4-22-1996

FASB in My Rear View Mirror

Robert J. Swieringa

FASB IN MY REAR VIEW MIRROR

by
Robert J. Swieringa (1)
Dean,
Johnson School of Management,
Cornell University
April 22, 1996

[Introductory note: Robert J. Swieringa was appointed to the Financial Accounting Standards Board (FASB) in 1986 and remained a member for 10 years. He is currently the dean of the Johnson School of Management at Cornell University.

Dr. Swieringa was a recipient of the Justice Foundation Award for outstanding teaching at Cornell, where he was a professor of accounting for 11 years. Prior to teaching at Cornell, he was on the faculty at the Stanford University Graduate School of Business. He has been an active consultant and member of the board of directors of two closely-held corporations.

Dr. Swieringa earned his A.B. degree at Augustana College in Rock Island, Illinois, an M.B.A. at the University of Denver, and a Ph.D. at the University of Illinois. He received the 1989 Outstanding Achievement Award of the Augustana College Alumni Association and the 1994 University of Denver School of Accountancy Alumnus of the Year Award. He has been a member of numerous committees of the American Accounting Association.

He is the co-author of four books: *Essentials of Financial Analysis* (with Robert T. Sprouse); *Some Effects of Participative Budgeting on Managerial Behavior* (with Robert H. Moncur); *Cases in Financial Accounting* (with Thomas R. Dyckman); and *Financial Accounting: An Introduction* (with Harold Bierman, Jr.). He has also authored or co-authored more than 50 articles in scholarly journals, has published several book reviews and technical reports, and has been on the editorial boards of several scholarly journals.]

It is a great honor for me to be here this evening. Baruch College has been blessed with a long tradition of outstanding scholars in accounting. This lecture honors Emanuel Saxe, who, during his 40 years at Baruch, was a professor, chairman of the Accountancy Department, Dean, Morton Wollman Distinguished Professor of Accountancy, and University Distinguished Professor.

One of his students was Abraham Briloff, who was a member of the accounting faculty for 43 years and was the Emanuel Saxe Distinguished Professor of Accountancy. I have been an avid reader of Professor Briloff's articles and used them extensively in my classes over the years.

The title of my lecture this evening is "FASB in My Rear View Mirror." (2) In two months, I will be leaving the FASB after ten and a half years as a member of the Board. Rather than exiting the Merritt Parkway at Exit 40B, I will continue to New Haven, and, quite literally, I will see the FASB (at 401 Merritt 7) in my rear view mirror -- those of you from Connecticut will add the qualifier not exactly."

But tonight, I want to talk figuratively about FASB in my rear view mirror. As I leave the FASB, I look back on accomplishments, disappointments, frustrations, and continuing challenges during those ten years, and I would like to try to put them in perspective.

PERSPECTIVES

I joined the Board in January 1986, following in the footsteps of Robert Sprouse, who was one of the original seven Board members in 1973. This was the second time that I tried to follow in his footsteps. The first time was when I inherited his Business 311 Corporate Reporting course at the Stanford Business School in 1973 when he joined the FASB. Robert Sprouse was not an easy professor to follow. He was an outstanding professor. He was also an outstanding Board member.

Arthur Northrop and I were the seventeenth and eighteenth individuals to join the FASB. We joined a very strong Board that included Victor Brown, Donald Kirk, Raymond Lauver, David Mosso, and Arthur Wyatt. (3) At this point, all of those individuals have left the Board. (4)

Agenda Projects

Recently, there has been increased interest in the productivity and efficiency of the FASB. Concerns have been expressed about how long it takes to resolve important issues. My term on the Board provides a perspective about what was and was not achieved during the last ten years.

The Board issued FASB Concepts Statement 6 on elements of financial statements and Statements 87 and 88 about employers' accounting for pensions in December 1985. Nine items were included on the technical agenda at January 1, 1986 (see Table 1). The project on postemployment benefits other than pensions was added in 1979, the projects on accounting for income taxes and consolidations were added in 1982, the projects on financial reporting and changing prices and on nonrefundable loan fees and costs were added in 1984, and the projects on regulated enterprises, insurance company issues, and cash flow statements were added in 1985. Exposure Drafts were issued in December 1985 for the projects on nonrefundable loan fees and costs and on regulated enterprises.

From January 1, 1986, through December 31, 1995, the Board considered 80 possible agenda items and added 29 of those items to its technical agenda. Of the 51 items that were not added to the technical agenda, nine items resulted in Technical Bulletins, two items resulted in AICPA pronouncements, and four items were deferred. During that period, the Board completed eight of the initial nine projects, completed 21 of the 29 projects added during that period, and removed two items from the agenda. In other words, 31 items (or 82 percent) of the 38 available projects were resolved during that period.

At January 1, 1996, the Board had seven items on its technical agenda (see Table 1). The project on consolidations that was added in 1982 was not completed during the ten-year period. The other six projects were added during that period, including the financial instruments project that was added in 1986, the present-value-based measurements project that was added in 1988, the earnings per share and liabilities for closure or removal of long-lived assets projects that were added in 1994, and the not-for-profit organizations project about intermediaries and the comprehensive income project that were added in 1995. Exposure Drafts were issued in 1995 for projects on consolidations, transfers of assets and extinguishments of liabilities, and not-for-profit organizations. Exposure Drafts were issued in 1996 on earnings per share, disaggregated disclosures, liabilities related to closure or removal of long-term assets, comprehensive income, and derivatives and hedging activities.

