Deloitte Fireside Chat IX

The FASB at Forty and Forward
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Dr. Parveen Gupta: Good afternoon and welcome to today's Deloitte Fireside Chat: The FASB at Forty and Forward, broadcast live on www.sechistorical.org. I am Parveen P. Gupta, Professor and Chair of the Department of Accounting at Lehigh University, and moderator for today's program.

This program is the ninth in the Deloitte Fireside Chat series and is made possible through a partnership between Deloitte LLP and the SEC Historical Society. Deloitte is the brand name under which tens of thousands of dedicated professionals and interrelated firms throughout the world collaborate to provide audit consulting, financial advisory, risk management and tax services to selected clients. The SEC Historical Society, through its virtual museum and archive at www.sechistorical.org, shares, preserves and advances knowledge of the history of financial regulation. I'm a member of the Society's Board of Advisors and serve on the Museum Committee, advising on the growth and outreach of the virtual museum and archive.

Since the inaugural Deloitte Fireside Chat broadcast in 2009, the series has examined such issues as exploring principles versus rules-based accounting and auditing standards, responsibility for preventing and detecting financial reporting fraud, the SEC's role in accounting standards setting, and international convergence. All of the previous Deloitte Fireside Chat broadcasts are available in both audio and edited transcript format in the Deloitte Fireside Chats section under Programs in the virtual museum and archive. I encourage you to check them out at the end of this broadcast. The SEC Historical Society is grateful for the continuing generous sponsorship of Deloitte LLP for this series.

Today we will look at the Financial Accounting Standards Board as it celebrates its 40th anniversary, what it has accomplished over the past four decades, what its strategies and focuses are now, and most importantly, where it sees its impact going forward. Joining with me today are Mr. Russell Golden, Chairman of the Financial Accounting Standards Board, and Mr. Joseph Ucuzoglu, National Managing Partner, Regulatory and Public Policy, Deloitte LLP. I had the good fortune of interacting with Joe when he served at the SEC as the senior adviser and a professional accounting fellow in SEC's Office of the Chief Accountant, and I served as an academic accounting fellow in the SEC's Division of Corporation Finance.

Before we begin, I would like to state that the views of the presenters are their own and do not necessarily reflect those of the FASB, Deloitte LLP or the SEC Historical Society. The Society selected me to moderate the program. I worked with the presenters to finalize the content of our discussion. I thank my colleagues and advisory board members at Lehigh University for their input in helping me develop a list of potential questions. One of the hallmarks of the Deloitte

Fireside Chats is that it is an interactive series. Visitors to the virtual museum and archive are encouraged to submit questions for the program. We have received a number of questions for today's program and I'll be using some of them during the broadcast.

Russ and Joe, let's start our conversation by looking back a little. The mission of the FASB is to establish improved financial accounting and reporting standards to provide decision-useful information to investors and other users of financial reports. The FASB's mission is achieved through an open and independent process that encourages broad participation from all stakeholders, and objectively considers and analyzes all their views. Russ, given this mission, I have a three-part question for you. As you look back, do you think that the FASB has successfully delivered on its mission during the past forty years? What are some of the key accomplishments of the FASB during this period, and what are some of the areas where it may have disappointed?

Russell Golden: Thank you, and it's a pleasure to be invited to this Fireside Chat. I think it's a great question. Recently, the FASB did celebrate its 40th anniversary and we had the opportunity to have all of the prior living Chairmen come and talk about what they view as successes of the FASB. That was very informative to me as the next Chairman to learn about the challenges that they faced and how they were able to overcome those challenges. I think the success of the board is the quality of the culture as it relates to independence, producing useful information for investors, and understanding the costs that companies will incur to make those changes. As I look back at the prior solutions of the board, I think there's been a lot of successes around share-based payments, pension accounting and OPEB, as well as – during the financial crisis – improving consolidations on special purposes entity. We still have a lot to do and I know we will be discussing later on in the Fireside Chat.

Dr. Parveen Gupta: Joe, you are a former regulator. Now, you are a user of FASB's standards. Given your experience, what is your view of FASB's performance in delivering on its mission in recent years? I wouldn't ask you for forty years, given how young you are, but what's your view in terms of the recent years?

