-assessment emphasis with greater attention to prospective information.

There are several possible implications of this shift in focus, including the following:

° Greater emphasis on current costs

° Greater recognition of changing price levels

° More emphasis on the relevance of information to risk assessment

° Greater subjectivity in the financial reporting process

° Less standardization in financial reporting

If accountants do not shift from providing retrospective information to providing prospective information, their role may continue to diminish, and they may be replaced by others who are more responsive to users' needs.

The Role of Conceptual Constructs

A major issue in promulgating financial reporting standards is the role of conceptual constructs. This issue brings into play the following questions: (1) where should the emphasis be on theoretical versus practical considerations and (2) how should recognition and measurement be addressed?

Theoretical versus Practical Considerations. One of the primary objectives of the FASB's conceptual framework project was to provide a theoretical basis for developing future financial accounting standards. By issuing Statements of Financial Accounting Concepts (FASB Concepts Statements) Nos. 1 through 6, the Board implicitly, if not explicitly, took a position of establishing standards based on conceptual soundness. The result has been the gradual replacement of *generally accepted* accounting principles with *promulgated* accounting principles.

Promulgated rules would not be controversial if they *became* generally accepted, but that often has not been the case. Some preparers of financial statements have been especially critical of the FASB for being overly theoretical. Concern is often expressed about insensitivity to the practical issues involved in implementing new standards. Furthermore, the Business Roundtable surveyed its active members in 1988 and found that over 90 percent were of the opinion that the FASB was too conceptual in its approach.[3]

The underlying cause of the concerns raised by the Business Roundtable (and others) may not be the FASB's preference for theoretical

[3]For further discussion of theoretical versus practical considerations in setting FASB standards, see A. Wyatt, "Accounting Standards: Conceptual or Political?" *Accounting Horizons*, September 1990, pp. 83-88.

over practical considerations. Instead, the problem may stem from the nature of "theory" in a social science such as accounting, and from problems inherent in the conceptual framework itself.

Social science "theory" consists of man-made rules. As such, the rules are subject to change as the composition of the rule-making body changes. This creates the potential for inconsistencies in rules over time. Furthermore, because the rules are man-made instead of occurring naturally, the likelihood of a lack of consensus and, therefore, lack of support for them increases. Evidence is found within the FASB itself—many of its statements were passed by mere 4 to 3 margins.[4]

Lease accounting rules illustrate some of the problems discussed above. For years, accounting for leases has been considered one of the most complex, theoretical, and troublesome of the topics addressed by the FASB.[5] When a lease is in essence a "financed purchase" of property, the property and related lease obligation should be recognized as an asset and a liability, respectively. Although the concept is straightforward, the rules for implementation are problematic. For example, "theory" did not determine the percentages used for the economic-life test or the cash-payments test of FASB Statement of Financial Accounting Standards (FASB Statement) No. 13. Furthermore, the FASB has issued six Interpretations and eight Technical Bulletins affecting lease accounting since the issuance of FASB Statement No. 13, and eleven subsequent Statements amend or otherwise affect the basic rules contained in this Statement.

Lease accounting rules are so complex that, when FASB Statement No. 91 was issued, amending the treatment of initial direct costs in direct financing leases, the prescribed treatment contained an error, with the result that initial direct costs would not be amortized over the term of the lease.

[4]Similar points were raised by Paul B.W. Miller in "The Conceptual Framework: Myths and Realities," *Journal of Accountancy* 159, March 1985, pp. 62-64 . It should also be noted that a minimum of five votes is now required to issue a statement, demonstrating the behavioral nature of standard setting.

[5]It is interesting to note that recent pronouncements on pension accounting, accounting for deferred taxes, and proposed rules for accounting for postretirement benefits make the lease accounting rules seem easy by comparison.

The error was subsequently corrected more than a year later with the issue of FASB Statement No. 98.