Some Demographics

The 36 standards issued from January 1, 1986, to December 31, 1995, are listed in Table 2. Three observations help to put those standards in perspective. First, the standards differ dramatically in the amount of time and effort that it took to complete them. On average, it took about three years to complete a standard. But, like many averages, that average is somewhat misleading. The range was from four months to almost twelve years, and the median was two years. Ten standards took less than a year to complete. Statements 99, 100, 103, and 108 reflected deferrals of effective dates; Statements 102, 104, 111, and 118 were amendments to existing standards; and Statements 112 and 119 were narrow-scope standards. Statements 106, 109, and 123 took more than ten years to complete. Statements 94, 96, 116, and 117 took more than five years to complete.

If the four deferred effective date standards (Statements 99, 100, 103, and 108), one technical correction standard (Statement 111), and three narrow amendments (Statements 102, 104, and 118) are eliminated from the analysis, the average becomes about three years and nine months. However, if the three standards that took the longest to complete (Statements 106, 109, and 123) are adjusted from the agenda date to the date when serious work began on the development of a standard, the average again becomes about three years.

Second, the standards were not equally distributed across years. Given that 36 standards were issued in ten years, the average per year was 3.6 standards. But that average also is somewhat misleading. Six standards were issued in 1987 and five standards were issued in 1992 and 1995. Four standards were issued in 1988 and 1993, three standards were issued in 1986 and 1989, and two standards were issued in 1990, 1991, and 1994.

Third, the standards were not equally distributed across topics. Eighteen standards focused on three topics -- financial instruments (eight standards), not-for-profit organizations (five standards), and income taxes (five standards). Nine standards focused on three topics -- rate-regulated enterprises (three standards), insurance company issues (three standards), and cash flow statements (three standards). The remaining nine standards focused on nine different topics.

THE STANDARDS

I would like to put the 36 FASB Statements that were issued from 1986 through 1995 in context.

1986-1987

The year 1986 was very hectic. Public hearings were held on nonrefundable loan fees and on regulated enterprises. Projects on accounting for not-for-profit organizations and on financial instruments were added to the technical agenda. Six Exposure Drafts were issued on financial reporting and changing prices, accounting for income taxes, cash flow reporting, universal life insurance contracts, consolidations, and depreciation accounting by not-for-profit organizations. Late in 1986, the Board issued Statement 89 on financial reporting and changing prices, Statement 90 on abandonments and disallowances, and Statement 91 on nonrefundable loan fees and costs.

The hectic pace carried over into 1987. Public hearings were held on income taxes and on consolidations. Statement 92 on accounting for phase-in plans by regulated enterprises, Statement 93 on depreciation accounting by not-for-profit organizations, and an Exposure Draft on sale and leaseback transactions were issued in August 1987. Statement 94 on consolidation of majority-owned subsidiaries was issued in October 1987; Statement 95 on cash flow statements and an Exposure Draft on disclosures about financial instruments were issued in November 1987, Statement 96 on accounting for income taxes and Statement 97 on universal life insurance contracts were issued in December 1987. Deliberations continued on postemployment benefits other than pensions, stock compensation, rate-regulated enterprises, and contributions to not-for-profit organizations.

1988-1991

Relatively few standards were issued during 1988-1991. The Board issued four narrow standards in 1988: Statement 98 focused on sale and leaseback transactions, Statements 99 and 100 merely deferred the effective dates of two standards that were issued in 1987, and Statement 101 focused on how to discontinue application of Statement 71.

The Board focused on implementation problems for applying Statement 96, reconsidered the direction of the financial instruments project based on comments on the 1987 Exposure Draft, and merged the stock compensation project into the liability and equity phase of the financial instruments project. The Board developed tentative conclusions on the postretirement benefits other than pensions project. Projects on interest methods and on impairment of long-lived assets were added to the technical agenda in 1988.

In 1989, the Board issued Statements 102 and 104, which amended Statement 95 on cash flow statements, and issued Statement 103 to defer the effective date of Statement 96. Exposure Drafts on postretirement benefits other than pensions and on disclosures about financial instruments also were issued in 1989. The Board continued to deliberate possible amendments to Statement 96 on income taxes.

The Board issued Statement 105 on disclosures about financial instruments and Statement 106 on postretirement benefits other than pensions in 1990. Exposure Drafts on disclosures about the market value of financial instruments and on contributions to not-for-profit organizations were issued in 1990, as well as Discussion Memorandums on impairment of long-lived assets, present-value-based measurements, and distinguishing between debt and equity financial instruments. The Board continued to focus on financial instruments, accounting issues of not-for-profit organizations, and a possible replacement for Statement 96 on income taxes. The Board issued Statement 107 on disclosures about market value of financial instruments and Statement 108 to delay the effective date of Statement 96 on income taxes in 1991. The long-awaited Exposure Draft on accounting for income taxes was issued in 1991, as well as Exposure Drafts on accounting for investments with prepayment risk and Discussion Memorandums on consolidations, financial instruments, and new basis accounting.

