

**Financial Accounting Foundation
Request for Comments on Proposed Changes to Oversight, Structure, and
Operations of the FAF, FASB, and GASB**

INTRODUCTION

The Financial Accounting Foundation (FAF) Board of Trustees is responsible for the oversight, funding, and appointment of members of the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB). While the Board of Trustees does not direct the standard-setting activities of the FASB or the GASB, the Trustees have the responsibility to periodically review the structure and governance of the organization to assess its effectiveness and efficiency.¹

In July 2007, the Board of Trustees established a Special Committee on Governance Review to reexamine the overall structure, effectiveness, and efficiency of the governance processes of the FAF, FASB, and GASB; to evaluate and plan for the future role of the FAF and FASB in a capital market environment moving toward a single set of global financial reporting standards; to evaluate and plan for the future funding and continuing role of the GASB; and to evaluate and plan for the ongoing and future role of the Board of Trustees in preserving the independence and promoting the effectiveness of private sector and governmental accounting standard setting.

Recent commitments by many countries to use International Financial Reporting Standards (IFRS) have opened a broad-ranging debate on issues related to accounting standards convergence and globalization. At its core, this debate must include a realistic assessment of how IFRS will work in actual application across the world and what contributions can be made by the FAF and FASB to the quality and consistency of those standards. The outcome of this debate will affect the future role, structure, and influence of the FAF and FASB on the global standard-setting process. However, regardless of the outcome, the FASB likely will continue to have a meaningful role in how international standards are set, and it may have continuing responsibility for setting standards for private enterprises and not-for-profit organizations in the United States.

The GASB also faces several critical issues: the lack of a stable funding base, the proposal and enactment in at least one State of legislation to create exceptions to

¹In April 2003, the Securities and Exchange Commission (SEC) issued a policy statement determining that the FAF and the FASB satisfied certain criteria in the Sarbanes-Oxley Act of 2002 and confirmed the status of the FASB as a recognized private-sector body for setting authoritative accounting standards in the United States. The policy statement describes the SEC's role in monitoring the activities of the FAF and FASB, including the appointment of Trustees and FASB members. In March 2007, the FAF confirmed with the SEC its understanding of the Commission's role in the process of appointing FAF Trustees and FASB members. SEC Commissioners may recommend candidates for consideration as nominees, and may express their views on finalist candidates for both FAF Trustee and FASB member appointments before the Board of Trustees makes its final appointment decisions.

governmental accounting standards, and the interest of federal regulators in the oversight of municipal and state accounting standards.

It is within this context that the Special Committee reported its findings and preliminary recommendations to the Board of Trustees at its meeting on November 27, 2007. At a special meeting on December 14, 2007, the Board of Trustees voted to expose for comment a series of recommendations focusing on the FAF's oversight role, operations and governance; the FASB's structure and operations; and the GASB's funding and operations. These recommendations are designed to better position the FAF and the standard-setting Boards to become even more effective and efficient in a changing environment. The Trustees believe these recommendations are of such significance to the capital markets that they should be exposed for public comment. Accordingly, the purpose of this document is to formally request comments from constituents and other interested parties on the proposed actions noted below.

FAF BOARD OF TRUSTEES

Nomination and Election of Trustees

Since the creation of the FAF in 1972, the size and composition of the Board of Trustees has undergone various changes. Currently, the FAF is governed by a sixteen-member Board of Trustees. Eleven members are nominated by organizations referred to as Financial Nominating Organizations (FNOs) and Governmental Nominating Organizations (GNOs); the remaining five members are members at large.

Financial Nominating Organizations

Currently, eight Trustees are nominated by six FNOs: three from the American Institute of Certified Public Accountants and one each from the American Accounting Association, CFA Institute, Financial Executives International, Institute of Management Accountants, and Securities Industry and Financial Markets Association. The FAF has the ultimate authority in determining whether to elect the FNO nominees.

Governmental Nominating Organizations

Three Trustees are nominated by nine GNOs. Currently, the three governmental Trustees are then elected by representatives of the Government Finance Officers Association and the National Association of State Auditors, Comptrollers, and Treasurers. Under the FAF's By-laws as currently adopted, the FAF does not have discretion to determine whether to accept or reject Trustees elected under this process.

At-Large Trustees

Five members of the Board of Trustees are members at large (appointed by the Board of Trustees) and are individuals with business, professional, government, or other experience who, in the judgment of the Trustees, can contribute to advancing the purpose of the FAF.

Proposed Action: *Expand the breadth of individuals and organizations that are invited to submit nominations for the FAF Board of Trustees with the understanding that final authority for all appointments rests solely with the Board of Trustees.*

The Board of Trustees concluded that the independence, quality, and diversity of its membership would be best served by expanding its nominating process to access a broader population of qualified nominees. Accordingly, in addition to the current FNOs and GNOs, the Trustees recommend that other groups be invited to submit nominations for the Board of Trustees, including additional accounting, financial, investor, government, and other groups. The public also would be invited to submit nominations through financial, business, accounting and investor protection publications, media sources, and similar outlets. The Trustees would make the final determination on the election of all members.

