



**Securities Industry Association**

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Re: *Request for Comments on Proposed Changes to Streamline the FASB Process*

Dear Joe:

I have received your letter requesting comments on the FAF's Board of Trustees set of proposed changes to the structure and operations of FASB. I know that the FAF takes seriously its responsibility for overseeing FASB, and that it desires to be responsive to the questions that have arisen in the wake of the Enron collapse concerning accounting standards and audited financials. However, the set of proposals that has been developed (reducing the size of FASB from 7 to 5 members; requiring only a simple majority to approve standards; and shortening comment periods) do not, I believe, go to the heart of the problem.

Before recommending changes to the makeup and procedures of FASB, I think one should first step back and analyze where FASB has demonstrated some weaknesses. (For example, any criticism of the length of comment periods is in my view a reflection of deeper problems in the process, not a problem itself.) Once those weaknesses have been identified, remedies to address those shortcomings can then be considered. With that in mind and from the perspective of someone in the securities industry, below are my thoughts on problems with the current accounting standard-setting process, and a few recommendations on how FASB might remedy those problems.

Overview

The shift to a service economy and the increasing sophistication and expansion of the capital markets are presenting a profound challenge to the existing accounting paradigm. If it is to meet that challenge, FASB needs to ensure that its standards are solidly grounded in an understanding of markets and financial products, and that it has developed a reasonably cost-effective means of providing investors with real insight into a preparer's financial results. The following three paragraphs describe problems with the recent accounting standards.

- 1) Overly Detailed -- Recent FASB efforts at standard setting have tended to be very detailed and overly prescriptive. In addition, the exercise of judgment by preparers of financial statements and auditors is increasingly frowned upon, when not explicitly prohibited. The result has too often been lengthy efforts that ultimately produce standards of great complexity, but of doubtful utility. One of the reasons why comment periods are as long as they are and why I would oppose shortening them in the absence of other reform, is that standards are so complex and detailed that it takes a good deal of time to surface lurking problems. FASB should focus instead on the "Big Picture," producing principle-based standards, leaving most compliance questions to the preparers, auditors and the SEC.
- 2) Standards don't reflect Economics -- There is an increasing gap between accounting practice and economic reality, and some recent standards and current proposals are not truly reflective of the substance of business activities. If FASB lacks a firm grasp of the economics underlying a transaction or line of business, the resulting standards are virtually certain to be unsuccessful. Conventional accounting standards often have the effect of distorting the underlying economics, not only to the detriment of firms but more importantly, to the users of their financial statements. One key means of addressing this problem would be for FASB to enlist the input of private sector experts *at the outset* of a new project, and to regularly engage in a substantive give-and-take dialogue with affected constituents throughout the course of the project. This would serve as a reality check and help ensure that difficulties in application are surfaced early in the process before "sunk costs" give a life of its own to the project.
- 3) Disproportionate Costs -- At times, accounting standard setters seem unwilling to balance costs and benefits. For example, complying with FAS 133 (*Accounting for Derivative Instruments and Hedging Activities*) requires an enormous effort on the part of preparers, particularly financial services companies. However, investors and users of financial statements appear to pay very little attention to the resulting disclosures. Unhappily, we fear that the securities industry's experience with FAS 133 may be duplicated with respect to the FASB project on Liabilities and Equity. Before a project gets too far down the track, we encourage FASB to seek

input from both the investor community and the private sector about whether the resources that would be spent in accumulating and disseminating the data is worth the effort. If the resulting disclosure will be of marginal interest to readers of financial statements, the proposed standard should be reconsidered.

With respect to corrective steps to address these problems, I would recommend that the FAF consider the following actions.

Hiring more staff with an understanding of financial markets – The capital markets have gone through nothing short of a revolution in the last few decades. New products and structures have been developed for monitoring and managing risks; assisting corporate clients with tools for addressing their needs on a global basis; tailoring investments and portfolios to customer appetites; etc. Keeping pace with these developments has created a continuing challenge to firms, especially in the hiring and training of staff. The staff hired by FASB should have hands-on experience with at least common marketplace transactions and products.

Regular turnover of Board members and staff – As a means of trying to ensure that standards are appropriately practical and implement-able, we believe it is important to ensure that both Board members and the staff are rotated regularly from the issuer/auditor community. With the very best of intentions, Board members and staffers who have spent too long in the “ivory tower” can sometimes lose touch with the practical difficulties encountered in the “real world.”

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I hope the FAF finds these thoughts helpful. I think I speak for the securities industry as a whole when I say that we are appreciative of the hard work and dedication that Board members and staff demonstrate daily. No one in the industry believes that a lack of effort or interest has ever been an issue. It is SIA’s hope that by working together with the private sector, FASB can make financial statements and disclosures more meaningful and transparent, thereby enhancing investor protection and ensuring greater public trust and confidence in U.S. accounting standards and the audit process. If the FAF would find it helpful, I would be pleased to organize a meeting with representatives of the securities industry to further amplify the thoughts and suggestions contained in my letter.

Regards,

Marc E. Lackritz,  
President