1992-1993

The pace quickened again in 1992 and 1993. The Board issued five standards in 1992, including Statement 109 on accounting for income taxes, and four relatively narrow standards: Statement 110 on investment contracts, Statement 111 on technical corrections, Statement 112 on postemployment benefits, and Statement 113 on reinsurance contracts. Also in 1992, the Board added projects on loan impairments and marketable securities to its technical agenda, and issued Interpretation 39 on offsetting and Exposure Drafts on loan impairments, marketable securities, accounting by mutual life insurance companies, financial statements of not-for-profit organizations, and contributions.

In 1993, the Board issued Statement 114 on loan impairments, Statement 115 on accounting for marketable securities, Statement 116 on accounting for contributions, and Statement 117 on financial statements of not-for-profit organizations. Exposure Drafts were issued on accounting for stock-based compensation and on impairment of assets, and Interpretation 40 was issued on mutual life insurance and other enterprises. The Board's deliberations focused on derivative financial instruments.

1994-1995

In 1994, the Board issued two narrowly focused standards: Statement 118 amended Statement 114, and Statement 119 focused on disclosure about derivative financial instruments. The Board continued to deliberate issues about stock-based compensation, derivatives and hedging, asset impairment, and consolidation policy. The Board issued Exposure Drafts on accounting by mutual life insurance enterprises and on accounting for mortgage servicing rights, and Interpretation 41 on offsetting.

In 1995, the Board issued five standards: Statement 120 on accounting for certain insurance contracts, Statement 121 on impairment of long-lived assets, Statement 122 on mortgage servicing rights, Statement 123 on stock-based compensation, and Statement 124 on certain investments held by not-for-profit organizations. The Board also issued Exposure Drafts on consolidated financial statements on transfers of assets and extinguishments of liabilities, and on a proposed interpretation of certain terms in Statement 116. Board deliberations continued on derivatives and hedging, and Exposure Drafts were developed on reporting disaggregated information, earnings per share, and accounting for closure or removal of long-term assets.

The Board is working hard to issue standards on consolidation policy and procedures and on transfers of assets and extinguishments of liabilities before 1996. (5) The Board is also trying to develop Exposure Drafts on derivatives and hedging activities and on comprehensive income. (6)

Accomplishments

I believe that the most significant accomplishment during my time on the Board was Statement 106. It required new information about the obligation and related costs of postretirement health benefits and changed the way people viewed the obligation and related costs. There are various reasons why that standard was successful.

- Statement 87 paved the way for Statement 106. The important battles took place over the extended period to develop and issue Statement 87. Statement 106 was based on the terminology, measures, and approach in Statement 87. Many people were comfortable with the measures and disclosures required by Statement 87. The Board and others expected that over time, postretirement health and other benefits plans would evolve to be like pension benefits plans, and therefore a Statement 87 approach was appropriate.
- Entities were experiencing escalating health care costs, and those increased costs made this issue more important, even in a pay-as-you-go world.
- Entities were considering amendments to their postretirement health benefit plans and arrangements. The consideration of amendments made some of the arguments for eligibility date more plausible than otherwise.
- The basic issues of recognition and measurement of a post-retirement health benefit obligation were appealing to matching and measurement advocates.
- The field test was important in the development of Statement 106 because it demonstrated that the obligation could be measured and it revealed how large the numbers were.
- Six seminars were held from April 1989 through June 1989 to describe and discuss the Exposure Draft.
- The process used to develop Statement 106 worked reasonably well. At a crucial point in that process, the question changed from *whether* to recognize and measure the obligation and related cost of postretirement health benefits to *how* to recognize and measure that obligation and cost.

The second most important accomplishment was the project on not-for-profit accounting. Statements 93, 116, 117, and 124 are having a major impact on the financial reporting of not-for-profit organizations. Members of governing boards and others are finding the new financial statements more understandable and useful because the statements focus on the organization as a whole and on measures of performance and because they will provide a basis for comparing the organization's performance with that of other organizations.

The third most important accomplishment was maintaining the credibility of accounting for rate-regulated enterprises under Statement 71. Statement 71 reflected the environment of cost-plus regulation that existed when it was developed. In the mid-1980s, that environment began to change. The costs of new capacity increased dramatically because of double-digit inflation, construction delays, and more stringent nuclear construction requirements after the accident at Three Mile Island. The costs of existing capacity, some of it excess capacity, were also increasing. The large rate increases required to cover those costs focused public attention on electric rates and galvanized opposition to rate increases.

Statements 90 and 92 were responses to those developments and the changing tone of regulation. Discussions that took place during the development of Statement 92 on phase-in plans led to Statement

101 about how to discontinue the application of Statement 71. Deregulation of certain industries and changes in the method of regulating others caused several enterprises to discontinue application of Statement 71 for all or some of their operations.

In recent years, the natural gas industry and telecommunications industries have been deregulated and restructured. The eight largest telecommunications companies reported restructuring charges in excess of $10 billion and have written off regulatory assets in excess of $30 billion. It is expected that electric utilities also will be deregulated and restructured in the years ahead, resulting in over $100 billion of regulatory and other assets being written off.