Since accounting is a social and not a natural science, it is inevitable that written rules will not anticipate every potential circumstance or behavior. Further, specific circumstances often vary significantly, leading to unintended outcomes in the application of inflexible rules. Instead of a detailed, rule-oriented approach to standard setting, we believe the cause of financial reporting would be better served through issuance of statements of general objectives. Accordingly, we offer the following proposition.

PROPOSITION 2

> Statements of the Financial Accounting Standards Board should address general objectives and not prescribe detailed rules.

We recognize that regulators have a need for specific rules as an aid to enforcement. We also recognize that standards that permit interpretation in their application place an increased burden on those who attest to financial statements. Nonetheless, we believe such an approach, if applied with integrity and at a consistently high level of quality, would benefit users.

Recognition and Measurement. Critical to any conceptual framework is a meaningful recognition and measurement system. Yet the FASB's conceptual framework provides no such system.

FASB Concepts Statements Nos. 1 through 4, although well constructed, have no meaning unless issues of recognition and measurement are addressed. FASB Concepts Statement No. 5 was awaited with great anticipation and expectation that it would complete the conceptual framework by providing a definitive recognition and measurement system. Instead, the Statement offered the following (in paragraph 2):

> The recognition criteria and guidance in this Statement are generally consistent with current practice and do not imply any radical change. Nor do they foreclose the possibility of future changes in practice. The Board

> intends future change to occur in the gradual, evolutionary way that has characterized past changes.

The conceptual framework was conceived to guide the FASB in developing future standards; however, FASB Concepts Statement No. 5 states that accounting is evolutionary and "further development of recognition, measurement, and display matters will occur as concepts are applied at the standards level." The logic seems convoluted, at best, when concepts that are to guide the development of standards will themselves be developed from the standards. Such reasoning calls into question the rationale for the conceptual framework in the first place. To capitalize on the work of FASB Concepts Statements Nos. 1 through 4 and to place standard setting back on its proper path, we recommend the following.

PROPOSITION 3

> FASB Concepts Statement No. 5 should be replaced with a new statement that clearly establishes a sound recognition and measurement system with the potential for guiding the development of standards that will more effectively serve the needs of users of financial statements.

From the investor's perspective, accounting concepts should strive to reflect economic reality. Efficient market research in accounting and finance suggests that all available information is speedily impounded in security prices. Ball and Brown concluded that more than 85 percent of the information in annual reports has been impounded in stock prices before the reports are released, and suggested that annual financial statements do not rank high as a timely medium for investment decisions.[6]

Since the efficiency of capital markets is determined by the adequacy of their data sources, it is reasonable to expect investors to use other, more

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[6]R. Ball and P. Brown, "An Empirical Evaluation of Accounting Income Numbers," *Journal of Accounting Research* 6, Autumn 1968, pp. 159-78.

timely sources of information.[7] Therefore, the role of accounting information needs to be clarified in an efficient market where other sources of information are available.

Ingberman and Sorter[8] suggest that, since financial statements cannot compete with other sources of information based on timing, they should be prepared to assist investors to confirm and validate other, more timely information in forming expectations of future cash flows. Their position is consistent with research findings that the stock market reacts only to unexpected portions of earnings that were not captured by other information.

The competition from other, more timely information does not obviate the importance of annual financial statements; however, it has important consequences for financial reporting standard setting. Financial reporting standards that reflect asset valuation and future cash flows should be among the paramount concerns for standard-setting authorities if accounting information is to validate all other available information in an efficient market.

Impact of Technology

Changing technology is having a profound impact on how information is captured, summarized, and communicated. Technology makes information available in "real time" modes and permits customizing of data for specific uses. Emerging technology calls for a reexamination of the appropriateness of the FASB's stated objectives of financial reporting.

The FASB has determined that the primary objective of financial reporting is to "provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions" and that financial reporting should help this set of users in "assessing the amounts, timing, and uncertainty of net cash

[7]For example, Dow Jones News Service (the "Broadtape"), *The Wall Street Journal*, and Dow Jones News/Retrieval usually provide more timely, firm-specific information.