Joseph Ucuzoglu: Parveen, it is a pleasure to be here as part of this conversation, and I do want to extend a special thank-you to Russ. This is really a unique opportunity to hear from the individual driving the FASB forward as it embarks on its next forty years. As we look backwards to start the conversation, there's no question in my mind that the FASB has delivered on its mission. I think Russ ticked off a few of the particular areas where standard-setting has been successful. I might add to that the areas of business combinations of derivatives. In each of these areas, the quality of information that is being delivered to the ultimate user, the investing public, is substantially superior to what they would have been receiving under the financial reporting framework before the FASB had acted. In some of these cases, there were no standards in the particular areas, and it was essentially a free-for-all. If you take this discussion up a level outside the individual areas in which standards have been enacted, and you look at some of the macro indicators, the FASB's eminence has certainly elevated substantially. Investors by and large would suggest that they are receiving the type of historical financial information they need to make high-quality investment decisions. Candidly, the financial reporting framework in the U.S. has served as the gold standard for the world for many decades, and the FASB deserves a significant amount of credit for that. It's not to say everything is perfect and there are certainly some challenges. If there is one area that's often cited, it is timeliness, and how long it takes to craft certain of these standards. There are valid reasons as to why this isn't a short or simple process, and we'll get into some of that. But directionally, very successful over the past forty years.

Dr. Parveen Gupta: Russ, let me come back to you. I'm trying to represent the views that I heard when putting these questions together. How do you respond to those who feel that the FASB may not have been as successful as the Board may want its constituents to believe? For example, the FASB has allowed standards, such as SFAS-13 on lease accounting, to continue to exist in poor state, not just for years, but for decades.

Russell Golden: I think it's important that, as we think about our current agenda and our future agenda, we are focused on solving existing problems in financial reporting. Many years ago, as a result of Sarbanes-Oxley, the SEC undertook a study as it related to off-balance sheet transactions. The largest off-balance sheet transactions in our economy, as observed by the SEC, were off-balance sheet leases transactions. We undertook a project to look at whether or not leases should be placed on the balance sheet. As you know, the project is ongoing. As we evaluate whether or not there is a problem in financial reporting, the first thing we do is we ask investors: What information are you using? What information are you adjusting in the financial statements? Almost unanimously, investors tell us that they believe lease commitments are lease liabilities, and they adjust existing balance sheet items to reflect that in their analysis. That said, we have issued two exposure drafts on leases. We've received over 600 comment letters to the current proposal, and there is significant pushback about putting leases on the balance sheet, and – if they are reflected on the balance sheet – how to reflect them on the performance statement.

Joseph Ucuzoglu: Parveen, if I could add? When criticisms like this come up – How could it take this long to fix FAS-13? – questions like that presuppose that there's an obvious answer – Of course, a lease should be on the balance sheet, and you would debit X and credit Y, and if only the FASB could enact the new standard, then we'd have this improvement in financial reporting. Frankly, those types of criticisms are unfair because accounting at its core is trying to communicate in a simple and straightforward fashion what are oftentimes very complex economic arrangements. A lease in particular, some of the leases we see in practice literally run thousands of pages with a series of highly complex rights in risks and rewards that don't always lend themselves to simply debiting a number and crediting an equal number on the right hand side of the balance sheet. It's important to appreciate that, when you are trying to construct a new accounting standard, there generally are several alternatives that people in good faith could disagree as to what's the most accurate depiction. No matter what model you pick, there will be imperfections simply because you can't capture the myriad of economic rights and risks in the several-thousand-page contracts in one number to go on one page. What generates, in many cases, the length of time and the complexity is the difficulty of boiling down in an understandable, easily-communicated way, such a complex economic arrangement.

Dr. Parveen Gupta: Russ, let's move further. From its mission, it is clear that the FASB's major focus is on investors. Is there sufficient investor representation on the Board and on the EITF to assure investors that their interests are first and foremost in deliberations? Is the 17-

member Financial Accounting Foundation appropriately balanced to insure investor representation on the Board?

Russell Golden: I agree our primary mission is to provide decision-useful information to investors, and the best way to do that is to obtain investor input. Since I've been on the Board, we have substantially increased our outreach to investors. One way is to increase the composition of investors on the Board. We now have two investors; one is a buy-side, and one is a sell-side. The Board is designed to represent those types of stakeholders where accounting is relevant. We have preparers, auditors, someone from academia, a buy-side and a sell-side. Amongst our staff, we try to have a similar balance. We have those who come from the investment community, the preparer community and the auditing community. We direct the staff to provide the analysis we need, the analysis to how investors currently gather the information and how investors could better gather the information. However, the data and research from the staff is no substitute to have the investor input among those actually making the decision both at the Board and the EITF. When I was Chairman of the EITF, I sought to increase investor input, because at that point I felt the EITF was dealing with too many issues, when they observed diversity in practice did not harm investors' interests. It is important to have investors on the EITF that could educate others to say, "Yes, there is diversity, but that diversity did not harm my analysis; we do not need to answer this question."

Dr. Parveen Gupta: Joe, what is your view on whether numbers really matter? The folks who raise this concern about investor representation would say that only four out of the 17 FAF trustees, two out of the seven FASB Board members, and two out of the 14 EITF members represent investor interests. How can one conclude that the investor focus prevails during the various deliberations, or should we focusing on the numbers at all?