Disappointments

The most disappointing standards have dealt with financial instruments. We are in the midst of a sea change in finance. Fundamental changes in global financial markets have transformed the financial activities of all entities. Increased volatility in foreign exchange and interest rates and other market prices have greatly increased market, credit, and liquidity risks. Efforts to manage those financial risks, competition, and government deregulation of financial markets and services, structural changes in the economies and taxation of different countries, and technological advances in computers and information services have stimulated financial innovation.

The FASB was ahead of the curve when it added the project on financial instruments and off-balance-sheet financing to its technical agenda in May 1986. But the FASB has fallen behind the curve in the 1990s. After ten years of effort, we have yet to come to grips with financial instruments. Instead of developing broad standards, the Board has issued a patchwork of inconsistent standards for marketable securities, loan impairment, and other issues.

- Financial instruments include a broad class of items. Some items can be readily valued; other items are difficult to value.
- Financial instruments are held by financial institutions, so trying to deal with those instruments necessarily requires that the Board try to deal with accounting and operating issues that arise in those institutions.
- Practices for financial instruments have become well established. It is more difficult to change accounting practices when they are well established.
- Financial instruments are used in a variety of ways. It is difficult to understand their varied uses in setting accounting standards.

Another disappointing project has been consolidations and related matters. Several issues papers from the AICPA provided the impetus for adding this project to the agenda in 1982. Even though the project was added in 1982, it was inactive for a couple of years, and the first staff paper was discussed early in 1986. The Board disagreed with several important details about the economic unit approach advocated in that paper. But, instead of pursuing those details, the Board decided to issue Statement 94 about majority-owned subsidiaries. At this point, in 1996, the Board is still grappling with those details. The fundamental issue in this project is the objective of financial reporting.

A third disappointing item has been the present-value-based measurement project. That project initially was linked with the project on impairment of assets. The interest methods and impairment of assets projects were on a parallel track, with Discussion Memorandums being issued and public hearings being held at about the same times. But the Discussion Memorandum for this project was not successful in defining the issues and alternatives. In addition, deliberations on this project were usurped by projects on loan impairment and asset impairment, and even the example of the warranty obligation used to stimulate discussion drew fire because of ongoing debates about how to measure financial liabilities.

Frustrations

The most frustrating standard was accounting for income taxes. Statement 96 was fashioned in a net deferred tax liability world. Discussions about criteria for deferred tax assets shifted from a probability assessment approach to an events approach that reflected very restrictive criteria for recognition. The prospects of tax legislation that would reduce corporate tax rates put considerable pressure on the Board to develop and issue a standard that would make measurement of deferred tax assets and liabilities more responsive to changes in tax rates.

But then, the tax world changed dramatically with the Tax Reform Act of 1986. That Act reduced corporate rates, but it also made the most significant changes in corporate income taxes in history. The Act enlarged the tax base by eliminating many items that had created deferred tax liabilities and added an alternative minimum tax that tied income tax calculations to book income measures, among other provisions. That Act changed interperiod tax allocation from a world of tax credits to, eventually, a world of tax debits. The likely effects of that Act were not well understood in 1986 and 1987.

Then, the Board began serious consideration of postretirement health benefits, and corporate America began its restructuring process. The recognition of liabilities for those benefits and restructuring provisions accelerated the movement to a net tax debit world.

The Board encountered continuing difficulties in dealing with an increasing list of implementation issues, some of which were new and others that were carried over from the debates before the standard was issued. Changes in Board membership and continuing pressures to reconsider decisions in Statement 96 made it even more difficult to reconsider and rethink a recently issued standard. That reconsideration process also exposed a very real limitation of the Board's process -- it focuses on one possible solution at a time. Rejection of that solution often results in a fresh start.

Another very frustrating standard was Statement 123 on stock-based compensation. We could spend the rest of the evening talking about this standard. The development of other standards has reflected political behavior. However, the focus of the stock-based compensation project increasingly was on Washington as the project progressed. People decided to go around the Board's due process. They were told by people in Washington and elsewhere to participate in our process, but their hearts were not in it. In addition, other political agendas were being pursued by various parties that affected the stock-based compensation project.

But we learned many things during that project:

- Valuation of stock-based compensation is widespread among consultants and academics.
- Some companies trade off salaries and bonuses for stock-based compensation.
- Some executives choose between bonuses and stock-based compensation.
- Some directors choose between fees and stock-based compensation.
- Some employees receive annual total compensation reports that include the fair value of stock-based compensation.
- Some companies routinely value stock-based arrangements with professional golfers (Calaway) and with college coaches (shoe companies).

An analyst from Boston said that the "jack was now out of the box," but AT&T Chairman Robert Allen's remarks last week that at-the-money options have no value at grant date suggest that some senior executives should have participated in the debates on this project. (7) With hindsight, the Board could have proposed a disclosure solution ten years ago.

CHALLENGES

Controversy has surrounded many of those 36 standards. I would like to conclude by focusing on several challenges we faced in resolving financial reporting issues.

Fair Values

One challenge is whether to expand the use of fair values or market values in financial reporting. The current accounting model is a mixed-attribute, transaction-based model. That model has worked reasonably well over the years, but some believe that this model should be replaced with a fair value model. Fair value is the price that would be obtained under normal conditions between a willing buyer and a willing seller.