[8]M. Ingberman and G. H. Sorter, "The Role of Financial Statements in an Efficient Market," *Journal of Accounting, Auditing and Finance*, Fall 1978.

inflows to the related enterprise."[9] Given the state of the art in financial reporting, the foregoing implies that standard setters know what is best for the individual investor, a curious notion, but understandable in the environment of the first half of the twentieth century. It is inconceivable that general-purpose financial statements can provide investors with precisely the information that they might desire.

Yet, the emerging technologies of the 1990s may enable individuals to quickly access financial data bases; for example, multiple sets of information prepared under differing asset and liability valuation bases. Divergent concepts of income measurement might be made available to meet investor information needs. Other possibilities include the recasting of financial information on a constant-purchasing-power basis, extracting a cash-basis income statement, analyzing the impact of capitalizing long-term noncancellable operating leases, and making available the impact of reporting pension liabilities based on a projected-benefits-obligation basis as well as on the presently decreed basis of the accumulated benefits obligation, to mention a few.

The technology needed to move from a single set of general-purpose financial statements to a multipurpose data base containing a variety of information that meets the needs of diverse users is clearly, now, the state of the art. Indeed, systems presentation of data is at a point where the system can learn what the user wants to see, providing any of a variety of formats, and even learn what the user wants over time without the user's requesting it. With this scenario, presentation issues become less relevant. We make no recommendation that general-purpose financial reporting be immediately replaced by the system described here, but only that the proposed system be implemented for a test period to determine feasibility and utility. Perhaps the scenario sketched here could be implemented in an evolutionary way— a general-purpose set of financial statements could continue to be produced and published as a public good, with the availability of all supplementary information and alternatives that investors

[9]FASB, Statement of Financial Accounting Concepts No. 1, Stamford: 1978.

might require contained in the computerized data-base system—much as the U.S. government is implementing for selected corporate data.[10]

One problem arises from this suggestion—which also affects existing financial data bases—namely, the degree of financial integrity that would be present in data bases that purvey financial information. It is axiomatic that such financial disclosure systems must be subject to the attest process. We recommend that the integrity of current and future data bases available to the investing public be subject to independent professional scrutiny.

In summary, we offer the following proposition.

PROPOSITION 4

> Research and field tests should be undertaken to determine the feasibility of developing data bases and systems to permit users to obtain the information they perceive necessary to meet their decision needs in whatever format they may desire, with the expectation that such information would be subjected to the attest process.

Globalization

Perhaps the most challenging issue that faces all accounting standardsetting organizations is the globalization of commerce. The world is becoming a common marketplace in which capital is raised and resources are allocated with less concern about national boundaries. Common information about investment opportunities throughout most of the world is needed to allow resource allocators to make informed decisions. Steps have been taken by the International Accounting Standards Committee (IASC) to address such needs, most notably with its comparability project;

[10]The additional costs of providing user-specific information might be recovered by the sale of accounting information to users who desire it. Free riders would be replaced by those who desire specific information and are willing to pay for it. The market would equate supply and demand. It would rapidly become apparent what information is used by investors in their decision-making processes and might help direct future standard-setting efforts.

however, much remains to be done. Many of the accounting policies in the United States are the product of the nation's cultural, economic, and political environment, and the same is generally true in other countries. Reconciling those diverse views and needs with U.S. national accounting standards poses problems that will not easily be resolved.

There is evidence that non-U.S. companies are avoiding U.S. financial markets because of the perceived regulatory burden, in favor of the United Kingdom, which accepts IASC-compatible financial statements, and other smaller markets such as the Netherlands and Singapore. The global market may accept a financial reporting model that represents the lowest common denominator in accounting and reporting standards, thus defeating the primary purposes of the U.S. standard-setting and regulatory functions, and potentially exposing U.S. companies to an "unlevel playing field" in the global market. For these reasons, the United States must enhance its role in the international standard-setting arena.