Joseph Ucuzoglu: I would wholeheartedly echo Russ' sentiments around the importance of bringing direct investor feedback into the standard-setting process. That's the constituency that this whole process is engineered to serve and so their views have to be paramount. I would not, though, fall into the trap of believing that the only viewpoints that further the interests of investors come directly from investors. Several other constituencies are directly aligned with serving investor needs. If you are a preparer in an accounting department at a company, your job is to accurately and transparently convey your company's financial performance to the investing community. If you are the representative of the auditor constituency, your job as an auditor is to serve the public interest and to attest to the accuracy and completeness of the financial reporting of that client that you have been engaged by for the benefit of the ultimate user – the investing public. The viewpoints that further investor interests are coming from a cross-section of constituents. You can't have an effective standard-setting process unless you have all of those constituents sitting at the table. Investors may have a laudable objective of getting a certain type of information in a certain format. But if you don't have sitting at the table the preparer who actually has to compile that information to engage in a dialogue around the art of the possible, you might come up with a standard that would produce phenomenal information but is incapable of being produced by the information systems that companies deploy. Or, the information request may be un-auditable and the auditor won't ultimately be able to attest to the accuracy of it, which would impair its credibility in the marketplace. You have to get all of those constituents around the table from a practicability standpoint so that you create a standard that's operational.

Dr. Parveen Gupta: What Joe talked about is some of the counterbalancing forces that occur in the process. Investors are not the only ones who are raising concerns about the performance of the FASB; during the recent years, some in the preparer community, or others on their behalf, have also said that the FASB's leadership has been somewhat unresponsive to their views and opinions during its deliberations. Russ, I would presume from your perspective that the FASB does need to manage perceptions of all its constituents. As the new Chairman, what are you planning to do to ensure that such perceptions or misperceptions are handled promptly, so that FASB's image as the independent standard setter isn't compromised in the minds of its stakeholders?

Russell Golden: There's a few things we can do first. Communication is extremely important. It is important that we be in a position to communicate to all our stakeholders: "What is the problem the Board has observed in financial reporting? What are the cost-effective solutions the Board has researched? What has the Board determined to be the most cost-effective solution? How did the Board evaluate whether the benefit justifies the cost?" We have to be able to explain to our stakeholders how we research and how each individual Board member weighed the benefit and the cost. I think it's important that we fully explain the types of costs that we evaluated, so people can feel that we are making informed decisions.

Dr. Parveen Gupta: On the question of cost, many times I have heard that the cost is coming from the shareholders/investors. When you are evaluating the cost and benefit, what perspective are you taking? If the shareholders are willing to bear the cost, where is the concern from the point of view of the preparer or the auditor?

Russell Golden: I do believe that the investor is ultimately bearing the cost. There are things that you could do to make accounting so exact that it could come at a substantial cost to the investor. Those are the types of trade-offs you need to think about when you're thinking about costs and benefits.

Joseph Ucuzoglu: When concerns are raised by the preparer community, usually they are on two fronts: cost and complexity. On the cost side, I probably wouldn't have much to add to what Russell already articulated. The issue of weighing the costs and the benefits is top of mind, not just at the FASB, but across the regulatory community. In an effort to ensure that business remains competitive and that regulation is well thought-out, it has to be inherent in any standard-setters' thought process that "I've well defined the problem, and that whatever the solution I've come up with carries with it benefits that are greater than costs." Easier said than done, in an area where the costs are often easily computed in the form of incremental man-hours and professional service fees, and the benefits are more nebulous. The benefit of more high-quality information being provided to the marketplace ultimately would be expected to manifest itself in a more efficient capital market and ultimately a lower cost of capital to companies, given that investors would have a higher degree of reliability in the reported financial information and demand less of a risk premium, but that is very difficult to measure. On the complexity side, and this is the most-often-mentioned criticism, why does the standard have to be so complex?

Sometimes it is complex because the business arrangement is complex. If the business arrangement and the economics are, at their core, complex, it may well take a complex accounting standard to accurately convey the underlying business arrangement. Sometimes, though, complexity creeps in even though it's not necessarily reflective of the underlying economics. I think that the FASB under Russ' leadership has really made a push to ensure that we ruled out that unnecessary complexity with the mindset that if it's overly exact, but it's not an issue of great importance to investors, let's take the complexity out, which might reduce the cost.

Dr. Parveen Gupta: Russ, on the side of cost, one could say at the end of the day, whoever is the regulator – the FASB, the SEC or anybody else – you are probably looking at the cost from the viewpoint that you want to make sure that the use of capital is for the most productive uses. You want to use as little of that capital for monitoring purposes, because monitoring doesn't yield a direct benefit.

