Testimony of
Leslie F. Seidman
Financial Accounting Standards Board
Before the
Subcommittee on Commerce, Trade and Consumer Protection of the
Committee on Energy and Commerce
July 22, 2003

Attachment 1

FACTS about FASB

FACTS about FASB 2003

401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116 ● www.fasb.org

Since 1973, the Financial Accounting Standards Board (FASB) has been the designated organization in the private sector for establishing standards of financial accounting and reporting. Those standards govern the preparation of financial reports. They are officially recognized as authoritative by the Securities and Exchange Commission (Financial Reporting Release No. 1, Section 101) and the American Institute of Certified Public Accountants (Rule 203, Rules of Professional Conduct, as amended May 1973 and May 1979). Such standards are essential to the efficient functioning of the economy because investors, creditors, auditors and others rely on credible, transparent and comparable financial information.

The Securities and Exchange Commission (SEC) has statutory authority to establish financial accounting and reporting standards for publicly held companies under the Securities Exchange Act of 1934. Throughout its history, however, the Commission's policy has been to rely on the private sector for this function to the extent that the private sector demonstrates ability to fulfill the responsibility in the public interest.

THE MISSION OF THE FINANCIAL ACCOUNTING STANDARDS BOARD

The mission of the Financial Accounting Standards Board (FASB) is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors and users of financial information.

Accounting standards are essential to the efficient functioning of the economy because decisions about the allocation of resources rely heavily on credible, concise, transparent and understandable financial information. Financial information about the operations and financial position of individual entities also is used by the public in making various other kinds of decisions.

To accomplish its mission, the FASB acts to:

- Improve the usefulness of financial reporting by focusing on the primary characteristics of relevance and reliability and on the qualities of comparability and consistency;

- Keep standards current to reflect changes in methods of doing business and changes in the economic environment;

- Consider promptly any significant areas of deficiency in financial reporting that might be improved through the standard-setting process;

- Promote the international convergence of accounting standards concurrent with improving the quality of financial reporting; and

- Improve the common understanding of the nature and purposes of information contained in financial reports.

The FASB develops broad accounting concepts as well as standards for financial reporting. It also provides guidance on implementation of standards. Concepts are useful in guiding the Board in establishing standards and in providing a frame of reference, or conceptual framework, for resolving accounting issues. The framework will help to establish reasonable bounds for judgment in preparing financial information and to increase understanding of, and confidence in, financial information on the part of users of financial reports. It also will help the public to understand the nature and limitations of information supplied by financial reporting.

The Board's work on both concepts and standards is based on research aimed at gaining new insights and ideas. Research is conducted by the FASB staff and others, including foreign national and international accounting standard-setting bodies. The Board's activities are open to public participation and observation under the "due process" mandated by formal Rules of Procedure. The FASB actively solicits the views of its various constituencies on accounting issues.

The Board follows certain precepts in the conduct of its activities. They are:

- *To be objective in its decision making* and to ensure, insofar as possible, the neutrality of information resulting from its standards. To be neutral, information must report economic activity as faithfully as possible without coloring the image it communicates for the purpose of influencing behavior in any particular direction.

- *To weigh carefully the views of its constituents* in developing concepts and standards. However, the ultimate determinant of concepts and standards must be the Board's judgment, based on research, public input and careful deliberation about the usefulness of the resulting information.

- *To promulgate standards only when the expected benefits exceed the perceived costs.* While reliable, quantitative cost-benefit calculations are seldom possible, the Board strives to determine that a proposed standard will meet a significant need and that the costs it imposes, compared with possible alternatives, are justified in relation to the overall benefits.

- *To bring about needed changes in ways that minimize disruption to the continuity of reporting practice.* Reasonable effective dates and transition provisions are established when new standards are introduced. The Board considers it desirable that change be evolutionary to the extent that it can be accommodated by the need for relevance, reliability, comparability and consistency.

- *To review the effects of past decisions* and interpret, amend or replace standards in a timely fashion when such action is indicated.

The FASB is committed to following an open, orderly process for standard setting that precludes placing any particular interest above the interests of the many who rely on financial information. The Board believes that this broad public interest is best served by developing neutral standards that result in accounting for similar transactions and circumstances in a like manner and different transactions and circumstances should be accounted for in a different manner.

AN INDEPENDENT STRUCTURE

Financial Accounting Standards Board (FASB)

The FASB is part of a structure that is independent of all other business and professional organizations. Before the present structure was created, financial accounting and reporting standards were established first by the Committee on Accounting Procedure of the American Institute of Certified Public Accountants (1936–1959) and then by the Accounting Principles Board, also a part of the AICPA (1959–1973). Pronouncements of those predecessor bodies remain in force unless amended or superseded by the FASB.

Financial Accounting Standards Advisory Council (FASAC)

The FASAC has responsibility for consulting with the FASB as to technical issues on the Board's agenda, project priorities, matters likely to require the attention of the FASB, selection and organization of task forces and such other matters as may be requested by the FASB or its Chairman. At present, the Council has more than 30 members who are broadly representative of preparers, auditors and users of financial information.

Financial Accounting Foundation (FAF)

The FAF, which was incorporated to operate exclusively for charitable, educational, scientific and literary purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code, is responsible for selecting the members of the FASB and its advisory council, ensuring adequate funding of their activities and exercising general oversight with the exception of the FASB's resolution of technical issues.

Governmental Accounting Standards Board

In 1984, the Foundation established a Governmental Accounting Standards Board (GASB) to set standards of financial accounting and reporting for state and local governmental units. As with the FASB, the Foundation is responsible for selecting its members, ensuring adequate funding and exercising general oversight.

Trustees

The Foundation is separate from all other organizations. However, its Board of Trustees is made up of members from constituent organizations having interest in financial reporting. Nominees from constituent organizations are approved by the Trustees. There also are Trustees-at-large who are not nominated by those organizations, but are chosen by the sitting Trustees. The constituent organizations are:

FAF Constituent Organizations

- American Accounting Association

- American Institute of Certified Public Accountants
- Association for Investment Management and Research
- Financial Executives International
- Government Finance Officers Association
- Institute of Management Accountants
- National Association of State Auditors, Comptrollers and Treasurers
- Securities Industry Association

The members of the FAF Board of Trustees are:

AN OPEN DECISION-MAKING PROCESS

Actions of the FASB have an impact on many organizations within the Board's large and diverse constituency. It is essential that the Board's decision-making process be evenhanded. Accordingly, the FASB follows an extensive "due process" that is open to public observation and participation. This process was modeled on the Federal Administrative Procedure Act and, in several respects, is more demanding.

