Downsizing FASB

The standards setter proposes shrinking the size of its board, raising a new accounting question: Is five worth more than seven?

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The parent organization of the Financial Accounting Standards Board aims to shrink the size of the standard-setting organization and give more power to its chairman, according to a proposal expected to be released late Tuesday afternoon.

The Financial Accounting Foundation plans to recommend cutting FASB from seven to five members, and giving its chairman, currently Robert Herz, more power to set the agenda for rulemaking, Terri Polley, the FAF's interim chief operating officer, told CFO.com. The plan was first reported by the *New York Times* Tuesday.

Polley told CFO.com that a smaller board would be more efficient and nimble and better able to respond to changes in the global marketplace. The proposal, which will be released for public comment, puts FASB in the "best position to fulfill its current and anticipated future mission," added Polley.

Polley would not speculate on whether FASB's future included a merger with the International Accounting Standards Board to form a single international standard-setting body, as many observers believe it will. But she said that "the U.S. needs to participate in that debate to make sure FASB has a role . . . in the international arena."

The plan has left other observers puzzled. "What is the problem or set of problems to which this [proposal] is the solution?" asked former FASB member Katherine Schipper, now a professor at Duke University's Fuqua School of Business. Schipper said it was difficult to comment on a proposal that she had only read about in the *Times*, but said that the article, a column by Floyd Norris, raised questions about why FAF and FASB were taking this step.

According to Polley, now is an "opportune" time to reduce the number of board members. She confirmed the departure of at least one board member and term ends for two others. Michael Crooch, a former Arthur Andersen partner, is retiring on June 30, 2008, three years into his second five-year term. George Batavick, a former controller of Texaco, finishes his five-year term in next year. Donald Young, a former director and technology analyst at investment funds and banks, completes a three-year term in 2008.

But Young, who is considered the investor representative on the board, expressed reservations about the plan. "I don't see any arguments for why this board should be smaller," he said. "A better way to go would be to try a more aggressive representation of investors and fundamentally increase investor representation on the board." The FASB board historically includes one member with an investor background, one academic, and five members with backgrounds as auditors or financial statement preparers.

There have been other calls recently for a larger investor voice on FASB, including by the Committee to Improve Financial Reporting, a blue-ribbon panel convened by the Securities and Exchange Commission and chaired by Robert Pozen.

Pozen told CFO.com he could not comment on behalf of the entire CIFR committee, but said the committee would take a position on the proposal at its next meeting on January 11. However, in the CIFR meeting last November, the subcommittee on accounting standards listed investor involvement as first among several "central issues" that would improve standard setting. "Additional user involvement in the standard setting and regulatory processes is central to improving financial reporting." The subcommittee noted that the perspective of users — that is, investors who use financial statements — is critical. "Additional user participation on the FAF and FASB, together with making FASB user advisory committees more effective, will help provide this perspective," the committee wrote.

In theory, a smaller board would give Young or his successor a stronger voice, but Young disputes that notion. "The investor representation is tokenism today with one out of seven, and it is still tokenism with one out of five," he said. Indeed, in addition to increasing investor representation, Young argues that the chairman also ought to be an investor.

"When I was a member of FASB, it was my view that there were seven board members and at least one of them at any given time was very weak," says Schipper. "That was a reason to have seven instead of five, frankly. Then you had six other people to carry the burden instead of four."

Former FASB chairman Denny Beresford said he had proposed shrinking FASB in the 1990s in response to trustee pressure to reduce expenses, but says the trustees at the time balked at the idea. "The trustees thought they should have as many voices involved in the process as possible," he told CFO.com.

Beresford, who stepped down from FASB in 1997, says FASB now has a different funding structure and the new proposal is "about efficiency and effectiveness." A smaller board, he says, "makes it easier to make decisions."

Beresford, currently an accounting professor at the University of Georgia, says he does not think a smaller board would harm the quality of standard setting. "I think five is a reasonable number," he noted, saying that the number of board members is not as significant as who the board members are. He also said it was difficult to recruit investors "who are willing and able" to join FASB because of its "narrow focus" on technical accounting issues and the financial commitment required."Investment bankers get paid a lot of money," he told CFO.com, "For a successful financial analyst, [joining FASB] would be a cut in pay."

Beresford also pointed out that the move to give the FASB chairman more power to set the board's agenda is a departure from current practice. Today, projects are added to, or in the rare case dropped from, the agenda via a full board vote. If the new proposal is accepted in its current form, the chairman would be given the "ultimate say on projects," said Beresford. But he expects that Herz, or any other chairman, will consult with the rest of the board before making a final decision.

Schipper, who is also formerly a member of the Financial Accounting Standards Advisory Council, which is supposed to advise FASB on setting its agenda, questions whether the FAF feels the FASAC is not doing its job. "I wonder if this is why they see the need to concentrate agenda setting power?"

Schipper also wondered whether the chairman's new power to set the agenda would include the ability to remove items. "That's an interesting idea," she said. "Suppose the chairman were on the losing side of a technical vote, would he not be in the position to have a supermajority vote and say that, since the item was not going his way, he could remove the item from the agenda?" Schipper said that the FAF should also be asked whether "concentrating this power in a single individual might cause potentially highly qualified board members to consider whether they want to join the board."

Comments on the proposal to shrink the board and cede more power to the FASB chairman are due by February 10.