Let's shift gears and talk about political interference in the FASB standard setting process. Russ, in a recent speech you gave at the FASB at Forty conference in New York City, you said, "When people talk about independence in connection with the FASB, they usually mean one of several things: independence from the influence of powerful stakeholders, who have a vested interest in the outcome of a particular standard setting decision; independence from political interference; or in some cases, independence from meddling, perceived or real, by our governing body, the FAF." Some FASB watchers would argue that, in the past, there has been significant political interference in FASB's standards-setting, especially from Congress, such as the example of stock options accounting. You may recall that Dennis Beresford, then FASB Chairman, once found himself on the cover of CFO magazine with the byline, "FASB Under Siege." I still have that cover in my office. Other issues that come to mind are accounting for investments held for sale during the financial crisis, and accounting for derivatives. During the recent financial crisis, many in Congress, the preparer and the user communities blamed the fair value accounting standards for the fallout. With the continued political interference, what's your sense on how the FAS B strives to maintain its roles as an independent standard setter? What do the individual Board members do to insulate themselves from the lobbying and the political pressures they face?

Russell Golden: It's important for our society to have an independent standard setter. In accounting standard-setting, we are trying to develop standards that neutrally reflect the economics that the transaction management enters into. We are not trying to pick a winner or loser. We are not trying to motivate the transaction one way or the other. I think a lot of things that elected or appointed officials do may drive one transaction over the other for the benefit of the economy, but we have made in this country a public policy decision that an independent standard setter will try to develop standards that neutrally reflect the economics of what management has entered into. I think the best way to ensure that we remain independent is that we have a robust due process that is trying to develop standards in the best interests of our capital markets, recognizing that there are costs of change and understanding what those costs are to make the judgment, to ensure that the actual standards we produce are providing relevant information to investors.

Dr. Parveen Gupta: Do you think the interference from Congress will continue, and if so, are there any specific communication strategies, etc. you may be putting in place to deal with that?

Russell Golden: It's always important to have an active dialogue with members of Congress. I'm down here in Washington oftentimes to have that active dialogue, so they can understand the problem that the Board has observed, what we are doing about the problem, and the types of research and analysis we've done to obtain that conclusion.

Dr. Parveen Gupta: Joe, let me ask you a conceptual question on behalf of my students in the undergraduate Intermediate Accounting class. They ask why our elected officials in Congress, or for that matter, preparers, investors, auditors and other stakeholders lobby the FASB. What are these groups trying to gain by meddling into the FASB standards-setting? As Russ just pointed out, their job is to capture the underlying economics of the transaction. Why don't we just leave them alone and let them do their job?

Joseph Ucuzoglu: The way in which the question was phrased leaves the impression that something sinister is going on by virtue of various constituents weighing in and expressing their views. Russ and his colleagues, to their credit, seek out feedback, in the context of an open standard setting process and looking to gain the views of a wide cross-section of constituents. At the end of the day, it's left to their professional judgment, those we've entrusted on the FASB to sort through conflicting perspectives, but it's absolutely critical that voices are heard from a broad cross-section. I can tell you as a former regulator that it's really difficult to sit in an office in Washington, DC or in Norwalk, Connecticut and come up with a set of rules in a vacuum. You want to hear from those that are out engaging in the transactions, auditing the transactions, advising on the transactions, and ultimately using the financial reporting information that is produced, on what is the most neutral and unbiased depiction of the underlying economics. I will say, in particularly a message to all the students, as you enter the profession, no matter what role you take on, whether working for a company as a preparer, or working for an audit firm, or any other path you may choose, that there is an obligation that comes with becoming a CPA, that professional designation of Certified Public Accountant. That obligation is to protect the public interest. If I'm at a company and the FASB is debating a particular topic, and one of the potential outcomes is that my own company would look worse under the proposed solution, if the FASB got it wrong and the standards are not depicting the economics, then by all means go argue against it; but if it's actually a more accurate depiction of the economics, I have an obligation in the standard-setting process to come forward with my view, informed by what is the most accurate depiction of the economics and what I believe users would most benefit from, not what happens to serve my own self-interest. There's a mindset for those involved in weighing in on the standard-setting process.

Dr. Parveen Gupta: You're saying there are economic consequences that follow the standards. Hence, it motivates the stakeholders to chime in to the process. Since we live in a democratic society, it makes perfect sense to get the views and opinions of all the stakeholders into the process.

Russ, let's continue in terms of the speech I cited earlier, the speech when you talk about independence. You say that independence is not a right; rather it is a privilege to be earned.