HOW TOPICS ARE ADDED TO THE FASB'S TECHNICAL AGENDA

The FASB receives many requests for action on various financial accounting and reporting topics from all segments of its diverse constituency, including the SEC. The auditing profession is sensitive to emerging trends in practice and, consequently, it is a frequent source of requests. Requests for action include both new topics and suggested review or reconsideration of existing pronouncements.

The FASB is alert to trends in financial reporting through observation of published reports, liaison with interested organizations and discussions with the EITF. In addition, the staff receives many technical inquiries by letter and telephone, which may provide evidence that a particular topic, or aspect of an existing pronouncement, has become a problem. The FASB also is alert to changes in the financial reporting environment that may be brought about by new legislation or regulatory decisions.

The Board turns to many other organizations and groups for advice and information on various matters, including its agenda. Among the groups with which liaison is maintained are the Accounting Standards Executive Committee (AcSEC) and Auditing Standards Board of the (AICPA), the International Accounting Standards Board (IASB), and the appropriate committees of such organizations as the Association for Investment Management and Research (AIMR), Financial Executives International (FEI) and Institute of Management Accountants (IMA). As part of the agenda process, the Board may make available for public comment agenda proposals that concisely describe the scope of potential projects. The Financial Accounting Standards Advisory Council (FASAC) regularly reviews the Board's agenda priorities and consults on all major projects added to the technical agenda.

After receiving input from the constituency, the Board must make its own decisions regarding its technical agenda. To aid in the decision-making process, the Board has developed a list of factors to which it refers in evaluating proposed topics.

Those factors include consideration of:

- *Pervasiveness of the issue*—the extent to which an issue is troublesome to users, preparers, auditors or others; the extent to which there is diversity of practice; and the likely duration of the issue (i.e., whether transitory or likely to persist);

- *Alternative solutions*—the extent to which one or more alternative solutions that will improve financial reporting in terms of relevance, reliability and comparability are likely to be developed;

- *Technical feasibility*—the extent to which a technically sound solution can be developed or whether the project under consideration should await completion of other projects;

- *Practical consequences*—the extent to which an improved accounting solution is likely to be acceptable generally, and the extent to which addressing a particular subject (or not addressing it) might cause others to act, e.g., the SEC or Congress;

- *Convergence possibilities*—the extent to which there is an opportunity to eliminate significant differences in standards or practices between the U.S. and other countries with a resulting improvement in the quality of U.S. standards; the extent to which it is likely that a common solution can be reached; and the extent to which any significant impediments to convergence can be identified;

- *Cooperative opportunities*—the extent to which there is international support by one or more other standard setters for undertaking the project jointly or through other cooperative means with the FASB; and

- *Resources*—the extent to which there are adequate resources and expertise available from the FASB, the IASB or another standard setter to complete the project; and whether the FASB can leverage off the resources of another standard setter in addressing the issue (and perhaps thereby add the project at a relatively low incremental cost).

It is not possible to evaluate the above factors in precisely the same way and to the same extent in every instance, but identification of factors to be considered helps to bring about consistent decisions regarding the Board's technical agenda.

Board Meetings

The core of the Board's due process is open decision-making meetings and exposure of proposed standards for public comment. Every technical project involves a number of Board meetings. The Board meets as many times as necessary to resolve the issues. A major project generally includes dozens of meetings over several years. All meetings are open to public observers, although observers do not participate in the discussions. The agenda for each meeting is announced in advance.

The staff presents written material, including analysis and recommendations, to the Board members in advance as the basis for discussion in a Board meeting. The written material is the result of extensive research by the staff, including a detailed review and analysis of all of the significant alternative views for each issue to be discussed at the meeting. The meeting format calls for oral presentation of a summary of the written materials by the staff, followed by Board discussion of each issue presented and questioning of the staff on the points raised. The Board may reach conclusions on one or more of the issues presented. Any conclusions reached are tentative and may be changed at future Board meetings.

The Exposure Draft

When the Board has reached conclusions on the issues, the staff is directed to prepare a proposed Exposure Draft for consideration by the Board. After further discussion and revisions, Board members vote by written ballot to issue the Exposure Draft. A majority vote of the Board is required to approve a document. Alternative views, if any, are explained in the document.

The Exposure Draft sets forth the proposed standards of financial accounting and reporting, the proposed effective date and method of transition, background information and an explanation of the basis for the Board's conclusions.

At the end of the exposure period, generally 60 days, all comment letters and position papers are analyzed by the staff. This is a search for new information and persuasive arguments regarding the issues; it is not intended to be simply a "nose count" of how many support or oppose a given point of view. In addition to studying this analysis, Board members review the comment letters to help them in reaching conclusions.

Further Deliberation of the Board

After the comments have been analyzed and studied, the Board redeliberates the issues. As in earlier stages of the process, all Board meetings are open to public observation. The Board considers comments received on the Exposure Draft, and often incorporates suggested changes in the final document. If substantial modifications appear to be necessary, the Board may decide to issue a revised Exposure Draft for additional public comment. When the Board is satisfied that all reasonable alternatives have been considered adequately, the staff is directed to prepare a draft of a final document for consideration by the Board. A vote is taken on the final document, again by written ballot. Four votes are required for adoption of a pronouncement.

Statements of Financial Accounting Standards

The final product of most technical projects is a Statement of Financial Accounting Standards (SFAS). Like the Exposure Draft, the Statement sets forth the actual standards, the effective date and method of transition, background information, a brief summary of research done on the project and the basis for the Board's conclusions, including the reasons for rejecting significant alternative solutions. It also identifies members of the Board voting for and against its issuance and includes reasons for any dissents.

Additional Due Process

For major projects, the Board generally goes significantly beyond the core due process described above. Soon after a major project is placed on the Board's technical agenda, a task force or working group usually is appointed, including preparers, auditors and users of financial information who are knowledgeable about the subject matter. Experts from other disciplines also may be appointed. Care is taken to ensure that various points of view on the issues involved are represented.

The task force meets with and advises the Board and staff on the definition and scope of the project, the nature and extent of any additional research that may be needed and the preparation of a discussion document and related material as a basis for public comment. Task force meetings are open to public observers. Task forces and working groups play an important role in the standard-setting process by providing expertise, a diversity of viewpoints and a mechanism for communication with those who may be affected by proposed standards.

Before it begins deliberations on a new major project, the Board often asks the FASB staff to prepare a Discussion Memorandum or other discussion document. The task force provides significant assistance and advice in this effort. The discussion document generally sets forth the definition of the problem, the scope of the project and the financial accounting and reporting issues; discusses research findings and relevant literature; and presents alternative solutions to the issues under consideration and arguments and implications relative to each. The discussion document is published to invite constituents to comment on the project before the Board begins deliberations.