The Public Oversight Board of the SEC Practice Section of the AICPA has urged the FASB to study comprehensively the possibility of fair value accounting. The General Accounting Office has recommended that the FASB consider the development of a market value rule for all financial instruments. However, a top-level government working group on financial markets that included Treasury Secretary Lloyd Bensten, Federal Reserve Chairman Alan Greenspan, and SEC Chairman Arthur Levitt urged the FASB to go slow on market value rules for financial instruments, and the AICPA Special Reporting Committee recommended that the FASB not devote attention to value-based accounting at this time.

The debate at the FASB has not been about changing to a different model; rather, it has been about changing the mix of the attributes in the current model. The debate has focused on four areas.

First, we have debated whether fair value should be used to initially measure certain assets. That debate has taken place in the context of contributions (Statement 116), mortgage servicing rights (Statement 122), and stock-based compensation (Statement 123). Contributions and stock-based compensation recognized under Statement 123 are required to be measured at fair value, but mortgage servicing rights are required to be measured at carryover basis.

Second, we have debated whether fair value should be used to remeasure certain assets when recorded amounts are not likely to be recovered. That debate has taken place in the context of loan impairment (Statement 114) and asset impairment (Statement 121). An assumption inherent in an enterprise's statement of financial position prepared in accordance with generally accepted accounting principles is that recorded amounts for assets will be recovered. If that condition does not hold, recorded amounts should be adjusted. Impaired loans may be recognized at fair value, but impaired assets are required to be recognized at fair value.

Third, we have debated whether fair value should be used to account for certain assets that are readily marketable. That debate has taken place in the context of marketable debt securities (Statement 115). During an extended period of reduced interest rates, financial institutions reported significant amounts of realized gains while concurrently having underwater investment portfolios. That behavior was described as gains trading, "cherry picking," or "snacking." Statement 115 retains amortized cost for some held-to-maturity debt securities. Statement 124 requires that all debt securities held by not-for-profit organizations be accounted for at fair value.

Fourth, we have debated whether fair value should be used to account for certain assets when underlying rights are unbundled. Loans or receivables can be pooled or packaged into homogeneous portfolios and transferred to a trust or special-purpose entity. The trust or entity can then issue debt or equity securities that are securitized by those receivables. Through the securitization process, receivables have been unbundled into rights and obligations. An Exposure Draft that was issued in October 1995 proposed that some of those rights and obligations should be recorded at fair value and some should be recorded at carryover basis.

The debate about fair value currently is taking place in discussions about accounting for derivatives. We have been told by the SEC chairman that the three most important issues in financial reporting are derivatives, derivatives, and derivatives. Statement 119 improved disclosures about the way entities use derivatives. But, until recently, the Board has been at an impasse about how to account for derivatives and hedges.

The challenge of whether to expand the use of fair values in financial reporting is being driven by the ongoing development of markets and the development of methods to approximate prices in those markets. The sweep of the sea change in finance has raised questions about the continued use of amortized cost for many financial instruments.

Present Values

A second challenge is whether to expand the use of present-value-based measurements in financial reporting. APB Opinion 21, which was issued in August 1971, requires the use of present values for receivables and payables. Yet, a close reading of Opinion 21 reveals that the use of that method is limited to contractual rights to receive or pay money on fixed or determinable dates. Moreover, trade receivables, purchase deposits, security deposits, lending activities, intercompany transactions, and certain other tax-related or restricted receivables and payables are excluded from the requirements of Opinion 21. Recent debates have focused on whether present-value-based measurements should be used in accounting for loan impairment (Statement 114), asset impairment (Statement 121), provisions for credit losses, and certain environmental liabilities.

The Board issued an Exposure Draft in February 1996 that focuses on accounting for obligations for certain closure or removal costs of long-lived assets such as nuclear power plants. Measuring those obligations requires estimates of uncertain future events. The amounts and timing of expected future payments for closure or removal activities have to be projected over periods ranging from 40 to 60 years, those payments have to be discounted back to their present value at an assumed interest or discount rate to reflect the time value of money, and the discounted amounts have to be allocated between current and future accounting periods. Between now and then, laws and technologies may change. Actual payments may differ dramatically from expected amounts.

The challenge of whether to expand the use of present values in financial reporting is being driven by assets and liabilities that are far removed from contractual rights to receive or pay money on fixed or determinable dates. The focus is on risky assets and risky liabilities for which actual cash flows may differ dramatically from expected amounts.

Use of Estimates

A third challenge is whether to expand the use of estimates in financial reporting. The use of fair values and present values reflects the use of estimates of cash flows and of other factors in valuation.

Accounting tends to be viewed as objective and precise and as reflecting measures of past transactions and events. Yet, those measures are based on assumptions or estimates about future events.

Estimates are becoming more prevalent because contract relations are increasingly prevalent. Accounting for contracts is easy if they are simple, discrete, and of short duration; if they reflect limited relations among the parties; and if precise measures exist for objects of exchange, no further cooperation is anticipated, and no sharing relations exist.

Accounting for contracts is difficult if contractual relations are complex and of long duration; if they reflect close relations among the parties; and if some objects of exchange cannot be measured currently, some future cooperation is anticipated, sharing relations exist, some troubles are anticipated, and interactions are assumed. Complex contractual relations exist for parent and subsidiary relations, financial instruments, contributions, postretirement benefit arrangements, compensation plans, insurance arrangements, warranty and service arrangements, regulated enterprises, software contracts, and so forth.