The FASB should recognize the trend towards acceptance of IASC standards in a growing number of countries and by important international organizations, such as the World Bank. To the extent that the FASB becomes more involved in the international standard-setting process, it may influence the nature and scope of international standards. Endorsement of IASC standards by the FASB and the Securities and Exchange Commission would bring the world's largest capital market into the fold, would remove or reduce some barriers to international investment in the United States, and would certainly create pressure on other capital markets to follow suit.

The FASB has extensive research capabilities, which could be placed at the disposal of the IASC and other bodies, such as Britain's Accounting Standards Committee, the Japanese Business Accounting Deliberation Council, and the European Community. The FASB should initiate research projects on topics unique to multinational corporations and should cooperate in identifying and developing needed standards in response to emerging issues.

Believing that much is to be gained by the United States' taking a vigorous strategic role in shaping international accounting standards, we propose the following initial step.

PROPOSITION 5

> A joint high-level commission (that includes the FASB) should be established by the Financial Accounting Foundation and the

Securities and Exchange Commission to define a prudent and timely course of action for the United States in establishing international accounting standards.

The FASB's Mission and Agenda

The long-term viability of the FASB must be of continuing concern to all who believe that the process of standard setting is best served if retained in the private sector. Issues that shape the long-term stability of the FASB include a continuing reassessment of its mission, the agenda-setting process, the primacy of users versus preparers, and financing FASB operations.

Mission

Contrary to intent, the standard-setting process has grown many tentacles since the FASB was established. In 1972, the Study on Establishment of Accounting Principles (Wheat Committee Report), chaired by Francis M. Wheat, made the following statement: "It is essential that financial accounting standards be in only one set of hands—the [Financial Accounting] Standards Board's."[11]

In 1990, what is the status with respect to the establishment of accounting standards, principles, and rules? In addition to FASB Statements, Interpretations, and Technical Bulletins, an accountant is faced with the following:

1. *EITF Abstracts.* Since its establishment by the FASB in 1984, the Emerging Issues Task Force, which was "to assist the FASB in the early identification of emerging issues affecting financial reporting,"[12] has reached a number of *consensuses* that the SEC

[11]AICPA, *Establishing Financial Accounting Standards: Report of the Study on Establishment of Accounting Principles,* New York: March 1972, p. 72.

[12]FASB, *EITF Abstracts: A Summary of Proceedings of FASB Emerging Issues Task Force,* Norwalk: October 6, 1988, p. i.

Chief Accountant expects to be applied by companies subject to the SEC's jurisdiction."[13]

2. *American Institute of Certified Public Accountants (AICPA) Statements of Position of the Accounting Standards Division.*[14] These statements deal with issues not covered by existing FASB pronouncements. The FASB may issue standards to supersede any AICPA statement of position by the AICPA's Accounting Standards Division.

3. *AICPA Accounting Standards Executive Committee Practice Bulletins.* These pronouncements are issued to disseminate the views of the Accounting Standards Executive Committee on narrow financial accounting and reporting issues. The issues dealt with are those that have not been and are not being considered by the Financial Accounting Standards Board or the Governmental Accounting Standards Board.[15]

4. *AICPA Audit and Accounting Guides.* These guides are intended to be helpful in areas such as determining whether prospective financial statements are presented in conformity with AICPA presentation guidelines.[16] Statement on Auditing Standards (SAS) No. 5, *The Meaning of "Presents Fairly in Conformity With Generally Accepted Accounting Principles" in the Independent Auditor's Report,* as amended by SAS No. 43, *Omnibus Statement on Auditing Standards,* identifies AICPA guides as sources of established accounting principles that an AICPA member should consider.

The AICPA's role is strengthened by the aforementioned SAS No. 5 and is further buttressed by actions of the FASB described as follows.

> In September 1979, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 32, *Specialized Accounting and Reporting Principles and*

[13]Ibid.

[14]See AICPA, *AICPA Technical Practice Aids,* New York: 1990, p. 16,001, for a discussion of the role of AICPA Statements of Position of the Accounting Standards Division.

[15]Ibid., p. 30,515.