After a discussion document or an Exposure Draft is issued for public comment, the Board may decide to hold a public hearing or a public roundtable meeting. These meetings provide an opportunity for the Board and staff to ask questions about information and viewpoints offered by constituents who participated in the comment process. Any individual or organization may request to be heard at a public hearing, and the FASB attempts to accommodate all such requests. Public observers are welcome.

Statements of Concepts

In addition to Statements of Financial Accounting Standards (SFAS), the FASB also issues Statements of Concepts. Those do not establish new standards or require any change in the application of existing accounting principles; instead, they are intended to provide the Board and constituents with a foundation for setting standards and concepts useful as tools for solving problems. The framework defined in the Statements of Concepts helps the Board identify the right questions to ask in structuring technical projects and contributes to a consistent approach over time. Because of their long-range importance, Statements of Concepts are developed under the same extensive due process the FASB follows in developing Statements of Financial Accounting Standards on major topics.

Other Documents

In addition to broad issues of financial accounting and reporting, the Board considers narrower issues related to implementation of existing standards and other problems arising in practice. Depending on their nature, application and implementation problems may be dealt with by the Board in Statements or Interpretations, by the staff in Technical Bulletins or in Implementation Guidance in question-and-answer form. All of those are subject to discussion at public Board meetings and to exposure for comment, although Technical Bulletins and Implementation Guidance are exposed more narrowly.

Emerging Issues Task Force (EITF)

The EITF was formed in 1984 in response to the recommendations of the FASB's task force on timely financial reporting guidance and an FASB Invitation to Comment on those recommendations. EITF members are drawn primarily from public accounting firms but also include representatives of large companies. The Chief Accountant of the Securities and Exchange Commission attends EITF meetings regularly as an observer with the privilege of the floor. Lawrence W. Smith, FASB Director, Technical Application and Implementation Activities, also serves as Chairman of the EITF.

Composition of the EITF is designed to include persons in a position to be aware of emerging issues before they become widespread and before divergent practices regarding them become entrenched. Therefore, if the group can reach a consensus on an issue, usually that consensus is taken by the FASB as an indication that no Board action is needed. A consensus is defined as an agreement, provided that no more than two of the thirteen voting members object. Consensus positions of the EITF are considered part of GAAP. If consensus is not possible, it may be an indication that action by the FASB is necessary.

The EITF meets six times a year. Meetings are open to the public and, generally, are attended by substantial numbers of observers. Because interest in the EITF is high, the FASB has separate subscription plans for keeping up-to-date on the issues.

Availability of Publications

To encourage public comment, Exposure Drafts and other discussion documents are distributed primarily through the FASB website.

Statements of Standards, Statements of Concepts and Interpretations also are distributed broadly when published through FASB subscription plans and may be purchased separately by placing an order at the FASB website.

The FASB strives to keep the public informed of developments on its projects through a monthly newsletter, *The FASB Report,* and a weekly notice, *Action Alert,* which provides notice of upcoming Board meetings and their agendas with brief summaries of actions taken at previous meetings. *Action Alert* is available by e-mail subscription at the FASB website.

FASB Website

The FASB website includes general information about the Board and its activities, information on upcoming public meetings, announcements of Board actions, summaries and status of all active technical agenda projects, summaries of previously issued FASB Statements and Interpretations, the quarterly plan for FASB projects and information about membership in the Foundation, as well as information on how to order publications online, by phone or mail.

The website can be accessed at www.fasb.org.

The Public Record

Transcripts of public hearings, letters of comment and position papers, research reports and other relevant materials on projects leading to issuance of pronouncements become part of the Board's public record. The public records on all projects are available for inspection in the public reference room at FASB headquarters in Norwalk, Connecticut. Copies of public records also may be purchased at prices that vary according to the volume of material that has to be copied by accessing the FASB website at www.fasb.org or by contacting Records Retention at (203) 847-0700, ext. 270, for more information.

MEMBERS OF THE FASB

The seven members of the FASB serve full time and are required to sever all connections with the firms or institutions they served prior to joining the Board. While collectively they represent diverse backgrounds, they also must possess "knowledge of accounting, finance and business, and a concern for the public interest in matters of financial accounting and reporting."

Board members are appointed for five-year terms and are eligible for reappointment to one additional five-year term.

Robert H. Herz *was appointed FASB Chairman, effective July 1, 2002. He was a Senior Partner with PricewaterhouseCoopers, its North America Theater Leader of Professional, Technical, Risk & Quality and a member of the firm's Global and U.S. Boards. He also served as a part-time member of the IASB.*

Mr. Herz joined Price Waterhouse upon graduating from the University of Manchester in England with a B.A. degree in economics. He later joined Coopers & Lybrand as its Senior Technical Partner and later held a similar position with PricewaterhouseCoopers.

He has authored numerous publications and chaired the AICPA SEC Regulations Committee, the Transnational Auditors Committee of the International Federation of Accountants and was a member of the EITF.

G. Michael Crooch *was a Partner with Arthur Andersen and Director of the firm's International Professional Standards Group before joining the FASB on July 1, 2000. Mr. Crooch was the American Institute of Certified Public Accountants' (AICPA) delegate to the International Accounting Standards Committee (IASC) and served on the IASC's Executive Committee. He also served on the Institute's Accounting Standards Executive Committee, including three years as the Committee Chairman. He earned bachelor's and master's degrees from Oklahoma State University and a Ph.D. from Michigan State University.*

John M. (Neel) Foster *was appointed as a member of the FASB, effective July 1, 1993. Previously, he had been the Vice President and Treasurer of Compaq Computer Corporation. Mr. Foster also worked in public accounting and was employed by Price Waterhouse for eight years, serving clients in the energy, construction and electronics industries. He was a member of the FASB's Advisory Council (FASAC) from January 1992 until his appointment to the FASB. Mr. Foster holds a bachelor's degree with honors from Colorado College where he majored in economics and was Phi Beta Kappa.*

Edward W. Trott *was appointed as a member of the FASB, effective October 1, 1999. Since 1992, he headed the Accounting Group of KPMG's Department of Professional Practice. Before joining the Board, he was a member of the FASB's Emerging Issues Task Force, the Financial Reporting Committee of the Institute of Management Accountants, the FASB's Advisory Council and the Accounting Standards Executive Committee and Auditing Standards Board of the AICPA. He holds a bachelor's degree from the University of North Carolina and an M.B.A. degree from the University of Texas.*

Katherine Schipper *was appointed to the FASB, effective September 2001. Prior to joining the FASB, she was the L. Palmer Fox Professor of Business Administration at Duke University's Fuqua School of Business. She has served the American Accounting Association (AAA) as President and as Director of Research. She was a member of the FASB's Advisory Council (FASAC) from 1996 to 1999. Ms. Schipper holds a B.A. degree from the University of Dayton and M.B.A., M.A. and Ph.D. degrees from the University of Chicago.*