Accounting for objects of exchange that cannot be measured currently makes extraordinary demands on accountants as measurers. Consider postretirement health benefits -- arrangements that may cover up to

80 years. The benefits are in kind and indexed rather than fixed; the contracts are not well-defined, like pension contracts; and the contracts are changing as arrangements evolve.

Also consider reclamation costs that can cover up to 90 years, decommissioning costs for nuclear power plants, and the costs of significant extended warrantees. All of those costs rely heavily on estimates of uncertain future events to make initial and subsequent measurements. Accountants are increasingly making interim measures of unfolding events. Estimates are difficult; changes in estimates are prevalent.

Recent debates have focused on accounting for restructurings. A restructuring occurs when an entity makes a fundamental change in its business strategy, operations, or structure in hope of achieving improved results of operations in future periods, often as a result of reduced costs. Companies in industries that have been deregulated have reported significant restructuring charges.

Restructuring charges have included costs of employee benefits, such as costs of severance and termination benefits; costs associated with the elimination and reduction of product lines; costs to consolidate or relocate plant facilities; costs for new system development or acquisition; costs to retrain employees to use newly deployed systems; and losses on asset impairments and disposals of assets.

In 1994, the Emerging Issues Task Force (EITF) discussed and reached several consensuses in Issue 94-3 about when an entity should recognize a liability and an expense for costs associated with a restructuring. In addition, Statement 121 addresses the accounting for the impairment of long-lived assets to be held and used by an entity and for long-lived assets to be disposed of. EITF Issue 94-3 and Statement 121 likely will result in lower restructuring liabilities and charges and in increased visibility of restructuring activities. However, EITF Issue 94-3 and Statement 121 now have been added to the tangled web of pronouncements that may apply to restructuring activities. The challenge of whether to expand the use of estimates in financial reporting is being driven by the increased reliance on contractual relations and by the increased uncertainty associated with judgments, assumptions, and estimates.

Distinctions between Organizations

The challenges of whether to expand the use of fair values, present values, and the use of estimates all relate to matters of valuation and measurement. A fourth challenge is whether to distinguish between organizations in financial reporting.

Distinctions between organizations are part of the fabric of generally accepted accounting principles. Those principles developed by industry and their codification became the articulation of generally accepted accounting principles. However, distinctions between organizations are becoming blurred.

Consider the distinction between governmental entities and other entities. That distinction is central to the jurisdiction agreement between the FASB and the GASB. That agreement requires that the FASB and the GASB distinguish between entities. (8) Yet, some organizations are both private and public. Cornell University, where I spent almost twelve years, is both governmental and private. Moreover, governmental and other organizations are increasingly engaging in the same transactions and competing in the same markets. Health care organizations provide both immediate and real examples.

A distinction is also made between not-for-profit organizations and other entities. But, increasingly, not-for-profit organizations and for-profit entities are operating in the same markets. Not-for-profit organizations have frequently moved into service areas previously dominated by for-profit entities (e.g., vocational rehabilitation, job placement, family, and other human services), and for-profit entities have moved into service areas previously dominated by not-for-profit organizations (e.g., health clubs and health care providers).

Distinctions are also made between financial and other entities. Specialized accounting exists for financial institutions and different requirements exist for savings and loans, banks, finance companies, insurance companies, and credit unions. But some financial institutions have all of those entities. A company like Citicorp has savings and loans, banks, finance companies, and insurance companies. And some nonfinancial institutions have savings and loans, banks, finance companies, and insurance companies. Those entities engage in the same transactions and compete in the same markets. It is not desirable to have different accounting treatments that depend on which entity engages in a transaction.

And, distinctions are made between U.S. and other organizations. We tend to accept the view that because different practices, legal systems, capital markets, tax systems, technical methods, social norms, and so forth exist across countries, different accounting treatments are appropriate. Yet, increasingly, entities in different countries are engaging in the same transactions and competing in the same markets. In particular, those entities are seeking capital in the same capital markets.

International Accounting Standards

A fifth challenge is international accounting standards. The FASB has become more active with standard-setting organizations around the world as the market for accounting standards has become global. The Board has worked closely with standard setters in other countries and with the International Accounting Standards Committee (IASC).

In January 1996 the FASB issued Exposure Drafts on segment reporting and on earnings per share calculations. The segments Exposure Draft was a joint effort between the FASB and the Accounting Standards Board of the Canadian Institute of Chartered Accountants, which simultaneously issued an identical exposure draft. The EPS Exposure Draft is very similar to one issued by the IASC, with which we coordinated our efforts. Other publications that have resulted from joint efforts include special reports on financial reporting in North America (with Canada and Mexico) and on future events, hedge accounting, and provisioning (with Australia, Canada, the United Kingdom, and the IASC).

During 1995, the FASB formed an "American Free Trade Agreement Committee for Cooperation on Financial Reporting" with representatives of Canada, Mexico, and Chile to explore areas in which the four countries could more fully cooperate on minimizing differences in their accounting standards.

The Board has become more active in IASC activities. A member of the FASB is a member of the IASC Consultative Group and responds to IASC proposals and attends IASC meetings.