You also say that one of the ways that the FASB earns this privilege is by being accountable. Some would say that accountability and standard-setting also imply that the FASB regularly reviews its past standards to see if they are working as intended, and if not, to take timely actions to remediate the bad accounting produced by the standards. The example of leasing is usually cited. What are some of the road blocks that the FASB faces in conducting a timely review of its past standards, especially the ones publicly known not to be working as intended? Are you planning to put any processes in place at the FASB to avoid such delays in the future?

Russell Golden: A few years ago, the committee on improving financial reporting, sponsored by the SEC, created this concept called "post-implementation reviews." The Financial Accounting Foundation has been conducting post-implementation reviews of FASB and GASB standards. There have been three completed post-implementation reviews of standards of the FASB; one is ongoing and due to be released within a short period of time. The staff members first evaluate if this standard is operating as intended, and if it is providing decision-useful information. They review our process and determine if there are any process improvements that the Board could make to have obtained better research about investors, better information about costs, and certain issues that are less operational that perhaps the Board should look at in making targeted improvements. The first PIR was on uncertain tax positions, the second on accounting for business combinations, and the third on accounting for operation segments. With respect to operating segments, one of the interesting observations was that, since the development of that standard, there's been a lot of changes in technology in the way that the chief operating decision maker gets his or her information – from a paper system to an electronic technological-based system. It is not as clear today as it once was what information they're reviewing to make decisions. We've assigned staff to look at what could be some cost-effective solutions, and we will have an agenda request shortly as to how we should proceed on that.

Dr. Parveen Gupta: Joe, do you have any suggestions in this area for the FASB?

Joseph Ucuzoglu: The post-implementation review has been a welcome addition to the process. None of us get it perfect. We all need to look at actual performance and learn those lessons that can be gleaned after the fact. That said, it's important not to go overboard, as we've talked about over the last half hour. Oftentimes, there is no perfect solution. The standard setters debate an issue and come up with what is deemed to be a high-quality answer that will nevertheless not be perfect, because the economic complexity simply can't be captured completely in one set of numbers. We supplement the numbers with disclosures so that the complete picture is provided in both numbers and words. What I would not want to see happen is for the post implementation review process to be used to essentially re-litigate every standard and throw sand in the inner workings of the years of the standard-setting process. If there's a fatal flaw, by all means we have got to go back and fix it. But to the extent that a standard is generally working as intended, even if it is not perfect, because there is no such thing as a perfect standard, there is something to be gained from continuity and consistency, and not constantly tweaking the rules.

Dr. Parveen Gupta: Let's spend the new few minutes talking about international convergence. International convergence was the topic of a previous Deloitte Fireside Chat, so I don't plan to delve into lots of in-depth questions. However, this conversation will be incomplete if I don't raise some macro level questions. May I point out to our listeners that they can access all

Deloitte Fireside Chats by going to www.sechistorical.org? The chat on international convergence took place on November 7, 2012. It's definitely worth your time; I highly recommend it.

Let me ask you the first question in this area. There's enough empirical research in accounting and corporate governance literature that documents an advantage to firms from weaker accounting and/or corporate governance regimes when they bind themselves to U.S. GAAP by listing on U.S. stock exchanges. Joe, in an earlier response, you said that U.S. GAAP has been the gold standard around the world. This advantage accrues to such firms in many ways, one of which is the reduced cost of capital. By implication, this means that U.S. GAAP, although rule-based, is viewed superior to their home country GAAP. With international convergence, the competition in standard-setting will disappear and all public companies, including U.S. companies, will use the same set of accounting standards. Yes, that will promote comparability. But, do you think the long competitive advantage enjoyed by U.S. firms - for example, measured by the cost of capital – will also disappear? Those who do not support convergence will claim that now all firms will regress to the so-called principles-based standards, which will motivate preparers to adopt the lowest common denominator accounting, which may not be as high a quality as it is under U.S. GAAP. How do you respond to such defenders of U.S. GAAP, and do you think there is any merit to this line of reasoning?

Russell Golden: I do agree with your observation about the empirical research in accounting corporate governance. I've read a lot of that, and I do think it is clear that, when you come to our capital markets and follow U.S. GAAP and are subject to the auditing standards promulgated by the PCAOB, and your auditor is subject to regulation by the PCAOB and your company is subject to regulation by the SEC, you lower the cost of capital. The reason I bring that up is I think accounting standards are one part of this system that functions extremely well in our country. Converging on accounting is just one aspect of what you need to be able to reach the common goal, which is a common set of information between those participating in the U.S. capital markets and those participating outside of the U.S. capital markets. You will eventually need common auditing standards, common auditing regulation, common enforcement and other securities law regulation to have the ultimate ability to have consistent application of transactions that have consistent economics.

Dr. Parveen Gupta: I agree with you, Russ, that accounting standards are one part of the larger rubric here, because you have auditing standards and governance and local regimes. Joe, do you think it's a relevant argument that these defenders of GAAP are presenting, or is it just bias? There is a presumption here, the presumption that the principles-based standards under IFRS would provide lower quality information than under U.S. GAAP. What's your view?

