

**Testimony of  
Robert H. Herz  
Chairman  
Financial Accounting Standards Board  
Before the  
Subcommittee on Securities and Investment of the Committee on Banking,  
Housing, and Urban Affairs  
November 12, 2003**

**Prepared Remarks**

Chairman Enzi, Ranking Member Dodd, and Members of the Subcommittee:

I am pleased to appear before you today on behalf of the FASB. I want to thank you, Mr. Chairman, for inviting me to testify on this very important topic. The active participation of users, auditors, and preparers of small businesses in our process is absolutely essential to the development of high-quality financial accounting and reporting standards. I have brief prepared remarks, and I would respectfully request that the full text of my testimony and all supporting materials be entered into the public record.

The FASB is an independent private-sector organization. We are subject to oversight by the private-sector Financial Accounting Foundation and the United States Securities and Exchange Commission.

Our independence from enterprises, auditors, and other constituents is fundamental to achieving our mission—to establish and improve general-purpose standards of financial accounting and reporting for both public and private enterprises. Those standards are essential to the growth and stability of the US economy because investors, creditors, and other users of financial reports rely heavily on credible, transparent, comparable, and unbiased financial information to make rational resource allocation decisions.

The FASB's independence, which through your leadership and hard work, Mr. Chairman and Ranking Member Dodd, was recently reaffirmed and enhanced by the Sarbanes-Oxley Act of 2002, is fundamental to our mission because our work is technical in nature, designed to provide preparers the guidance necessary to report their economic activities. The guidance creates the yardstick to measure and report on the underlying economic

transactions of business enterprises. Like investors and creditors, Congress and other policy makers need an independent FASB to maintain the integrity of a properly designed yardstick in order to obtain the financial information necessary to appropriately assess and implement the public policies they favor. While bending the yardstick to favor a particular outcome or industry may seem attractive to some in the short run, in the long run an inaccurate yardstick (or a biased accounting standard) is harmful to investors, creditors, and the US economy in general.

The FASB's open and thorough due process is also fundamental to our mission. Because the actions of the FASB affect so many organizations, its decision-making process must be fair and objective. The FASB solicits and carefully considers the views of all interested parties—users, auditors, and preparers of financial information. Our Rules of Procedure require an extensive due process. It involves public meetings, public hearings or roundtables, field visits or testing, liaison meetings and other meetings with interested parties, and exposure of our proposals to external scrutiny and public comment.

As part of our due process, the FASB and our Emerging Issues Task Force regularly provide additional guidance to assist preparers in implementing the requirements of new and existing standards. For example, as described in more detail in the full text of my testimony, we have recently issued implementation guidance and a proposed modification pertaining to our Interpretation No. 46 on consolidation of variable interest entities. We also have announced plans to issue additional guidance addressing the application of certain provisions of the Interpretation to franchises and other industries.

We also have recently issued implementation guidance for our Statement No. 150 on accounting for certain financial instruments with characteristics of liabilities and equity. The guidance includes an indefinite deferral of the effective date of certain provisions of the Statement relating to the accounting for mandatorily redeemable instruments. The deferral is applicable to all nonpublic enterprises, including cooperatives.

More generally, with respect to the FASB and small businesses, the subject of this hearing, I would like to make four brief points. Each of these points is discussed in more detail in the full text of my testimony.

First, small businesses are difficult to define; from our perspective different constituents have very different notions of what is a small business. To the extent that a small business is a registrant under the federal securities laws, the enterprise is required by the SEC to prepare financial reports in accordance with generally accepted accounting principles, which include the FASB's standards.

For most all other small businesses, the use of GAAP is primarily a private choice. For many small businesses, their current and potential lenders, suppliers, or other contracting parties may influence or control that choice. To the extent, however, that one of those parties requires that the financial reports of a small business comply with GAAP, that party has also made a private choice. That choice presumably reflects that party's opinion that GAAP results in better, more transparent, information than other existing comprehensive bases of accounting, such as tax basis, cash basis, or regulatory reporting.

Second, it has been our experience that the views of representatives of small businesses about financial accounting and reporting are not monolithic. Historically, the users,

auditors, and preparers of small business financial reports have provided the FASB with distinct and sometimes conflicting input on FASB proposals and other activities. As indicated earlier, our mission and due process procedures require that we carefully consider all views and make an independent, objective judgment on what will provide the most decision-useful information, subject always to the constraints of the costs and benefits of implementing changes to GAAP.

Third, the Board has long recognized that the costs of complying with financial accounting and reporting standards fall disproportionately on smaller businesses. In recognition of that fact, the FASB carefully considers requests received from small businesses to defer effective dates and provide for differential disclosures to alleviate the costs of implementing changes to GAAP.

The Board also has explored on many occasions requests by representatives of small businesses to provide for differential recognition and measurement provisions in GAAP. After public deliberations, the Board generally has rejected those requests. Many of our constituents, particularly users of financial reports, have expressed concerns that a “big GAAP/little GAAP” system could undermine the comparability and credibility of financial reports. They believe that such a two-tiered system also would add costs to the users, auditors, and preparers of those reports that would likely more than offset any perceived benefits achieved by a differential reporting system.

Finally, the Board actively solicits the views of users, auditors, and preparers of the financial reports of small businesses in several ways, including through:

- Seeking their participation on our Emerging Issues Task Force, our Financial Accounting Standards Advisory Council, and the recently established User Advisory Council, and other less formal project task forces and working groups,
- Scheduling regular public liaison meetings and less-formal private meetings with representatives of small businesses--two examples include our public liaison meetings and regular contacts with the Technical Issues Committee of the AICPA Private Companies Practice Section, and with the Accounting Practices Committee of the Risk Management Association, and, finally, through
- Participating in conferences and other speaking engagements sponsored by or attended by representatives of small businesses around the country.

The FASB is aware of the significant focus over the past year on the financial accounting and reporting of public enterprises, in part because of the many activities relating to Sarbanes-Oxley and the increased attention on the movement toward convergence of international accounting standards. We, however, remain committed to serving all of our constituents including private companies, small businesses, and not-for-profit entities.

Accordingly, we appreciate the opportunity that this hearing presents to publicly encourage representatives of private companies, small businesses, and not-for-profits to more actively participate in our activities. Greater participation by those constituents will be welcomed and will help ensure that, consistent with the FASB's mission and Rules of Procedure, the various perspectives of those constituents are effectively communicated to the Board and receive the careful consideration they deserve.

Thank you, Mr. Chairman. I would be happy to respond to any questions.