The Board has exchanged staff members with the Australian Accounting Research Foundation, has had an intern from Japan, and an accountant from China will join the staff. An FASB staff member is working with the U.K. Accounting Standards Board, and a former FASB staff member and consultant is an international accounting fellow at the IASC. The Board has encouraged visits with standard setters and staff from other countries, has shared its work product with other countries, and has focused on international standards in discussing financial reporting issues.

The FASB is committed to promoting the development and acceptance of superior international accounting standards. The Board will work with other standard-setting organizations to reduce differences in national accounting standards, promote cooperative relations and communication between the FASB and other standard-setting organizations, and strengthen and formalize its internal policies and procedures for international activities. The FASB also will complete an IASC-U.S. accounting standards comparison study that analyzes similarities and differences and assesses their significance and implications. The results of that study will be disseminated broadly.

However, the FASB must decide soon how to respond to the potential acceptance of IASC standards in U.S. capital markets. Foreign issuers and others are pushing for acceptance of IASC standards by the SEC. U.S. companies want a level playing field vis-a-vis foreign issuers. Emerging markets need accounting standards as a basis for financial reporting. How the FASB responds to these developments may be the most significant and critical actions it takes in the 1990s.

CONCLUSION

Congressman Henry Hyde of Illinois has said that when he came to Washington he wanted to change the world. Now he feels lucky if he can leave the room with dignity.

I didn't come to the Board to change the world, but I have had an extraordinary opportunity to help shape 36 standards, or about 30 percent of the FASB's 124 Statements of Financial Accounting Standards. (9)

The great American philosopher Ann Landers has said that there are three types of people in the world: Those who make things happen, those who watch things happen, and those who ask, "What happened?" I have had a very special opportunity to make things happen in financial reporting.

When I was at Stanford and Cornell, happiness was teaching and research about accounting issues. Then I thought that joining the FASB would be happiness. For someone who has a keen interest in financial reporting, the FASB has been a wonderful opportunity to learn about accounting issues that are swirling anywhere in the world. I have been enthralled by those issues and by the judgments that I have been asked to make. And I have enjoyed working with the people of the FASB and others who participate in the various social networks and organizations of standard setting. Standard setting is inherently a social activity, and I have worked with and developed friendships with some terrific people.

But, now, happiness is returning to teaching and research and the world of academe, and seeing FASB in my rear view mirror.

Table 1

FASB AGENDA PROJECTS

At January 1, 1986:	Date Added
Accounting for income taxes	January 1982
Accounting for stock compensation	March 1984
Cash flow statements	April 1985
Consolidations and the equity method	January 1982
Financial reporting and changing prices	September 1984
Nonrefundable loan fees and costs	February 1984
Postemployment benefits other than pensions	May 1979
Insurance company issues	February 1985
Regulated enterprises	January 1985
At January 1, 1996:	Date Added
Comprehensive income	September 1995
Consolidations and related matters	January 1982
Earnings per share	March 1994
Financial instruments	May 1986

Liabilities for closure or removal of long-lived assets	June 1994
Not-for-profit organizations-acting as intermediaries	November 1995
Present-value-based measurements	October 1988

Table 2

FASB STATEMENTS AND INTERPRETATIONS ISSUED IN 1986-1995

FASB Statement No.89, *Financial Reporting and Changing Prices,* December 1986.

FASB Statement No.90, Regulated Enterprises -- *Accounting for Abandonments and Disallowances of Plant Costs,* an amendment of FASB Statement No.71, December 1986.

FASB Statement No.91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases,* an amendment of FASB Statements No.13, 60, and 65 and a rescission of FASB Statement No. 17, December 1986.

FASB Statement No.92, *Regulated Enterprises -- Accounting for Phase-in Plans,* an amendment of FASB Statement No. 71, August 1987.

FASB Statement No.93, *Recognition of Depreciation by Not-for-Profit Organizations,* August 1987.

FASB Statement No.94, *Consolidation of All Majority-Owned Subsidiaries,* an amendment of ARB No. 51, with related amendments of APB Opinion No. 18 and ARB No. 43, Chapter 12, October 1987.

FASB Statement No.95, *Statement of Cash Flows,* November 1987.

FASB Statement No.96, *Accounting for Income Taxes,* December 1987.

FASB Statement No.97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments,* December 1987.

FASB Statement No.98, *Accounting for Leases: Sale-Leaseback Transactions Involving Real Estate, Sales-Type Leases of Real Estate, Definition of the Lease Term, Initial Direct Costs of Direct Financing Leases,* an amendment of FASB Statements No.13, 66, and 91 and a rescission of FASB Statement No. 26 and Technical Bulletin No. 79-11, May 1988.

FASB Statement No.99, *Deferral of the Effective Date of Recognition of Depreciation by Not-for-Profit Organizations,* an amendment of FASB Statement No. 93, September 1988.

FASB Statement No.100, *Deferral of the Effective Date of FASB Statement No. 96,* an amendment of FASB Statement No. 96, December 1988.

FASB Statement No.101, *Regulated Enterprises -- Accounting for the Discontinuation of Application of FASB Statement No.71,* December 1988.

FASB Statement No.102, *Statement of Cash Flows -- Exemption of Certain Enterprises and Classification of Cash Flows from Certain Securities Acquired for Resale,* an amendment of FASB Statement No. 95, February 1989.