Gary S. Schieneman *was appointed to the FASB, effective July 1, 2001. Prior to joining the FASB, Mr. Schieneman served as Director, Comparative Global Equity Analysis, of Merrill Lynch. He is a member of the American Institute of Certified Public Accountants (AICPA), the New York Society of Security Analysts and the Association for Investment Management and Research (AIMR). He received a bachelor's degree in accounting from the University of Illinois and earned an M.B.A. degree from New York University.*

John K. Wulff *was appointed to the FASB, effective July 1, 2001. Prior to joining the FASB, he was Chief Financial Officer of Union Carbide Corporation where he directed the company's global financial operations, including its internal and external audits, treasury, control, financial analysis and corporate financial reporting. He is a past Chairman of the Financial Executive Institute's Committee on Corporate Reporting and is a member of the American Institute of Certified Public Accountants. He is a graduate of the Wharton School of the University of Pennsylvania.*

FASB Staff

The Board is assisted by a staff of approximately 40 professionals drawn from public accounting, industry, academe and government, plus support personnel. The staff works directly with the Board and task forces, conducts research, participates in public hearings, analyzes oral and written comments received from the public and prepares recommendations and drafts of documents for consideration by the Board.

FASB Fellows are an integral part of the research and technical activities staff. The Fellowship program provides the Board the benefit of current experience in industry, academe and public accounting and offers the Fellows first-hand experience in the accounting standard-setting process. Fellows take a leave of absence from their firms or universities and serve as project managers or consultants on a variety of projects.

Suzanne Q. Bielstein *is Director, Major Projects and Technical Activities for the FASB. Previously, she served in various capacities at the FASB, including Assistant Director of Technical Research and Project Manager on the business combinations and combinations for not-for-profit organizations. Prior to joining the FASB in early 1999, she spent five years with Caradon plc in two different roles—Vice President of Planning, North America, and Vice President and Corporate Controller of Clarke American Checks, Inc. (a subsidiary of Caradon). Before joining Caradon, Ms. Bielstein was an Audit Partner at KPMG in Boston. Ms. Bielstein earned a B.B.A. degree in accounting from the University of Notre Dame.*

Kimberley Ryan Petrone, *who has been a member of the FASB staff since 1989, was named Director, Planning, Development and Support Activities in April 2002. Previously, Ms. Petrone was a Project Manager on the Board's business combinations project from 1997 through issuance of Statements 141 and 142 in July 2001 and has been involved in a number of other FASB projects. Before joining the FASB, Ms. Petrone was a Corporate Accounting and Financial Reporting Manager with Savin Corporation. Prior to Savin, she was with AMAX Inc. She earned a B.S. degree in accounting from the University of Bridgeport and an M.B.A. degree from the University of Connecticut.*

Lawrence W. Smith *was named Director, Technical Application and Implementation Activities of the FASB in August 2002. Prior to assuming this post, he was a Partner with KPMG for 14 years, headquartered most recently in Stamford, Connecticut. From 1992–1996, Mr. Smith served as a Partner in KPMG's Department of Professional Practice in New York. During his 25-year tenure with KPMG, he served as Engagement Partner and SEC Reviewing Partner on a number of international* Fortune *1000 clients. He is a past member of the Technical Standards Subcommittee of the Professional Ethics Committee of the AICPA. Mr. Smith received an M.S. degree in accounting from Northeastern University.*

ADDITIONAL INFORMATION

General Information
For further information about the FASB, including Board meeting schedules, access the FASB website at www.fasb.org, call or write Financial Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116, telephone (203) 847-0700 or via e-mail at director@fasb.org.

To Order Publications
Statements, Interpretations, Exposure Drafts and other documents published by the FASB may be obtained by placing an order on the FASB website at www.fasb.org or by contacting the FASB Order Department at 1-800-748-0659, weekdays 9:00 a.m. to 5:00 p.m. EST.

Public Hearings and Comment Letters
For information about submitting written comments on documents or about public hearings, access the FASB website at www.fasb.org or contact the FASB Project Administration Department at (203) 847-0700, ext. 389.

Public Reference Room and Files
The FASB maintains a public reference room open during office hours, Monday through Friday. The public reference room contains all FASB publications, comment letters on documents and transcripts of public hearings. Copies of this material may be obtained for a specified charge by accessing the FASB website at www.fasb.org or by contacting Records Retention at (203) 847-0700, ext. 270, for an appointment.

* * *

To order additional copies of *FACTS about FASB* without charge, contact Public Relations at (203) 847-0700, ext. 252, or fax a request to (203) 849-9714.

6/03

Testimony of
Leslie F. Seidman
Financial Accounting Standards Board
Before the
Subcommittee on Commerce, Trade and Consumer Protection of the Committee on Energy and Commerce
July 22, 2003

Attachment 2

The FASB and the Capital Markets

The FASB and the Capital Markets

By John M. "Neel" Foster, FASB Member

This article addresses three related issues that have been prevalent throughout my ten-year term at the FASB and will likely be in the future:

• The importance of neutral financial reporting to the efficient functioning of capital markets;

• The role of the FASB in achieving high-quality, neutral financial reporting; and

• The importance of preserving the FASB's independence to achieving neutral accounting standards.

Capital markets allocate economic resources in this country in an extremely efficient manner. But they can continue to do so only if participants in those markets have available to them credible, reliable and neutral financial information that faithfully portrays the economic effects of transactions.

Uncertainty Influences the Cost of Capital
Numerous academic studies have concluded that more information in the marketplace lowers the cost of capital. Upon reflection, although it is nice to have empirical support, academic studies are not really necessary to reach this conclusion—it is intuitive. More information always equates to less uncertainty, and it is clear that people pay more for certainty. Less uncertainty results in less risk and a consequent lower premium being demanded. In the context of financial information, the end result is that better disclosure results in a lower cost of capital.

For example, let us say an investor has $10,000 that he is required to invest and has a choice between two investment alternatives. That investor has some information about one of the alternatives, but no information about the other. Having no choice but to invest the $10,000, I cannot imagine circumstances that would cause the investor to choose the alternative about which he knew nothing unless it was apparent from the available information about the other investment alternative that it was a certainty it was a loser.

Another example where uncertainty results in a higher cost of capital can be seen in the marketplace everyday—junk bonds yield significantly more than treasury bills. Obviously, the reason junk bonds have a higher yield is that there is more uncertainty about whether the principal will be returned.

