June 11, 2006

Technical Director
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116, Norwalk,
Connecticut 06856-5116

Dear Sir or Madam

Reference No. 1310-100
Financial Accounting Series
Enhancing the Financial Accounting and Reporting
Standard-Setting Process for Private Companies

Attached are my comments on the above topic.
My name is Don Bjerke. I am a Canadian citizen and I would like to respond to your invitation to comment on the above topic. Although the Canadian Accounting Standards Board (ASB) is examining the needs of users of financial statements, our financial reporting model usually harmonizes with the FASB accounting directives. These comments are therefore being sent to both the FASB and the Canadian ASB.

I am a member of the Society of Depreciation Professionals. The Society issues a periodic journal in which I have published a number of articles over the years. I was employed as a Professional Engineer in the telecommunication industry with job responsibilities, for which I received additional education, in the area of economic analysis and depreciation. Prior to retirement, I was employed at SaskTel in the finance department. Saskatchewan Telecommunications (SaskTel) is a crown corporation owned by one shareholder, the Province of Saskatchewan that follows incumbent telecommunication company accounting procedures (i.e. Bell Canada) in reporting their financial position to their stake-holder and also to the federal regulator, the Canadian Radio-television and Telecommunications Commission (CRTC).
I continue to maintain an interest in Economic Analysis and Financial Analysis. I feel that there are deficiencies with FASBs conceptual framework, from an economic perspective, on which I wish to comment.
I thank the Financial Accounting Standards Board and the American Institute of Certified Public Accountants for the opportunity to comment on this proposal.

Yours Truly

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Enhancing the Financial Accounting and Reporting Standard-Setting Process for Private Companies

Introduction

In developing financial accounting and reporting standards, both the FASB and AICPA will be guided by FASBs conceptual framework that states the financial accounting and reporting is to provide information (a) that is useful to present and potential investors and creditors in making investment and credit decisions, (b) that will help users of financial statements assess amounts, timing, and uncertainties of prospective cash flows from their investments, and (c) that informs users about the economic resources of and claims against enterprises, and transactions that affect such resources and claims.

As stated in the invitation to comment, the conceptual framework places **decision usefulness** at the top as the most important quality. But decision-making is an economic objective[1] and not a financial objective. All the telecommunication companies that I am familiar with and the CRTC make a distinction between the two disciplines of Financial Analysis and Economic Analysis. It is suggested that FASBs conceptual framework should also reflect the distinction between Economic Analysis and Financial Analysis.

Defining Economic Analysis and Financial Analysis

Economic Analysis is used for decision-making purposes and includes the fields of managerial and engineering economics. It includes cost comparative studies, economic profitability studies and cost studies for pricing decisions. The characteristics of this discipline are shown in Exhibit A. It is prospective and can relate to individual activities within the firm and to the overall firm.

The discipline of Financial Analysis, on the other hand, relates to the company or company segment performance and constitutes a different set of characteristics to that of Economic Analysis as shown in Exhibit A. Performance compares what the company or company segment *actually did* to what it *should have done*.[2] It is both prospective (i.e. budgetary) and retrospective and can also relate to activities within the firm and the overall firm. It encompasses the fields of cost accounting, financial accounting and management accounting. Although there are some commonalties such as the use of time value of money and the use of future cash flows, economic analysis and financial analysis are two distinctly separate disciplines. The information from financial statements should only be used for judging performance. These statements should not be used for decision-making purposes. Decisions regarding credit, buying, selling, securities etc. would be better served by set of pro-forma statements such as a pro-forma contribution (income) statement and a pro-forma balance sheet. These can be generated as required from economic study cash flows. These statements are illustrated in Exhibits B and C.

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[1] See **Economic Analysis** For Engineering and Managerial Decision Making by Norman N. Barish and Seymour Kaplan page ix that states “Making decisions is the key function in engineering and business activity. Most of the engineering and management decisions made in industry are or should be based upon economic analysis.”

[2] See **Management Accounting** Text and Cases by Robert N. Anthony page 524. He states on page 313 that “The essential task is to find a standard or norm with which actual performance can be compared.” He lists them to be “(1) subjective standards derived from the analyst’s experience; (2) goals, or budgets, set in advance of the period under review; (3) historical figures, showing performance of the same company in the past; and (4) the performance of other companies, as shown by their financial statements, or by averages compiled from the financial statements of a number of companies.”

The following are my comments regarding your questions on page iv:

Q1. Do you believe the proposal contained in paragraphs 16-29 will improve the accounting standard-setting process for private companies?

A1. The proposal contained in paragraphs 16-29 will improve the accounting standard-setting process for private companies provided that the conceptual framework allows for a parallel process of conducting financial analysis and economic analysis. The objective of financial analysis is to assess the performance of a company and accountants should be allowed to continue with this process. The objective of economic analysis is decision-making and when certain decisions are to be made, economic analysts can be called upon to address these issues. It is suggested that the new committee consider an accounting model that would permit financial statements for transaction based activity using historical and projected (budgetary) costs. Pro-forma statements can be generated, as need be, as part of an economic (Net Present Value) study for decision-making purposes. This would be the most cost-effective way of improving the accounting/economic standard-setting process.