FASB Statement No.103, *Accounting for Income Taxes -- Deferral of the Effective Date of FASB Statement No. 96,* an amendment of FASB Statement No. 96, December 1989.

FASB Statement No.104, *Statement of Cash Flows -- Net Reporting of Certain Cash Receipts and Cash Payments and Classification of Cash Flows from Hedging Transactions,* an amendment of FASB Statement No. 95, December 1989.

FASB Statement No.105, *Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk*, March 1990.

FASB Statement No.106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* December 1990.

FASB Statement No.107, *Disclosures about Fair Value of Financial Instruments,* December 1991.

FASB Statement No.108, *Accounting for Income Taxes -- Deferral of the Effective Date of FASB Statement No. 96,* an amendment of FASB Statement No. 96, December 1991.

FASB Statement No.109, *Accounting for Income Taxes,* February 1992.

FASB Statement No.110, *Reporting by Defined Benefit Pension Plans of Investment Contracts,* an amendment of FASB Statement No. 35, August 1992.

FASB Statement No.111, *Rescission of FASB Statement No. 32 and Technical Corrections*, November 1992.

FASB Statement No.112, *Employers' Accounting for Postemployment Benefits,* an amendment of FASB Statements No. 5 and 43, November 1992.

FASB Statement No.113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, December 1992.

FASB Statement No.114, *Accounting by Creditors for Impairment of a Loan,* an amendment of FASB Statements No. 5 and 15, May 1993.

FASB Statement No.115, *Accounting for Certain Investments in Debt and Equity Securities,* May 1993.

FASB Statement No.116, *Accounting for Contributions Received and Contributions Made,* June 1993.

FASB Statement No.117, *Financial Statements of Not-for-Profit Organizations*, June 1993.

FASB Statement No.118, *Accounting by Creditors for Impairment of a Loan -- Income Recognition and Disclosures,* an amendment of FASB Statement No. 114, October 1994.

FASB Statement No.119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments*, October 1994.

FASB Statement No.120, *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts*, an amendment of FAS13 Statements No. 60, 97, and 113 and Interpretation No. 40, January 1995.

FASB Statement No.121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, March 1995.

FASB Statement No.122, *Accounting for Mortgage Servicing Rights*, an amendment of FASB Statement No. 65, May 1995.

FASB Statement No.123, *Accounting for Stock-Based Compensation,* October 1995.

FASB Statement No.124, *Accounting for Certain Investments Held by Not-for-Profit Organizations,* November 1995.

FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts,* March 1992.

FASB Interpretation No. 40, *Applicability of Generally Accepted Accounting Principled to Mutual Life Insurance and other Enterprises,* April 1993.

FOOTNOTES

(1) Robert J. Swieringa was a member of the Financial Accounting Standards Board (FASB) at the time that he delivered this lecture. The views expressed here are those of Dr. Swieringa. Official positions of the FASB on accounting matters are determined only after extensive due process and deliberations.

(2) The context for that title is a song by Mac Davis, entitled "Texas in My Rear View Mirror." In that song, Davis describes a teenager's desire to leave Lubbock, Texas "Happiness is Texas in my rear view mirror." The teenager faces several challenges in writing songs in Hollywood and in wrestling with what is important in life. The song concludes with the adult returning to Lubbock, Texas, and observing that now, "Happiness is Lubbock, Texas ... and, when I die, you can bury me in Lubbock, Texas, in my jeans."

(3) Over the years, Dennis Beresford replaced Donald Kirk, James J. Leisenring replaced Arthur Wyatt, Clarence Sampson replaced David Mosso, Joseph Anania replaced Raymond Lauver, Robert Northcutt replaced Arthur Northrop, James (Neel) Foster replaced Victor Brown, and Anthony Cope replaced Clarence Sampson.

(4) When I leave the Board in June 1996, I will be one of five individuals who have served more than ten years on the Board. Donald Kirk served fourteen years, Robert Sprouse served thirteen years, Victor Brown served ten and a half years, and David Mosso served ten years.

(5) The Board was not able to issue a standard on consolidation policy before June 1996, but it did issue Statement of Financial Accounting Standards No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* in June 1996.

(6) Exposure Drafts on *Reporting Comprehensive Income and Accounting for Derivative and Similar Financial Instruments and for Hedging Activities* were issued in June 1996.

(7) The following excerpt of Mr. Allen's remarks at the April 17, 1996, AT&T annual meeting is from the April 29, 1996 edition of *The News Hour with Jim Lehrer:*

> If you as share owners don't benefit, I don't benefit, and when we get to the other issue that's had a good deal of mis-reporting, and I'd like to clarify it, it goes to the options that were awarded to me and other senior officers by the board late last fall. They were options that today have no value, absolutely none. They are not worth the paper that they're written on. But they do have an incentive for all of us at the senior level to be sure that this restructuring, this transition is successful on behalf of AT&T's share owners and its employers. And the way they do this, if the stock price goes up, you benefit; the stock price goes up, I benefit. [Transcript by Strictly Business, page 7]

(8) The FASB and the GASB recently agreed on a definition of governmental entities.

(9) Actually, I ultimately helped shape 37 standards, since Statement of Financial Accounting

Standards No. 125 was issued in June 1996, two months after I presented this Emanuel Saxe lecture.