

The FAF is comprised of independent trustees and is responsible for overseeing, funding,⁶ and appointing members of the Board, as well as selecting members of an advisory body.⁷ The Commission has been informed that the majority of the FAF trustees are not, and have not been during the two-year period preceding their service on the FAF, associated with a public accounting firm. Based on our past relationship with the FAF, we believe that the FAF serves the public interest. Accordingly, the FAF meets the applicable criteria in section 108 of the Sarbanes-Oxley Act for the board of trustees of a recognized private sector accounting standard setter.

The Board is responsible for promulgating financial accounting and reporting standards. It currently has seven members who have expertise in accounting and financial reporting. Members generally are appointed for five-year terms and can be reappointed to one additional term. Board members are full time employees of the FAF.

B. Commission Oversight of FASB Activities

While the Commission consistently has looked to the private sector in the past to set accounting standards, the securities laws, including the Sarbanes-Oxley Act, clearly provide the Commission with authority to set accounting standards for public companies and other entities that file financial statements with the Commission.⁸ In addition, recognition of standards set by a private sector standard-setting body as "generally accepted" is only appropriate under section 108 of the Sarbanes-Oxley Act if,

⁶ The funding provisions under section 109 of the Sarbanes-Oxley Act replace the FAF's funding responsibilities; the FAF will continue to be responsible for the fee requests, including establishing the FASB's budget for review by the Commission each year.

⁷ The FASB receives input from, among other sources, a standing advisory body, the Financial Accounting Standards Advisory Council (FASAC), which is comprised of members from the accounting and business communities, academia, and professional organizations, all of whom share an interest in fostering quality financial reporting and disclosure. FASAC's primary mission is to advise the FASB on its projects and agenda. In addition, the FASB has established a User Advisory Council (UAC) to assist the FASB in raising awareness of how investors and investment professionals, equity and credit analysts, and rating agencies use financial information. The FASB has recruited more than 40 professionals, representing a variety of investment and analytical disciplines, to participate on the UAC.

⁸ Section 108(c) of the Sarbanes-Oxley Act states, "Nothing in this Act, including this section * * * shall be construed to impair or limit the authority of the Commission to establish accounting principles or standards for purposes of enforcement of the securities laws."

among other things, the Commission determines that the private sector body "has the capacity to assist the Commission in fulfilling the requirements of * * * the Securities Exchange Act * * * because, at a minimum, the standard setting body is capable of improving the accuracy and effectiveness of financial reporting and the protection of investors under the securities laws."⁹ As noted above, section 108 also emphasizes the Commission's responsibility to determine that the standard setting body:

- Has "procedures to ensure prompt consideration * * * of changes to accounting principles necessary to reflect emerging accounting issues and changing business practices";

- Considers the need to amend standards "to reflect changes in the business environment"; and

- Considers, to the extent necessary or appropriate, international convergence of accounting standards.

Given the Commission's responsibilities under the securities laws and our specific responsibilities under the Sarbanes-Oxley Act to make findings regarding the procedures, capabilities, activities, and results of any designated accounting standards-setting body, we believe that:

- The FAF and FASB should give the Commission timely notice of, and discuss with the Commission, the FAF's intention to appoint a new member of the FAF or FASB.¹⁰ While the FAF makes the final determinations regarding the selection of FASB and FAF members, we believe that to fulfill our statutory responsibilities we should provide the FAF with our views and that the FAF should consider those views in making its final selection. The Commission, FAF, and FASB share the belief that the qualifications and appropriateness of each member of the FAF and the FASB are critical if the

⁹ See Securities Act of 1933, section 19(b)(1)(B), as added by the Sarbanes-Oxley Act.

¹⁰ Such consultations have occurred in the past. See, e.g., SEC Press Release No. 96-87, "FAF and SEC Reach Agreement on Changes in Composition of Accounting Foundation: Appointing Three New Trustees to Serve," dated July 8, 1996, which states, "The FAF selected the new At-Large Trustees in consultation with the SEC"; SEC Annual Report 1996, at 90-91, which states, "The change in composition of the FAF's Board was made in consultation with the SEC to include a greater representation by those who do not have a special interest in the outcome of accounting standards setting," and FAF, *1996 Annual Report of the Financial Accounting Foundation*, at 5, which states, "In consultation with the chairman of the Securities and Exchange Commission, the FAF agreed in July to change the composition of the Foundation's Board."

FASB is to continue to be a premier private-sector standards-setting body.

- The FASB, in its role of "assist(ing) the Commission in fulfilling the requirements of the Securities Exchange Act,"¹¹ should provide timely guidance to public companies, accounting firms, regulators and others on accounting issues that the Commission considers to be of immediate significance to investors. The Commission and its staff, however, do not prohibit the FASB from also addressing other topics, and do not dictate the direction or outcome of specific FASB projects so long as the conclusions reached by the FASB are in the interest of investor protection. We expect that the Commission staff¹² will refer issues to the FASB or one of its affiliated organizations¹³ when those issues may warrant new, amendments to, or formal interpretations of, accounting standards. We also expect that the FASB will address such issues in a timely manner. On those occasions when the FASB may determine that consideration of the issue is not advisable or that the issue cannot be resolved within the time frame acceptable to the Commission,¹⁴ we expect that the FASB promptly will notify the Commission or its staff, provide us with its views regarding an appropriate resolution of the issue, and diligently work with us and our staff to ensure the protection of investors from misleading or inadequate accounting or disclosures.

- Because the Commission and FASB share the common goal of providing investors with the disclosure of meaningful financial information, we anticipate continuation of our collegial working relationship with the FASB. To that end, we expect that, when

¹¹ Section 19(b)(1)(B) of the Securities Act of 1933, as added by section 108 of the Sarbanes-Oxley Act of 2002.

¹² The Commission staff will continue to take such action on a day-to-day basis as may be appropriate to resolve specific accounting and reporting issues under the particular factual circumstances involved in filings and reports of individual registrants.

¹³ For example, the issue may be referred to the FASB's Emerging Issues Task Force (EITF). The EITF is comprised of approximately 13 members who serve, generally without compensation, on a part-time basis. EITF members are partners in large, medium and small accounting firms, business executives, financial analysts and other users of financial statements, and academics. Upon ratification of an EITF consensus by the FASB, the consensus is published as part of the EITF's minutes and may be relied on by Commission registrants and others in the preparation of financial statements that purport to conform to generally accepted accounting principles.

¹⁴ We expect such occasions will be infrequent because the Commission and the FASB share the goal of providing timely guidance to public companies and accounting firms on matters that are significant to investors.