Joseph Ucuzoglu: I'm a strong believer that the overall movement towards convergence has benefited both us and the rest of the world, driving to higher-quality accounting standards for use by companies both domestically and abroad. This topic comes up from time to time – is the so-called "rules-based standards" under U.S. GAAP better, or the so-called "principles-based standards" under IFRS better – and frankly, the debate is somewhat of a mischaracterization in my mind. It's an oversimplification and even misleading to suggest that you can draw lines that clearly between the underpinnings of both sets of GAAP. U.S. GAAP is underpinned by plenty of principles; people didn't just randomly dream up some of these rules that exist. There are clear principles that are tied to the economics of these transactions. In many cases when abuses took place because too much latitude was afforded, the standard setter came in and drew some boundaries, and that's how you got the rules, but they were intended to enforce the principles. IFRS has plenty of rules. If they have less rules today than U.S. GAAP, I don't think it's because of some grand judgment to have a different type of framework than we do in the U.S. as much as it is they haven't had as much time to infuse all the rules. If you look at the agenda of the IFRIC, which is the EITF equivalent internationally, they've got plenty of mundane, in the weeds, issues that are giving rise to thick sets of rules. If you give them a couple more decades, they may well catch up. I wouldn't fall into this trap of rules versus principles.

You raise the question of "isn't it healthy to have a competition and will you lose the competition if we go to one set of standards?" Competition is a double-edged sword. The optimist would say that if you had multiple rule makers competing, perhaps you have a race toward the top. In reality, what we've too often seen is the other direction, a race toward the bottom. If there are different standards, then the various interests in the international community will tend to find the lowest common denominator, and in some cases, either lobby themselves or look to regenerate political interference under the guise of "in my economy, I'm at a competitive disadvantage because the company in that other geography is allowed to do X, and that makes their company look better, and so you're making my company look worse and therefore putting our economy at a competitive disadvantage to their economy." So there's something to be said for rooting out the ability of a race toward the lowest common denominator.

Dr. Parveen Gupta: They're definitely two sides to that. Russ, I've heard that there's a high incidence of litigation in the U.S. We continue to issue detailed standards from the FASB and the SEC. Given the rate of litigation and the litigation environment we face here, do you think a principles-based approach to accounting standard-setting is truly feasible in the U.S.? Does it complicate the convergence in any way? I think it's important to note that in most of the countries that are using the IFRS, they don't have class action lawsuits in their legal system. Is there an inherent difference between the U.S. environment and what the rest of the world is doing?

Russell Golden: I believe different legal environments in different cultures complicate the convergence process. I don't believe, however, that the detailed guidance that's embedded within both U.S. GAAP and IFRS is there for legal reasons. Ultimately, what we are trying to do is have the accounting portray the economics of what management enters into; you need principles to help that. We're also trying to ensure that there's comparability between companies. Sometimes, you need rules to clarify those principles so you can have a balance and ensure comparability, but you have to be careful. You want to make sure that the detailed rules do not circumvent the principle that's established to neutrally reflect the economics. I think both sets of U.S. GAAP and IFRS need to have a combination of principles and application guidance to ensure those principles can be consistently applied.

Dr. Parveen Gupta: We received a number of questions, and many of my students have submitted questions on the IFRS. I will paraphrase one common question that Ms. Boyle, Ms. Nawrocki, Mr. Monaghan and Mr. Quackenbos have submitted. Where do you think the U.S. is headed ultimately on the issue of convergence with IFRS, and what are the three key challenges that we will need to deal with in regard to convergence from your perspective?

Russell Golden: We're still committed to the goal, which is developing a common set of accounting standards that can reflect consistency across the globe. I think the way in which we achieve that goal is changing. In the past, we had a bilateral relationship with the ISB, where both the FASB and the IASB sat around the boardroom and resolved the issues. That needs to change as more and more countries accept IFRS. The ISB appropriately needs to broaden their net to have other countries involved. At the FASB, our ultimate responsibility is to constantly improve U.S. GAAP for the U.S. capital markets and for other capital markets that use U.S. GAAP. Our neighbor to the north, Canada, has a significant number of companies that come to our capital market and use U.S. GAAP. Japan has a significant number of companies that use U.S. GAAP within the Japanese capital markets. We at the FASB need to reach out to them and understand the unique culture and legal environment in those countries, so, as we make improvements in the U.S., they can be accepted in other countries and cultures that use U.S. GAAP.