Some people who prepare financial statements apparently do not buy into the paradigm that uncertainty results in a higher cost of capital. This is apparent from the resistance we get at the FASB almost every time we propose to issue a new standard directed toward improving the understanding of a company's financial position and results of operations. Consider disclosures about derivatives, for example. I voted for Statement 119, *Disclosure* *about Derivative Financial Instruments and Fair Value of Financial Instruments*, even though its disclosure requirements were limited only to the effects of the derivatives themselves, largely because I thought that, given the bad connotation that any use of derivatives had at that time, issuers of financial statements would want to tell the whole story. I thought concerns about how users of financial statements would react to an entity's use of derivatives, especially if the derivative positions had resulted in losses for the period, would compel people to provide an in-depth explanation of their risk-management policies and how the derivatives held or used related to or offset the underlying exposures that they were trying to hedge. I was wrong. Except for financial institutions, which do a pretty good job of explaining their risks, most entities have simply complied with the minimum disclosure requirements that are now embodied in Statement 133, *Accounting for Derivative Instruments and Hedging Activities.* Companies generally do not relate their derivative transactions to the risks that they are hedging or explain how gains and losses on the derivatives are offset by losses and gains on other transactions. The result is that investors and potential investors still do not understand many *companies'* risk-management activities.

Importance of Investor Trust in Financial Statements

Another indication of the importance of credible financial information can be found in the recent call for a single set of international accounting standards that could be used by everyone to raise capital in any country without reconciliation to U.S. generally accepted accounting principles (GAAP). Much of the clamor has occurred outside the U.S., and the reason this issue is so important to offshore companies is that they want to raise capital in the U.S., but some do not want to have to file under GAAP and other SEC disclosure requirements.

Only three major exchanges in the world do not already accept International Financial Reporting Standards—those in the U.S., Canada and Japan. So, why is it so important that they be accepted in the U.S.? It's like Willie Sutton said when he was asked why he robbed banks: "Because that's where the money is." And the reason the money is here is no accident. It's here because investors, who supply the money, trust the U.S. markets.

Clearly that trust results from investors' belief that financial statements prepared under GAAP are reliable, relevant, consistent and comparable. That, in turn, is the result of a body of high-quality financial reporting standards established by the FASB and its predecessors. Despite the recent accounting scandals, generally, the high level and quality of financial reporting and disclosure, which enable investors to confidently compare investment alternatives, have attracted the suppliers of capital, making our markets the premier markets of the world—markets that coincidentally yield the lowest cost of capital.

Role of the FASB

The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors and users of financial statements. In fulfilling that role, we help reduce uncertainty and thereby lower the cost of capital by maintaining and developing standards that provide decision-makers—investors—with thorough, neutral and credible information to enable economic resources to be allocated as efficiently as possible.

There are two inevitable characteristics of every issue we address that destine the FASB to be an unpopular institution. First, the issue, and almost any proposed answer, will be controversial. Easy questions do not need accounting standards. Consequently, we only deal with difficult questions—questions that engender strongly held views and much disagreement.

The second characteristic is that FASB pronouncements almost always have consequences that some consider undesirable. To management, an accounting standard represents a loss of control over information—that is, the loss of the ability to decide whether, when or how to present information. It is well known that people don't like change. They especially don't like changes that are perceived to adversely affect them, and most new accounting standards restrict the ability to manage earnings or display, which is perceived as a particularly adverse effect when bonuses and stock options are at stake.

The Board understands that managers will sometimes alter their behavior in response to a new accounting pronouncement. This is a natural result of reporting information. People manage what they measure or get measured by. But, if financial information had no consequence, if it did not change the way markets and users of financial statements evaluate performance, it would be of little benefit.

To make the best economic decisions, users of financial statements must have statements that are both useful and credible. If financial statements are to be useful, they must report all economic activity, not selected activity, as faithfully as possible. If they are to be credible, they must neither omit information nor color the message to favor one party over another or a specific transaction structure.

Importance of Neutrality
The need for useful and credible financial information on which to base decisions is the reason that the FASB strives to establish neutral accounting standards that provide a picture of a company's financial position and its results of operations in a way that is unbiased and as complete and faithful as possible. It also is the reason we believe that good financial reporting requires accounting for similar transactions and circumstances similarly and for different transactions and circumstances differently.

Some suggest that the FASB should consider the economic or social impacts of accounting standards. The FASB should not act, they maintain, if a new accounting standard would have undesirable consequences. That argument has been made frequently over the history of the FASB. We heard this argument the first time we addressed the accounting for stock-based compensation, and we are hearing it again in this go round. But, it has also been raised in projects on accounting for pension liabilities, postretirement benefits, derivatives and business combinations. It has been asserted that changing the accounting for these transactions would be the end of Western Civilization. Obviously that is a bit of an exaggeration, but it does generally capture the flavor of the objections.

There is a common thread in all of these assertions. Those who make them may pursue desirable goals, like providing retiree healthcare to their employees or reducing economic risks through hedging. But they hope to achieve the goal without clearly explaining its financial impact to those who use financial statements. On the surface this may seem desirable, but in the long run it can be very harmful. The costs and benefits of transactions exist whether or not they are recognized and reported in financial statements. Concealing the financial impact of certain transactions from those who use financial statements may benefit a company in the short run. However, over the longer term it will ultimately increase that company's cost of capital to a higher level than it would have been without the concealment. This is obvious if one follows the stock price consequences of some of the recently reported scandals. Moreover, on a macro basis, it can only lead to inefficient economic decisions and misallocation of resources.

The adverse consequences of abandoning neutrality by concealing the true impact of certain transactions can, perhaps, be best illustrated by the collapse of the thrift industry. During the 1970s and 1980s many argued that GAAP would force regulators to close institutions and that institutions using GAAP would not be able to compete in development and commercial lending. Preserving the industry became an overriding objective. Consequently, regulatory accounting principles were altered to obscure problems in troubled institutions. I certainly would not suggest that the lack of transparency resulting from the accounting caused the downfall of the thrift industry, but it did enable the people responsible to ignore the problem and pretend it did not exist, thereby delaying action that could have contained the problem when it was relatively small.

The same sort of activity has recently occurred in Japan where the government sanctioned banks' hiding loan and securities losses with the same inevitable result. Companies can only hide behind the accounting for so long—eventually the truth will be revealed.

Most people would condemn slanting or concealing information in the pursuit of national goals. They also would be appalled at the suggestion that selected SAT scores be altered to improve a certain student's *chances* of admission to a particular university or, worse yet, make one team's goal in an athletic contest smaller than the other team's goal. I believe those same people would be equally opposed if asked directly whether accounting standards should be slanted to favor one company's ability to raise capital over another's. Yet, the FASB is continually lobbied to do exactly that.