Q2. Specific to paragraphs 16-29 do you believe that the proposed changes will help ensure that the financial reporting needs of constituents of private companies are met?

A2. The current FASB process in developing accounting standards stated on page 2 of the invitation to comment will <u>not</u> help ensure the financial reporting needs of constituents of private companies are met. This conceptual framework will lead to the adoption of the current mixed attribute accounting model containing fair value “noise” that will extremely complicate the development of financial statements. What is required is one standard for determining financial performance (i.e. accelerating the Financial Performance Reporting Project) and another standard for conducting economic studies.

Q3. The FASB and the AICPA believe that differences in generally accepted accounting principles (GAAP) for private companies should be based on financial statement user needs and cost-benefit considerations. Do you agree?

A3. The mixed attribute model will cause unnecessary volatility in a company’s financial statements and will cause the need to depart from GAAP in reporting accounting results. A separate standard-setting process for decision-making purposes would not involve GAAP and be used only when required, resulting in the greatest cost-benefit.

Q4. The FASB and the AICPA believe that members of the committee (except the chair) should not be compensated beyond a reasonable reimbursement of expenses. Do you agree?

A4. I agree.

Q5. The FASB and the AICPA believe the committee should set its own agenda and priorities. Do you agree?

A5. Yes, the FASB and the AICPA should set its own agenda and priorities as long as it is within its given mandate.

Exhibit A

Financial Analysis	***Economic Analysis***
Considers the performance of financial statements over a short term	Considers viability over the long term
Viewed on a company or business segment basis	Viewed on a company, project, product, or service basis
Uses historic and projected financial information	Uses current and future cash flows
Does not relate to valuation or appraisal	Does relate to valuation or appraisal
Factors Considered: - Earning impact - Legal and tax requirements - Full cost recovery - GAAP - Allocation of common costs - Financial regulatory requirements	Factors Considered: - Opportunity costs - Elasticity - Causal cash flows - Price/quantity relationships - Contribution to common costs - Economic regulatory requirements
Uses: - Determining profitability on an accounting basis - Constraint on economic decision-making - Operational goal setting on a corporate and segment basis - Determining full costs - Setting revenue requirements on a segment or company basis	Uses: - Determining profitability on an economic basis - Decisions to accept - reject or continue - discontinue - Choosing the best of all possible alternatives - Determining pricing "mark-ups" - Determining minimum revenue requirements for pricing
Capital Recovery: - Depreciation + Debt Interest + Equity Interest	Capital Recovery: - Annuity $\{(a/p)^{r}$ or $(a/f)^{r}\}$ where r = cost of capital
Indicators: - EBITDA - EBIT - NOPLAT - Net Income - Return on Equity (or Capital Employed) - Financial statements	Evaluators: - Net Present Value - Rate Of Return on Capital - Present Worth of Annual Costs - Annual Equivalent Costs - Discounted Pay Back - Pro-forma statements

Exhibit B

Pro-Forma Contribution (Income) Statement

For a $1,000,000 asset

	2007	**2008**	**2009**	**2010**
Revenues	$545,000	$585,000	$575,000	$565,000
Expenses:				
Cash Expenses[3]	400,000	400,000	400,000	400,000
Depreciation[4]	50,000	100,000	100,000	100,000
Debt Interest[5]	47,500	42,500	37,500	32,500
Equity Interest[6]	47,500	42,500	37,500	32,500
Total Expenses	545,000	585,000	575,000	565,000
Contribution[7]	0	0	0	0
Net Income[8]	47,500	42,500	37,500	32,500

Exhibit C

Pro-Forma Balance Sheet

For a $1,000,000 asset

	2007	**2008**	**2009**	**2010**
Assets				
Asset Cost	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Less Depreciation Reserve[9]	50,000	150,000	250,000	350,000
Total Assets	950,000	850,000	750,000	650,000
Equities				
Debt	475,000	425,000	375,000	325,000
Equity	475,000	425,000	375,000	325,000
Total Equities	950,000	850,000	750,000	650,000

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[3] Cash expenses include all expenses with except of depreciation, debt interest, equity interest, and fixed (common) costs. Fixed (common) costs are zero on a company basis.

[4] Depreciation uses a mid-year convention which assumes that capital expenditures occur in mid-year. The average service life is 10 years with a rectangular (or no) dispersion.

[5] The cost of debt interest is equal to the cost of equity interest with a 50-50 debt-equity ratio. Weighted average debt interest and equity interest costs are equal to 10% of the Total Assets

[6] This terminology is based on Robert N. Anthony's definition of equity costs in his book **Rethinking the Rules of Financial Accounting** Examining the Rules for Proper Reporting chapter 4. He states on page 74 "I propose that accounting adopt the concept of interest used in economics. Specifically, interest on the use of both debt and equity capital should be accounted for as an item of cost – the cost of using capital – and should be reported in the same way other items of cost are reported:"

[7] Contribution on a company basis should equal zero. Contribution on a company segment basis would contribute to the fixed (common) costs.

[8] Net Income equals the equity interest.

[9] Since this is a prospective statement Depreciation Reserve is the theoretical depreciation reserve based on current life characteristics. Financial Statements would show this as Accumulated Depreciation.