At the same time, as we improve U.S. GAAP, we need to recognize what other countries have done to improve their accounting standards, so we can learn from them and can provide advice and input to them. I'm a member of the newly-created Accounting Standards Advisory Forum of the IASB, which is 12 large standard-setters, designed to provide advice to the IASB as they make improvements to IFRS. I view my role as to bring a U.S. perspective into their process, so that they can consider U.S. legal requirements, culture and accounting standards as they make improvements, and we can be in the best position to potentially accept those improvements. This three-step process will help continue the path towards the goal that we've always had, but it's just a different procedure, different methodologies to try to achieve that goal.

Dr. Parveen Gupta: Let's see if we achieve this goal. Russ, the convergence occurs and the U.S. had adopted or converged with the IFRS. Under such a scenario, what role do you see for the FASB? To be more direct, will there be a FASB four decades later or will the IASB be the only international accounting standards setter?

Russell Golden: Again, I think that the goal is a common set of accounting standards that provides information to investors. The path that I've laid out creates a mechanism where there is both the IASB and the FASB, as well as other national standards-setters that want to collaborate and cooperate to try to improve accounting across the globe.

Dr. Parveen Gupta: Joe, what do you see in your crystal ball for the future of the FASB in an environment of increasing convergence?

Joseph Ucuzoglu: We will continue down the path of convergence; I think it's a laudable objective. At 30,000 feet, who can argue with the goal of providing investors with comparable information so that they can compare investment opportunities on an apples-to-apples basis across borders and around the globe? It's a hard objective to quibble with. The way in which you get there is very complex. As an example, even in as simple a topic as the unit of measure, should we use the metric system or the U.S. system? We haven't been able to achieve convergence and that's just a mechanical translation. I wonder if we set the bar too high of thinking that we would have absolute, identical standards everywhere throughout the world. That may be unachievable. I do think the FASB will continue to play a role over the longer term, that we will strive to have one set of bedrock principles coming out of the IASB, driving consistency throughout the world, but that perhaps there is still an ability for national standard-setters, such as the FASB, to have an obligation to their own capital markets to be able to, in the interests of producing high-quality information for their respective capital markets, provide whatever necessary implementation guidance or other standards-setting is necessary in their particular jurisdiction, building off of the underlying core set by the IASB but it may not all be exactly identical in every single country. I don't know if that objective is achievable.

Dr. Parveen Gupta: Let's shift gears a bit. This is a question from Dr. Pamela Strickland, professor of accounting at Reeves School of Business, Southern Methodist University. To paraphrase, her question relates to the issue of the accounting courts that arose in the '60s. Under the current system, when a registrant has a disagreement on the interpretation of an accounting standard, the registrant reaches out to the auditor. If the auditor has a certain view with which the registrant does not agree or needs a further clarification, they both approach the SEC's Division of Corporation Finance and, if need be, go to the SEC Office of the Chief Accountant in order to get the so-called right answer before accounting for that transaction. In the '60s, the idea of the accounting courts emerged. The thought was that it would be the job of the accounting courts, after the fact, to resolves some of these differences in regard to the opinions of the interpretation. What is your view on whether the current system is working as intended? Is it the right system or has the time come for us to debate the idea of the accounting courts?

Russell Golden: At least at the accounting standards level, we have the Emerging Issues Task Force. It was designed to bring together preparers, auditors, regulators and users to resolve differences in practice as it relates to emerging issues. It has been very successful and has resolved a lot of diversity and differences. As we move forward on some of these very challenging, large, macro projects, we need to stand ready to provide implementation support to companies' auditors to ensure that as they, in good faith, attempt to do what the Board intended, they fully understand what it is that the Board intended. We have announced that we plan to create a transition resource group for revenue that will stand ready to answer questions to help people understand what the Board intended, to narrow diversity if we think diversity would be meaningful or harmful to investors, and to make any amendments for unforeseen circumstances. This is something we've done on some other significant projects after we issued share-based payments and after we issued fair value; again, the goal is to help people implement the standard and resolve their concerns before the effective date of the standard.

Dr. Parveen Gupta: So, essentially you are saying that a before the fact system is better, with the EITF as one mechanism and going to the Commission as another. To follow up on the comment on the EITF, Joe, let me ask you a question. I was reading a transcript of the interview with Dennis Beresford, which is in the virtual museum and archive. When commenting on the formation of the EITF, he recalls and I quote, "I remember some of the CFOs were of the view that they deal with these kinds of issues all the time, they just have to resolve them on a judgmental basis. Why do others need so much guidance, whereas the accounting firm types basically wanted an answer for everything?" Just to give a context, the interviewer was exploring the formation of the EITF and Denny, working at Ernst & Young at the time, was involved in some of these things very early. The last statement caught my attention, so hence the question for you: Do auditors crave more guidance in the form of rules-based accounting standards, which eventually leads to more complexity?