FASB's Role in Public Debates

We also must recognize that, as a private entity, the FASB has neither the authority nor the qualifications to weigh various, and often conflicting, national priorities or goals. Nor do we seek that authority. Consequently, we must discount those arguments that maintain a proposed standard is bad public policy. There may be others who think it's good policy. Our charge is not to decide who is right in these arguments. Rather, our mission—and the only public policy goal with which we can be concerned—is to improve, through accounting standards, the usefulness of financial statements so that public and private decision-makers have the information to make better, more informed decisions.

We often hear assertions that our standards will have adverse economic effects, such as certain industries will lose their competitiveness resulting in lost jobs, or people won't enter into as many derivative transactions or companies will discontinue their stock option plans. These assertions are generally prognostications that cannot be supported by actual data. But even if they turn out to be true, if those effects resulted from the market (that is, the decision-makers) having more and better information, which in turn resulted in a redirection of capital, isn't that the right consequence from a public policy standpoint? A "no" answer to this question denies that free markets and market forces result in the most efficient allocation of resources and that efficient allocation of resources should be the foremost public policy goal. Free markets cannot function effectively if they are deprived of reliable and neutral information.

Supporting the FASB's Role

I recognize that it is human nature to try to influence the rules—any rules—to an individual's or organization's advantage, and even though we try to resist those efforts, we expect people to do so. However, if the institution setting the rules is to survive, people must be willing to abide by the rules. While this is not the first time it has happened, there is currently an interest group lobbying Congress to overrule or prevent the issuance of any standard that would require companies to recognize the cost of stock options in their financial statements. While this group, for the most part, claims to support independent, private-sector standard setting and the role of the FASB, it is clear from their actions that they don't. Rather, they want to be able to say that they support private-sector standard setting and at the same time be able to control it. They can't have it both ways. They can't say they support having standards set in the private-sector and, concurrently, because they don't like a particular standard, appeal to a higher public authority to have it overruled. Again, one either supports the process or doesn't.

Arthur Levitt, former Chairman of the SEC, once stated, "The true test of a democratic institution is whether it is respected even by those who disagree with its decisions. If we don't abide by FASB's decisions when they go against our interests, then we will seriously undermine, and ultimately destroy, the institution."

I agree with Chairman Levitt's observation. If a group of constituents that is dissatisfied with a proposal or a standard issued by the FASB has the ability to successfully appeal to Congress to overrule that standard, the authority and the viability of the FASB will soon vanish. If the FASB were no longer viable, one of two things probably would happen. One possibility is that the FASB would be replaced by a new private-sector standard setter, which likely would have a structure extremely similar to that of the FASB—perhaps one even more insulated from outside pressure.

The other possibility is that the SEC or some other governmental agency would take over accounting standard setting. If that happened, I don't believe anyone would be happy with that result for very long. Governments come and go, and as administrations change, the political color and policies change with them. I don't believe anyone would want accounting standards to continually tack with every change in the political winds, or to be determined by social policy or the special interests that *others* have—think about the tax code. Some of the answers under that regime might be appealing, but, I venture to say, there would be some standards that some would find extremely unfair.

Conclusion
I conclude by summarizing the three issues discussed. First, the principal reason the U.S. has the preeminent financial markets in the world is due to the quality, timeliness and credibility of the financial information and disclosures required of public companies. That, in turn, is the result of the support and resources provided to private-sector standard setting in this country over the last 70 years.

Second, those that would have accounting standards influence the allocation of capital to achieve a perceived public policy goal or further their own self-interests are, in reality, opposed to the free and efficient market system that is universally acknowledged to be the driving force of the U.S. economy.

Third, the FASB will not survive if every time a special interest group doesn't like a standard, it appeals to Congress or the SEC to overrule it. If it is desirable that accounting standards be set in the private sector, universal support of the process—always, not just when the answer is appealing—is imperative.

On June 30, FASB Board member John M. "Neel" Foster concludes his second and final term with the Board.

Neel joined the FASB in July of 1993 after having served as Vice President and Treasurer of Compaq Computer Corporation. During his ten-year career with the FASB, Neel helped establish a long list of standards, including those on accounting for stock-based compensation (Statement 123) and derivatives (FAS 133).

Source: The FASB Report No. 360, June 30, 2003

Testimony of
Leslie F. Seidman
Financial Accounting Standards Board
Before the
Subcommittee on Commerce, Trade and Consumer Protection of the Committee on Energy and Commerce
July 22, 2003

Attachment 3

FASB News Releases

NEWS RELEASE 02/05/98

FASB Appoints Task Force to Aid with Implementation Issues on Derivatives

Norwalk, CT, February 5, 1998—The Financial Accounting Standards Board has appointed a task force to assist in providing timely guidance on its upcoming standard on derivatives and hedging. The Task Force will help in identifying implementation issues and recommending conclusions to the Board. James J. Leisenring, vice chairman of the FASB, will chair the Task Force.

FASB Chairman Edmund L. Jenkins said that "the new standard is necessarily complicated because derivatives are complicated financial instruments. We have had several constituents comment that the Board should be prepared to provide assistance on a timely basis for that project and the task force will be one of the important ways we will meet that need."

Essentially, the new standard will require companies to put derivative financial instruments on the balance sheet as assets or liabilities, measured at fair value. Changes in value would be reflected in earnings depending on how the derivative is used. "Billions of dollars of derivatives transactions are taking place in the marketplace and investors have little, if any, information about them," Mr. Jenkins said. "Our new standard will give investors readily available information so they can make more knowledgeable investment decisions."

Members of the Task Force are: Philip D. Ameen, vice president and controller of General Electric Company; Robert H. Herz, partner of Coopers & Lybrand LLP; Michael Joseph, partner of Ernst & Young LLP; Jack LaGue, vice president and controller of National Life of Vermont; Carlos Mello, senior vice president and managing director of People's Bank of Connecticut; De*mre Shiela, partner of Price Waterhouse LLP; David H. Sidwell, managing director and controller, J.P. Morgan & Co., Inc.; John T. Smith, partner of Deloitte & Touche LLP; John E. Stewart, partner of Arthur Andersen LLP; Steve Swad, partner of KPMG Peat Marwick LLP; Richard G. Ueltschy, partner of Crowe, Chizek and Company LLP. Additionally, Jane Adams, deputy chief accountant of the Securities and Exchange Commission, and Robert Storch, chief-accounting section, Division of Supervision of the Federal Deposit Insurance Corporation, will participate as observers.

NEWS RELEASE 06/16/98

FASB Derivatives Statement Now Available

Norwalk, CT, June 16, 1998-As expected, the Financial Accounting Standards Board today issued Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Statement is effective for fiscal years beginning after June 15, 1999, with earlier adoption encouraged.

