FINANCIAL ACCOUNTING FOUNDATION

STATEMENT FOR THE RECORD

OF

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PRESIDENT & CEO

FINANCIAL ACCOUNTING FOUNDATION

FOR THE HEARING ON

"SPURRING JOB GROWTH THROUGH CAPITAL FORMATION
WHILE PROTECTING INVESTORS, PART II"

BEFORE

THE U.S. SENATE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

MARCH 6, 2012

Thank you for the opportunity to submit this statement for the record.

As the organization overseeing the Financial Accounting Standards Board ("FASB") and the Governmental Accounting Standards Board ("GASB"), the Financial Accounting Foundation ("FAF") is the private-sector entity with responsibility for establishing and improving financial accounting and reporting standards, including protecting the integrity of the standard-setting process. High-quality financial reporting has always been critical to building investor confidence in U.S. capital markets and that is especially true in today's dynamic, global marketplace. Increased investor confidence leads to better capital allocation decisions and, by extension, a stronger and more robust economy.

We applaud the Committee for its consideration of measures to lessen the administrative burden on small and medium companies. However, Section 3(c) of S. 1933, the "Reopening American Capital Markets to Emerging Growth Companies Act of 2011," raises serious issues about the continued independence of the standard-setting process. Section 3(c), "New Accounting Pronouncements," would prohibit FASB from establishing "any accounting principles that would require an emerging growth company to comply with any new or revised financial accounting standard as of an effective date that is earlier than the effective date that applies to a [privately held] company." Thus, Section 3(c) would effectively legislate accounting standards, jeopardizing the integrity of the high-quality accounting standards on which investors and other stakeholders rely. Moreover, this provision would establish a troubling precedent. As a result, we respectfully urge the removal of Section 3(c) from S. 1933.

BACKGROUND

FAF and FASB

The FAF, organized in 1972, is an independent, private-sector organization with responsibility for the oversight, administration, and finances of the FASB, the GASB, and their Advisory Councils. The FASB, which began operations in 1973, establishes standards of financial accounting and reporting for private-sector entities, including businesses (both public and private) and not-for-profit organizations. Those standards are recognized as authoritative, Generally Accepted Accounting Principles ("GAAP") by the U.S. Securities and Exchange Commission ("SEC" or "Commission") for public companies and by the American Institute of Certified Public Accountants ("AICPA") or the State Boards of Accountancy for other nongovernmental entities, depending on state laws.

The Critical Need for High-Quality Financial Reporting

GAAP is essential to the efficient functioning of the U.S. economy. Investors, creditors, donors, and other users of financial reports need credible, transparent, comparable, and unbiased financial information. In today's dynamic financial markets, integrity, transparency, and objectivity in financial reporting are necessary to ensure the strength of U.S. capital markets and provide investors with accurate and timely information.

Reliable financial reporting has a critical role in supporting the efficient functioning of the capital markets: robust financial reporting increases investor confidence, which in turn leads to better capital allocation decisions and economic growth. Today, as the U.S. economy continues to recover from the financial crisis and recession, the FAF and FASB remain committed to ensuring that our nation's financial accounting and reporting standards provide investors with the information they need to confidently invest in the U.S. markets.

The Standard-Setting Process

An independent standard-setting process has always been paramount to producing high-quality, confidence-inspiring accounting standards in the U.S. This process relies on the collective judgment of experts, informed by the input of all interested parties through a thorough, open, and deliberative process. The FASB sets accounting standards through comprehensive, robust processes that are open; accord due process to all interested parties; and, allow for extensive input from all stakeholders. This rigorous process of stakeholder outreach includes public meetings, public round table discussions, field visits and tests, meetings with stakeholder groups, the exposure of proposed standards for public comment, and extensive redeliberation to review the stakeholder input.

The FASB's accounting standard-setting process is subject to oversight by the FAF, which consists of 16 independent trustees. The FASB is also subject to oversight by the SEC with respect to standard-setting for public companies. Additionally, we understand Congress's interest in the capital markets, which is why we regularly participate in oversight hearings and brief Members and their staffs on accounting-related developments.

This thorough process allows the FASB to learn and understand the views of all interested parties and results in high-quality standards that are thorough, deliberative, and balance the multifaceted and often countervailing factors at issue. The Board's wide consultation helps it to assess whether the benefits to users of improved information from proposed changes outweigh the costs of the changes to financial statement preparers and others. Wide consultation also provides for the identification of unintended consequences and, ultimately, broad acceptance of the standards that are adopted. This assessment extends to all aspects of accounting standards – including determining the appropriate effective dates for new or revised accounting standards applicable to all types of companies, including the emerging growth companies that are the subject of S. 1933, Section 3(c). Stated differently, although the effective date of a new standard is not a technical accounting matter, the FASB sets effective dates using the input received from the thorough process that informs every other aspect of a new standard.

S. 1933, SECTION 3(C)

The Statutory Foundation of FASB

The statutory foundation of FASB is contained in the Securities Act of 1933 ("'33 Act"). Specifically, Section 19(b) of the '33 Act (15 U.S.C. 77s(b)) provides that the Securities and Exchange Commission ("SEC") may recognize as GAAP accounting principles established by a standard setting body meeting certain requirements. The Section 19(b) requirements are entirely focused on the standard setting body's structure, processes, and broad objectives. In particular, the standard setting body must: (i) be organized as a private entity; (ii) have a board of trustees serving in the public interest; (iii) be funded as provided by the Sarbanes-Oxley Act of 2002; (iv) adopt procedures to ensure prompt consideration of changes to accounting principles; and (v) consider the need to keep standards current, including the extent to which international convergence is necessary or appropriate.

In sum, Section 19(b) is the statutory foundation that allows the SEC to rely on FASB as the standard-setting body that promulgates GAAP. For nearly 40 years, the SEC has delegated this authority to the FASB. In 2003, the SEC issued a Policy Statement reaffirming this longstanding relationship.

Undermining the FASB

Section 3(c) of S. 1933 would amend Section 19(b) of the '33 Act and require the standard-setting body to meet an additional requirement. As stated previously, Section 3(c) would prohibit FASB from establishing "any accounting principles that would require an emerging growth company to comply with any new or revised financial accounting standard as of an effective date that is earlier than the effective date that applies to a [privately held] company…."

Section 3(c) would direct the standard-setting process in a specific way, by removing the issue of appropriate effective dates for new or revised accounting standards applicable to emerging growth companies from FASB's thorough, deliberative, independent standard-setting process. Legislating the effective dates of accounting standards in this way would restrict the FASB's ability to consider stakeholder input and result in a standard that may not balance the diverse interests or incorporate expert judgment.

Additionally, Section 3(c) is unlike the existing Section 19(b) requirements, which, as noted above, are entirely focused on the standard-setting body's structure, processes, and broad objectives. Further, it would have the unintended effect of making FASB's adherence to this restriction a condition on the SEC's authority to recognize GAAP.

In sum, Section 3(c) would undermine the rigorous, independent standard-setting process undertaken by FASB. Section 3(c) would effectively prevent FASB from considering and balancing the broad range of interests in setting an effective date, including the time and effort necessary to transition to new requirements. The provision would significantly compromise the FASB's objective of ensuring that investors have the benefit of high-quality financial statements that provide timely, transparent, and representative depictions of a company's financial condition.

Conclusion

As Congress contemplates the worthy objective of lessening the administrative burden on small and medium companies, the FAF respectfully requests that Section 3(c) be removed from S. 1933.

Thank you for the opportunity to submit this statement for the record. I would be pleased to provide any further information the Committee might require as it considers this important legislation.