Joseph Ucuzoglu: It's an excellent question and one we could debate an entire hour in answering. Part of this is a cultural issue. Once upon a time, the job of the CPA and the job of the auditor was to exercise professional judgment in a unique fact pattern and come up with a high quality reporting answer in the interest of investors, even if there were no rule book telling you what to do. Over time, for a variety of reasons that we could debate, there emerged a generation of accountants trained to look for an answer in a rulebook. Some of our young auditors, we'll ask them, "Go out and look for the answer to this issue," and the first thing they'll do is go look in the rulebook. I always tell them, don't go look in the rulebook; that's the last thing you do. The first thing is understand the fact pattern, consider what the economics are, judge what a high-quality answer could be to depict the economics, and then go to the rule book to confirm that it is one of the acceptable answers under the accounting standards. It is incumbent upon us, not just as auditors but as preparers as well, to be comfortable in exercising judgment in good faith to achieve high-quality answers and not relay on a particular technical interpretation to answer every question. Trying to come up with an answer written down in a rule book to every unique fact pattern is a fool's game, and leads to a body of U.S. GAAP that's thousands of pages long, that we would all agree is not conducive to the very highest quality of financial reporting.

Dr. Parveen Gupta: Russell, let's follow up with regard to the complexity issue. Two examples out in the marketplace now are on leases and on revenue recognition. Using those two standards as an example, is it possible to achieve simplification and accounting standards-setting without losing relevance, or is simplification just a talking point or pipe dream?

Russell Golden: I think it is very feasible to reduce complexity and promote simplification. We have to think why there is complexity in the system. Complex transactions probably do need complex accounting solutions, but simple transactions need simple accounting conclusions. The best way to deal with it is to evaluate what is the economics you are trying to portray and then stay committed to looking at the conceptual framework to resolve the accounting problem you've identified.

Dr. Parveen Gupta: Let's talk about changes in the environment. All kinds of new industries are emerging. Going forward, how does the FASB ensure that its standards stay current with changing industry or emerging capital market issues? For example, current GAAP may be difficult to apply to creative financing transactions that have elements of both debt and equity. Similarly, the codified guidance does not address revenue, capitalization or asset repairmen related to the issues in the new and emerging energy industry. What are your thoughts, Russ?

Russell Golden: There's a few ways that we gather the information we need to determine if there are actually problems out there. First, we meet regularly with different groups that represent different industries and understand the types of economic trends that they are seeing.

At each of our advisory council meetings, we ask them what are new and unique transactions, and then we evaluate the types of information investors are using, whether they are using non-GAAP measures or other supplements provided by companies to make their investment decisions. That helps us understand if there are specific problems or holes in GAAP that we need to make changes to.

Dr. Parveen Gupta: Joe, what are your thoughts on how the FASB can stay ahead of all these new emerging transactions?

Joseph Ucuzoglu: The outreach process is critical. But again, it's important that we not fall into the trap of trying to design a new pronouncement to cover each industry or evolving development in the marketplace. If we get the principles right, if we get the conceptual framework right, and if we get the underpinnings correct to allow accountants and auditors to use their judgment, generally, practitioners can come to high-quality answers without a prescribed checklist-based approach for each new type of transaction that we see in the marketplace.

Dr. Parveen Gupta: Let me go to wrap-up as we are getting close to the end of the broadcast. What opportunities and challenges do you see for the FASB during the next 40 years? Russ?

Russell Golden: We are focused, and will continue to focus, on solving those substantial issues. We have more things that we need to resolve. One is financial statement presentation and the use of OCI. We need to start working today on laying the foundation of making improvements to the conceptual framework. We have to constantly focus and recognize that private companies are different than public companies, and we need to ensure that the accounting, both the recognition measurement and disclosures, that they are required to do meet the needs of their investors.

Joseph Ucuzoglu: I'll add technology and international engagement to that. Technology from the standpoint that the ability of companies to provide incremental volumes of information and allow for some kind of click-down mechanism, so that investors can regain a deeper understanding over and above the summarized financial reporting, will be an issue that gains increasing prominence. The FASB is one piece of a microcosm across the world, and ultimately engaging with not just one part of the IASB, but a broad cross-section of standard setters to promote higher-quality financial reporting around the world.

Dr. Parveen Gupta: Russ and Joe, thank you so much for sharing your thoughts as we commemorate the 40th anniversary of the FASB. Whatever the future brings, the impact of the FASB on enhancing the quality of financial reporting in the U.S. and around the globe will be felt for decades to come. This has been a wonderful discussion.

Today's program will be an important addition to the museum's collection of materials and information on accounting and auditing. On behalf of the SEC Historical Society, I would like to thank Deloitte LLP for its generous support and assistance in making this program possible. Thank you for joining us today.