[16]AICPA, *Guide for Prospective Financial Statements,* New York: 1986, p. ii.

> *Practices in AICPA Statements of Position and Guides on Accounting and Auditing Matters* (as amended by Statement of Financial Accounting Standards No. 83, *Designation of AICPA Guides and Statement of Position on Accounting by Brokers and Dealers in Securities, by Employee Benefit Plans, and by Banks as Preferable for Purposes of Applying APB Opinion 20)*, an amendment of APB Opinion No. 20, *Accounting Changes*. This Statement specifies that the specialized accounting and reporting principles and practices contained in designated AICPA Statements of Position are preferable accounting principles for purposes of applying APB Opinion No. 20.[17]

Clearly, over the years, varied sources for authoritative standards have evolved. It is clear that both the EITF and the AICPA are active players in the establishment of accounting principles, in contravention of the recommendation of the Wheat Committee. As a result, FASB standards are not the single source of standards as envisioned by that committee. If the process continues unabated, the FASB may eventually be relegated to being a minor player.

Accounting standard setters should have a degree of independence that is exceptionally high. While the FASB is organized in such a way as to ensure considerable objectivity in its members, the same is not true for other groups active in the accounting standard-setting process. For example members of the EITF and the AICPA's Accounting Standards Executive Committee participate in the standard-setting processes of those organizations only part-time, and most are public accountants or preparers of financial statements and reports. While the perspectives and beliefs of active practitioners are vital to the standard-setting process, we believe that those subject to the effects of accounting standards should not be directly responsible for the development of individual standards. We believe that the process is best served if left in the hands of one independent, full-time body. Accordingly, we propose the following.

PROPOSITION 6

> A major initiative should be launched to reestablish the FASB as the sole private-sector body with responsibility for setting financial

[17]AICPA, *Technical Practice Aids*, New York; 1990, p. 16,001.

> accounting standards. All other private financial accounting standard-setting activities should be cleared through the FASB and be viewed as nonauthoritative.

Unless the primacy of the FASB in the private sector is clearly established, we believe the standard-setting process in the private sector is doomed.

Standard setting in the private sector exists at the discretion of the SEC. Although it looks to the FASB as the primary source of financial accounting standards, the SEC continues to exert significant influence on accounting principles and practices through Regulation S-X and Staff Accounting Bulletins.[18] That the SEC's actions have an impact—salutary or otherwise—on the work of the FASB is clear. While frequently demonstrating its support for FASB pronouncements in its enforcement of the Securities Acts, the SEC often is the court of last resort for publicly owned companies that perforce must seek SEC—rather than FASB—approval of their financial accounting.

Obviously, the FASB, or any other private-sector standard setter, must be ever cognizant of the views of the SEC. To those who are outside this process, it appears that the FASB has handled matters in this area as well as could be expected.

Setting the FASB Agenda

The FASB agenda is the product of a deliberative, thoughtful process, as described by the FASB in its publication, *Facts About FASB*.[19] Although on its face this *agenda-setting* process appears well structured, on occasion topics have been *removed from the agenda* for reasons not entirely clear. For example, accounting for business combinations, which was on the original agenda of the FASB and was the subject of a lengthy Discussion Memorandum, was removed from the agenda "because of [its] low priority in relation to other existing and potential projects."[20] Similarly, the FASB undertook a comprehensive study and issued a Discussion Memorandum

[18]SEC, *Codification of Financial Reporting Policies*, Washington: 1989, Sec. 101.

[19]FASB, *Facts About FASB*, Norwalk: 1990, pp. 2-3.

[20]FASB, *Status Report*, Stamford: April 10, 1981, p. 3.

on interim financial accounting and reporting, but subsequently abandoned the project.

We believe that removal of agenda items should receive the same thoughtful, careful consideration as was used in placing the item on the agenda in the first instance. We recommend the following.

PROPOSITION 7

> The removal of items from the FASB agenda should receive the same deliberate "due process" as does the placement of items on the agenda, including broad-based consultation. Further, the basis for removing items from the agenda should be fully disclosed to all constituents.