The new standard requires companies to record derivatives on the balance sheet as assets or liabilities, measured at fair value. Gains or losses resulting from changes in the values of those derivatives would be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. The key criterion for hedge accounting is that the hedging relationship must be highly effective in achieving offsetting changes in fair value or cash flows.

"I am particularly pleased to announce the availability of the new derivatives Statement," said FASB Chairman Edmund L. Jenkins. "There are trillions of dollars of derivatives transactions out there and investors didn't have readily available information about them. It's impossible to make informed investment decisions without all the facts about significant transactions a company has entered into. When companies begin to apply Statement 133, investors will have that information included directly in the financial statements."

Copies of the Statement are available through the FASB Order Department, telephone (203) 847-0700, ext. 555 for $11.50 each.

NEWS RELEASE 07/07/99

FASB Delays Implementation Date for Derivatives and Hedging Standard

Norwalk, CT, July 7, 1999—Citing concerns about companies' ability to modify their information systems and educate their managers in time to apply Statement 133 on derivatives and hedging, the Financial Accounting Standards Board has delayed its effective date for one year, to fiscal years beginning after June 15, 2000. The delay, published as FASB Statement 137, applies to quarterly and annual financial statements.

FASB Chairman Edmund L. Jenkins explains, "We have received a number of requests from constituents asking for a one-year delay, based on unforeseen problems with getting systems up to speed for year 2000 considerations. Others had questions about applying Statement 133 in practice and had a need to educate their people internally about the new standard's requirements.

"The Board continues to believe that investors must have the kind of information that will be provided under Statement 133—information that, for the most part, has never been available to investors before," Mr. Jenkins continued. "But we also must be responsive to the companies that will be supplying that information to ensure that the standards are implemented consistently and in a manner that is the most complete and the most useful to investors."

Copies of Statement 137, deferring Statement 133's effective date, are available from the FASB Order Department, PO Box 5116, Norwalk, CT 06856-5116, telephone 800-748-0659.

NEWS RELEASE 6/15/00

FASB Issues Amendment to Derivatives Standard

Norwalk, CT, June 15, 2000—The Financial Accounting Standards Board today issued an amendment of Statement 133, *Accounting for Certain Derivative Instruments and Certain Hedging Activities.* The new Statement addresses a limited number of issues causing implementation difficulties for a large number of entities getting ready to apply Statement 133.

The new Statement amends Statement 133 such that:

- The normal purchases and normal sales exception is expanded.
- The specific risks that can be identified as the hedged risk are redefined so that in a hedge of interest rate risk the risk of changes in a benchmark interest rate would be the hedged risk.
- Recognized foreign-currency-denominated assets and liabilities may be the hedged item in fair value hedges or cash flow hedges.
- Intercompany derivatives may be designated as the hedging instruments in cash flow hedges of foreign currency risk in the consolidated financial statements even if those intercompany derivatives are offset by unrelated third-party contracts on a net basis.

Certain Board decisions based on recommendations of the FASB's Derivatives Implementation Group to clarify Statement 133 also have been incorporated in the Statement.

The Statement is the result of the Board's decision, after listening to its constituents, to address a limited number of issues using the following criteria:

- Implementation difficulties would be eased for a large number of entities.
- There would be no conflict with or modifications to the basic model of Statement 133.
- There would be no delay in the effective date of Statement 133.

Statement 138 is available for purchase from the FASB Order Department, telephone (800) 748-0659.

NEWS RELEASE 04/30/03

FASB Issues Standard That Amends and Clarifies Accounting Guidance on Derivatives

Norwalk, CT, April 30, 2003—Today the Financial Accounting Standards Board (FASB) issued Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities.* The Statement amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under Statement 133.

The new guidance amends Statement 133 for decisions made:

- as part of the Derivatives Implementation Group process that effectively required amendments to Statement 133,
- in connection with other Board projects dealing with financial instruments, and
- regarding implementation issues raised in relation to the application of the definition of a derivative, particularly regarding the meaning of an "underlying" and the characteristics of a derivative that contains financing components.

The amendments set forth in Statement 149 improve financial reporting by requiring that contracts with comparable characteristics be accounted for similarly. In particular, this Statement clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative as discussed in Statement 133. In addition, it clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. Statement 149 amends certain other existing pronouncements. Those changes will result in more consistent reporting of contracts that are derivatives in their entirety or that contain embedded derivatives that warrant separate accounting.

Effective Dates and Order Information

This Statement is effective for contracts entered into or modified after June 30, 2003, except as stated below and for hedging relationships designated after June 30, 2003. The guidance should be applied prospectively.

The provisions of this Statement that relate to Statement 133 Implementation Issues that have been effective for fiscal quarters that began prior to June 15, 2003, should continue to be applied in accordance with their respective effective dates. In addition, certain provisions relating to forward purchases or sales of *when-issued* securities or other securities that do not yet exist, should be applied to existing contracts as well as new contracts entered into after June 30, 2003.

Copies of Statement 149 may be obtained through the FASB Order Department at 800-748-0659 or by placing an order **on-line** at the FASB website.

About the Financial Accounting Standards Board

Since 1973, the Financial Accounting Standards Board has been the designated organization in the private sector for establishing standards of financial accounting and reporting. Those standards govern the preparation of financial reports and are officially recognized as authoritative by the Securities and Exchange Commission and the American Institute of Certified Public Accountants. Such standards are essential to the efficient functioning of the economy because investors, creditors, auditors and others rely on credible, transparent and comparable financial information. For more information about the FASB, visit our website at www.fasb.org.

The Financial Accounting Standards Board

Serving the investing public through transparent information resulting from high-quality financial reporting standards developed in an independent, private-sector, open due process.

Testimony of
Leslie F. Seidman
Financial Accounting Standards Board
Before the
Subcommittee on Commerce, Trade and Consumer Protection of the
Committee on Energy and Commerce
July 22, 2003

Attachment 4

Summary of Statement of Financial Accounting Standards No. 133,
Accounting for Derivative Instruments and Hedging Activities

Summary of Statement No. 133

Accounting for Derivative Instruments and Hedging Activities (Issued 6/98)

Summary

This Statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, (collectively referred to as derivatives) and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (b) a hedge of the exposure to variable cash flows of a forecasted transaction, or (c) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security, or a foreign-currency-denominated forecasted transaction.

The accounting for changes in the fair value of a derivative (that is, gains and losses) depends on the intended use of the derivative and the resulting designation.