The Trustees would be mindful in the selection process of new Trustees of the range of experience and expertise needed at that particular time on the FAF Board. It is expected that the Trustees would include members who are investment and capital market professionals, public accountants, financial executives, accounting educators, state and municipal government finance or elected officials, and investor protection professionals. Further, government finance or elected officials would continue to fill a minimum of three seats on the Board of Trustees.

Terms of Trustees

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

At present, Trustees are eligible to serve a maximum of two three-year terms. The Trustees believe that changing to one five-year term will provide the opportunity for a larger number of qualified Trustees to bring their skills and perspectives to the FAF. The Trustees believe that this change also will reduce the potential for an inherent pitfall in self-perpetuating Boards that results in near automatic reappointment.

Size of the Board of Trustees

Proposed Action: *Change the size of the Board of Trustees from sixteen members to a range of fourteen to eighteen members.*

The Trustees recommend changing the size of the Board of Trustees from the fixed number of sixteen members to a flexible range of fourteen to eighteen members, which

would enable the Board of Trustees to better react to a changing environment by having the ability to add particular experience and expertise as needed. (As noted above, government finance or elected officials would continue to fill a minimum of three seats on the Board of Trustees.)

Governance and Oversight Activities

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

Although the Trustees always have maintained effective oversight of the FASB and GASB as one of their primary responsibilities, the Trustees believe that in a changing environment, this role needs to be enhanced and strengthened. Accordingly, the Trustees propose taking a more active oversight role as to the efficiency and effectiveness of the standard-setting process, such as due process, agenda setting, solicitation of public comment, consideration of comments, and the retrospective evaluation of the effectiveness and efficiency of standards. The Board of Trustees would be mindful when implementing this recommendation that it not insert itself into the independent standard setters' substantive deliberations. The Trustees would welcome comments on enhancing our oversight, recognizing that the standard setters' independence must be maintained.

FASB

Background

The FASB began operations in 1973, based on the recommendations of the AICPA Wheat Committee in its 1972 report. The FASB replaced the Accounting Principles Board, an 18-member group composed entirely of part-time members. The following excerpt from the Committee's report is relevant:

The seven-man Standards Board that we are recommending seems to us to be small enough to be efficient and large enough to provide for a variety of views and backgrounds. If experience with a seven-man Standards Board suggests that a smaller or larger board would be better, it could be changed under the power of review given to the Board of Trustees of the Foundation.

The original FASB was established with a supermajority voting requirement of 5–2 to issue a standard. The Wheat Committee believed that a 5–2 vote was appropriate to increase the acceptance and to reduce the controversy associated with the Board's standards. Further, there was a concern that four Board members "representing" the AICPA could vote as a block over the objections of the other Board members. In 1977, the Trustees changed the voting requirements to a 4–3 simple majority. This reflected the change in composition from 4 to 3 members from public accounting and the Trustees' Structure Committee's report that the 5–2 requirement may have caused delays in the FASB's decisions. Several subsequent Trustee reviews maintained the simple majority requirement until 1989 when the Structure Committee recommended a change to a 5–2

supermajority. This change was based mostly on the belief that the perception of a 4–3 vote was an impediment in obtaining general acceptance of FASB standards.

In 2002, events from that time and the lengthy process of issuing standards in a rapidly changing business environment caused the Trustees to consider reducing the seven-member FASB to five members. Citing language in the Wheat Committee’s recommendation acknowledging that experience might suggest a smaller or larger board would be better, the Trustees debated whether a smaller FASB would represent a step toward accelerating the issuance of standards in a business environment that was quite different from that which existed in 1973. The Trustees also recommended that a 3–2 simple majority voting requirement would be appropriate if the Board size was reduced to 5 members, saying that a 4–1 requirement might slow the process and give undue weight to minority views. Ultimately, the Trustees voted not to reduce the number from seven to five. However, they voted to change the FASB voting requirement back to a 4–3 vote on the basis that this would expedite the standard-setting process, making it more timely and less cumbersome.

The original composition of the FASB included four members from public accounting, one from industry or the preparer community, one from the academic community, and a financial executive from the Federal Power Commission. The requirement for four members from public accounting was eliminated in 1977 and over time the Board evolved into its present composition of three members from public accounting, two from industry or the preparer community, one from the user or investor community, and one from the academic community.

Size of the FASB

Proposed Action: Reduce the size of the FASB from seven members to five.

The size of the FASB has not changed since 1973, when it was established with a seven-member Board, even though the financial markets have experienced significant change. The Trustees believe that the continuing expansion of the global financial markets and the drive toward the use of a converged or a single set of global accounting standards will place new and greater demands on the standard-setting process. The FASB will need to be more nimble and responsive to both domestic and global demands. In accepting the realities of today’s and tomorrow’s world, some Trustees believe that a five-member FASB would be more effective and efficient and would operate without any decrease in quality or due process. Trustees advocating this view noted that the recommendation is consistent with the operations of government commissions such as the SEC and other quasi-private organizations such as the Public Company Accounting Oversight Board (PCAOB), both of which have a five-member board. Other Trustees believe that the seven-member FASB should be retained at the present time.