Role of Users

If the purpose of accounting is to provide information useful for decision making, then it follows that the role of public financial reporting is to aid external users in making informed decisions. In this context, the standardsetting process ultimately exists solely for the benefit of public users of financial information. Despite the public need that is served by the financial reporting process, many competing variables interact to influence the standard-setting process.

Therefore, in the setting of standards, the views of preparers should always be secondary to the needs of users. In fact, if financial statements are issued to facilitate the securing of capital by an entity, this objective will best be served by responding to the needs of users. When the difference between the cost to preparers and the benefit to users of a standard is marginal, the scales usually should be tipped in favor of users.

The consequences of preparers of financial statements dominating the standard-setting process could not be more vividly illustrated than by the savings and loan industry, where regulatory accounting principles were

modified in the interest of issuers at the expense of the taxpayers.[21] To the extent that the process is unresponsive to user needs, it is doomed to failure. Based on this analysis, we propose the following.

PROPOSITION 8

> The interests of users of financial statements should take precedence over the interests of preparers, and therefore the user constituency should dominate the governance of standard setting.

In this context, the focus of standard setting should always be on the benefits to be achieved. Recent calls for shifting the focus to the cost of standards may tend to be counterproductive. Obviously, cost must be considered. Through field testing and other means, a reasonable perspective on the cost of proposed standards may be obtained. However, cost to preparers must not be permitted to take precedence over benefits to users simply because costs are more easily measured.

Financing the FASB

For standard setting to remain in the private sector, a stable funding base must be secured for the FASB. Reliance on voluntary contributions places the standard-setting structure in a precarious position. Corporate contributions, a major source of current funding, may diminish significantly if there is widespread dissatisfaction with particular standards, no matter how well such standards serve the public interest. The potential for such action cast a long shadow over the *independence* of the members of the FASB.

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[21]Regulatory accounting principles were promulgated by the Federal Home Loan Bank during the 1980s in an effort to increase regulatory net worth reported by savings and loans. These procedures have been criticized as increasing the total cost of resolving the savings and loan crisis. It should be noted that the FASB issued FASB Statement No. 72 (on accelerating goodwill amortization) and FASB Statement No. 91 (requiring deferral of loan fees) during this period. These pronouncements tended to lower the reported net worth of savings and loans.

Funding from public accounting firms is also problematic. If the role of the independent CPA is to serve as an information intermediary between suppliers and users of financial information, one could (and many firms do) question the validity of charging CPA firms with a major underwriting responsibility for the FASB. As major contributing firms merge and cost pressures increase, the level of financial support from CPA firms will likely diminish.

Under the present structure, financial information essentially is provided to users as a free "good." Although custom-designed information of the future may carry a user charge, general-purpose information will likely continue to be made available at no direct cost to users because it serves the interest of the suppliers of the information.[22] Assuming that an active, reliable financial market exists in the long run for the benefit of suppliers of information, it may be appropriate for providers of financial statements to underwrite the cost of setting standards, using an assessment system similar to that of the New York Stock Exchange. The ideal long-term solution would be the creation of a permanent endowment, with the interest therefrom being used to finance FASB operations. For the short term, we recommend the following.

PROPOSITION 9

> Consideration should be given to establishing an assessment system to underwrite the FASB by each publicly held company based upon an appropriate measure such as a percentage of total revenues or total assets.

Conclusion

Generally, the FASB has served users well for almost two decades. But as is inevitable, environmental changes necessitate a periodic reexamination of its mission and role. We strongly believe there are many benefits to retaining the setting of financial accounting standards within the private sector, but we are concerned whether the FASB can maintain the relevance of its product, remain independent in pursuit of its mission, and generate adequate financial support to operate through the next decade. There are serious issues to be resolved, and their resolution cannot wait.

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[22] It could be argued that since the U. S. government is becoming a more prominent user of financial reporting, it, too, should contribute to underwriting the cost of standard setting.