- For a derivative designated as hedging the exposure to changes in the fair value of a recognized asset or liability or a firm commitment (referred to as a fair value hedge), the gain or loss is recognized in earnings in the period of change together with the offsetting loss or gain on the hedged item attributable to the risk being hedged. The effect of that accounting is to reflect in earnings the extent to which the hedge is not effective in achieving offsetting changes in fair value.
- For a derivative designated as hedging the exposure to variable cash flows of a forecasted transaction (referred to as a cash flow hedge), the effective portion of the derivative's gain or loss is initially reported as a component of other comprehensive income (outside earnings) and subsequently reclassified into earnings when the forecasted transaction affects earnings. The ineffective portion of the gain or loss is reported in earnings immediately.
- For a derivative designated as hedging the foreign currency exposure of a net investment in a foreign operation, the gain or loss is reported in other comprehensive income (outside earnings) as part of the cumulative translation adjustment. The accounting for a fair value hedge described above applies to a derivative designated as a hedge of the foreign currency exposure of an unrecognized firm commitment or an available-for-sale security. Similarly, the accounting for a cash flow hedge described above applies to a derivative designated as a hedge of the foreign currency exposure of a foreign-currency-denominated forecasted transaction.

- For a derivative not designated as a hedging instrument, the gain or loss is recognized in earnings in the period of change.

Under this Statement, an entity that elects to apply hedge accounting is required to establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the entity's approach to managing risk.

This Statement applies to all entities. A not-for-profit organization should recognize the change in fair value of all derivatives as a change in net assets in the period of change. In a fair value hedge, the changes in the fair value of the hedged item attributable to the risk being hedged also are recognized. However, because of the format of their statement of financial performance, not-for-profit organizations are not permitted special hedge accounting for derivatives used to hedge forecasted transactions. This Statement does not address how a not-for-profit organization should determine the components of an operating measure if one is presented.

This Statement precludes designating a nonderivative financial instrument as a hedge of an asset, liability, unrecognized firm commitment, or forecasted transaction except that a nonderivative instrument denominated in a foreign currency may be designated as a hedge of the foreign currency exposure of an unrecognized firm commitment denominated in a foreign currency or a net investment in a foreign operation.

This Statement amends FASB Statement No. 52, *Foreign Currency Translation,* to permit special accounting for a hedge of a foreign currency forecasted transaction with a derivative. It supersedes FASB Statements No. 80, *Accounting for Futures Contracts,* No. 105, *Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk,* and No. 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments*. It amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments,* to include in Statement 107 the disclosure provisions about concentrations of credit risk from Statement 105. This Statement also nullifies or modifies the consensuses reached in a number of issues addressed by the Emerging Issues Task Force.

This Statement is effective for all fiscal quarters of fiscal years beginning after June 15, 1999. Initial application of this Statement should be as of the beginning of an entity's fiscal quarter; on that date, hedging relationships must be designated anew and documented pursuant to the provisions of this Statement. Earlier application of all of the provisions of this Statement is encouraged, but it is permitted only as of the beginning of any fiscal quarter that begins after issuance of this Statement. This Statement should not be applied retroactively to financial statements of prior periods.

Testimony of
Leslie F. Seidman
Financial Accounting Standards Board
Before the
Subcommittee on Commerce, Trade and Consumer Protection of the
Committee on Energy and Commerce
July 22, 2003

Attachment 5

Derivatives Implementation Group

Derivatives Implementation Group

The Derivatives Implementation Group is a task force that was created in 1998 to assist the FASB in answering questions that companies will face when they begin implementing Statement 133, *Accounting for Derivative Instruments and Hedging Activities*. The FASB's objective in forming the group was to establish a mechanism to identify and resolve significant implementation questions in advance of the implementation of Statement 133 by many companies.

The role of the Derivatives Implementation Group is different from that of other task forces previously assembled by the FASB because it was established to address issues related to a new Statement that had not yet been implemented by most companies. The responsibilities of the Derivatives Implementation Group are to identify practice issues that arise from applying the requirements of Statement 133 and to advise the FASB on how to resolve those issues. In addition to members of the implementation group, any constituent or organization may submit questions to be debated by the group by sending a detailed letter to the group chairman, FASB Vice Chairman Jim Leisenring. The FASB staff also seeks input from the implementation group on selected technical inquiries that it resolves.

The model for the Derivatives Implementation Group is the Emerging Issues Task Force (EITF) with the key difference being that the Derivatives Implementation Group does not formally vote on issues to reach a consensus. Instead, it is the responsibility of the Chairman to identify an agreed-upon resolution that emerges based upon the group's debate. Implementation group members are free to submit written objections to any issue where the group reaches an agreed-upon resolution. In instances where no clear resolution of an issue emerges, the issue may be further discussed at a future meeting or handled by the FASB staff.

After each meeting of the Derivatives Implementation Group, the FASB staff has the responsibility of documenting tentative conclusions for each issue. Those tentative conclusions are publicly available on the FASB web site typically several weeks after a meeting of the Derivatives Implementation Group. Those conclusions will remain tentative until they are formally cleared by the FASB and become part of an FASB staff implementation guide (Q&A). The Board is typically not asked to formally clear the staff's tentative conclusions at a public Board meeting until those conclusions have been publicly available on the web site for a 35-day period. That delay provides constituents the opportunity to study those conclusions and submit any comments before the Board considers formal clearance.

Meetings of the Derivatives Implementation Group are held at the FASB offices in Norwalk, CT and are open to public observation. The group will meet bimonthly during 1998, 1999, and 2000 when companies are planning for transition to the new accounting requirements. The need for meetings of the group throughout the year 2001 will be assessed at that time.

The members of the Derivatives Implementation Group and their affiliations are:

Members

Mr. Philip D. Ameen, Vice President and Comptroller, General Electric Company

Mr. Tim Bridges, Vice President Derivative Products, Goldman, Sachs & Co.

Mr. Michael D. Foley, Partner, KPMG LLP

Mr. Michael Joseph, Partner, Ernst & Young LLP

Mr. Ira Kawaller, President, Kawaller & Company, LLC

Mr. Carlos Mello, Senior Vice President & Managing Director, People's Bank Connecticut

Ms. Deidre Schiela, Partner, PriceWaterhouseCoopers

Mr. David H. Sidwell, Managing Director and Controller, J. P. Morgan & Co., Inc.

Mr. John T. Smith, Partner, Deloitte & Touche LLP

Mr. John E. Stewart, Partner, Arthur Andersen LLP

Mr. Pascal Desroches, Assistant Controller, Time Warner Inc.

Observers

Mr. Jackson Day, Deputy Chief Accountant, Securities and Exchange Commission

Mr. Robert Storch, Chief, Accounting Section, Division of Supervision, Federal Deposit Insurance Corporation