FASB Voting Requirement

Proposed Action: *Retain the FASB simple majority voting requirement.*

In a potential move to a five-member FASB, the Trustees considered the appropriate voting requirement and determined that a simple majority voting requirement should be maintained. Requiring a supermajority (4–1) vote would have the potential to give too much weight to a minority view and could unduly slow the standard-setting process in an era when timeliness would be critical. Also, a simple majority voting requirement would be consistent with how other Boards and government commissions with accounting-related responsibility operate.

FASB Composition

Proposed Action: *Realign the FASB composition.*

In a potential move to a five-member FASB, the Trustees recommend that the composition should be changed. The Trustees recommend that the Board include one member from each of the following areas of primary experience: auditor, preparer, academic, and financial statement user. In selecting a member for the remaining seat, the Trustees would analyze the expertise and experience of the candidates to achieve the appropriate balance on the FASB and would select one at-large, best-qualified member.

The Trustees do not recommend any changes to the member terms of a maximum of two five-year terms.

Setting the FASB Technical Agenda

Proposed Action: *Provide the FASB Chair with decision-making authority to set the FASB technical agenda.*

Consistent with the need for the FASB to be more nimble and efficient in a changing environment, the FASB will need the ability to initiate and more quickly respond to pressing issues. Currently, the FASB technical agenda is set by a majority vote of the Board. However, agenda setting works largely through a process driven by Board member consensus. This process at times is inefficient and causes the agenda to become overloaded. To alleviate this problem, the Trustees recommend that the FASB Chair have decision-making authority for the Board's agenda. This has the added benefit of further facilitating and improving the interface with the International Accounting Standards Board (IASB).

GASB

Background

In 1981, the Governmental Accounting Standards Board Organization Committee (GASBOC) recommended the establishment of the GASB “to issue pronouncements on governmental accounting standards following due process procedures that provide for broad public participation at all stages of the standard-setting process.” The current 7-member GASB consists of six part-time members and one full-time chairman.

In its report issued in October of that year, the GASBOC stated as one of its criteria that the “new structure should be adequately funded.” However, the GASB’s funding has continued to come from voluntary contributions which, by definition, are not guaranteed and therefore do not provide a stable funding base.

In 2006, GASB’s funding totaled \$6 million derived as follows: \$2.1 million or 35 percent was contributed from state and local governments; \$2.2 million or 37 percent came from net sales of GASB publications and subscriptions; \$1.7 million or 28 percent was transferred from FAF reserves to make up the shortfall.

GASB Funding Source

Proposed Action: *Secure a stable mandatory funding source for the GASB.*

The Trustees have determined that a mandatory stable funding source for the GASB through state funding is required, as experience has proven that a voluntary approach does not provide the financial stability that is needed for the GASB to fulfill its mission. This suggests that the funding be mandated through a state government assessment. The Trustees do not have a recommendation on the best method by which to achieve this, but will be interested in comments from the public in this regard.

GASB Size, Term Length, and Composition

Proposed Action: *Retain the current size, term length, and composition of the GASB.*

The Trustees considered the size, term length, and composition of the GASB. The Trustees recommend retaining the current structure of a full-time Chair and six part-time Board members. Given the part-time nature of the GASB structure, the Trustees believe it is appropriate to maintain a seven-member Board, rather than reduce the size as in the case of the FASB recommendation.

Setting the GASB Technical Agenda

Proposed Action: *Provide the GASB Chair with decision-making authority to set the GASB technical agenda.*

Some Trustees believe that the GASB Chair should have the authority to set the GASB technical agenda. Those Trustees believe that in the changing government accounting environment, a “leadership agenda” will enable the GASB to be more agile and able to initiate and more quickly respond to pressing issues. Other Trustees believe that the agenda-setting process should continue to be determined by a majority vote of the GASB.

REQUEST FOR COMMENTS

In summary, the Trustees have voted to expose for public comment the following proposed actions:

1. Expand the breadth of individuals and organizations that are invited to submit nominations for the FAF Board of Trustees with the understanding that final authority for all appointments rests solely with the Board of Trustees.
2. Change the term of service for Trustees from two three-year terms to one five-year term.
3. Change the size of the Board of Trustees from sixteen members to a range of fourteen to eighteen members.
4. Strengthen and enhance the governance and oversight activities of the Trustees as to the efficiency and effectiveness of the standard-setting process.
5. Reduce the size of the FASB from seven members to five.
6. Retain the FASB simple majority voting requirement.
7. Realign the FASB composition.
8. Provide the FASB Chair with decision-making authority to set the FASB technical agenda.
9. Secure a stable mandatory funding source for the GASB.
10. Retain the current size, term length, and composition of the GASB.
11. Provide the GASB Chair with decision-making authority to set the GASB technical agenda.

Responses from interested parties wishing to comment on *Proposed Changes to Oversight, Structure, and Operations of the FAF, FASB, and GASB* must be received in writing by February 10, 2008. Comments should be submitted by email to tspolley@f-a-f.org. Those without email may send their comments to:

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

Responses should *not* be sent by fax. All comments received are considered public information and will be available on the FASB and GASB websites.