

Evolution of US Generally Accepted Accounting Principles (GAAP)

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- 1932-33 Following the Stock Market Crash of 1929, an American Institute of Accountants' special committee, in correspondence with the New York Stock Exchange, recommends five 'broad principles of accounting which have won fairly general acceptance' and introduces the passage '[the financial statements] fairly present, in accordance with accepted principles of accounting consistently maintained' in the auditor's report. These five 'broad principles,' plus a sixth, are approved by the Institute's membership. The purpose is to improve accounting practice.
- 1934 Congress completes approval of two major Securities Acts to restore public and investor confidence in the fairness of the securities markets after the Stock Market Crash of 1929; and creates the Securities and Exchange Commission with authority to prescribe 'the methods to be followed in the preparation of [financial] reports'. The SEC becomes a strict regulator and insists on comparability, full disclosure and transparency. In 1935, the SEC creates the Office of the Chief Accountant. The SEC insists upon historical cost accounting so that the financial statements do not contain 'misleading disclosures.'
- One of the important units created in the SEC is the Division of Corporation Finance, which is charged with reviewing periodic filings by companies to determine whether they satisfy the SEC's requirements, especially for conformity with proper accounting, full disclosure and comparability.
- 1936 The Institute publishes *Examinations of Financial Statements*, which introduces the term 'generally accepted accounting principles,' known as GAAP.
- 1938 SEC issues its first *Accounting Series Release*, which conveys the Commission's views on accounting and auditing. They become known as *Financial Reporting Releases* in 1982.
- 1938/39 SEC, by a narrow vote, supports a reliance on the private sector to establish GAAP. Under pressure from the SEC's chief accountant, the Institute's Committee on Accounting Procedure begins issuing *Accounting Research Bulletins* to provide the SEC with 'substantial authoritative support' for proper accounting practice. The Committee is composed of

practitioners and three accounting academics, all serving on a part-time basis, with a small research staff. Dissents are to be recorded.

- 1938/39 Congress permits companies to use a new inventory method, LIFO, for income tax purposes only if LIFO is also used in all corporate reports. There is immediate pressure to allow LIFO as an accepted practice for financial reporting purposes.
- 1939 An Institute committee recommends the wording, 'present fairly...in conformity with generally accepted accounting principles' in the standard form of the auditor's report.
- 1940 AAA publishes Professors W.A. Paton and A.C. Littleton's monograph, *An Introduction to Corporate Accounting Standards*, which is an eloquent defense of historical cost accounting. The monograph provides a persuasive rationale for conventional accounting practice, and copies are widely distributed to all members of the Institute. The Paton and Littleton monograph, as it came to be known, popularizes the 'matching principle,' which places primary emphasis on the matching of costs with revenues, with assets and liabilities being dependent on the outcome of this matching.
- 1940s During the decade, the Committee on Accounting Procedure frequently allows the use of alternative accounting methods when there is diversity of accepted practice.
- 1947 Committee issues *ARB 29*, which allows FIFO, LIFO and average; LIFO is accepted primarily because of its acceptability for income tax purposes.
- 1947 Committee issues *ARB 32*, which favors the 'current operating performance' concept of the income statement, thus displaying 'unusual' and 'extraordinary' items after net income; the SEC chief accountant, favoring the 'all-inclusive' income statement, threatens not to enforce the *ARB*.
- 1947/48 Contrary to pressure from some major companies, the Committee opposes use of inflation-adjusted depreciation expense except in supplementary disclosures, a view that the SEC supports. Committee reaffirms this view in 1953. In 1947-49, major companies were trying to persuade Congress to allow replacement cost depreciation for income tax purposes, and they hoped that an *ARB* in support of that position would strengthen their argument. The companies were also trying to resist labor unions' claims for wage increases based on overstated profits during a sharp inflation.

- 1953 Congress amends the Internal Revenue Code to allow companies to use accelerated historical cost depreciation for income tax purposes. Many companies adopt faster depreciation for taxes but continue to use straight line depreciation in their financial statements, making ‘deferred tax accounting’ an important issue.
- 1950s Leonard Spacek, managing partner of Arthur Andersen & Co., begins to criticize the Committee on Accounting Procedure for allowing alternative accounting methods. This reflects a philosophical split among big accounting firms: uniformity versus flexibility.
- 1957 In *ARB 48*, the Committee allows the ‘pooling of interests’ method for business combinations in the presence of certain ‘attendant circumstances.’
- 1958 In *ARB 44 (Revised)*, the Committee favors ‘deferred tax’ accounting when tax depreciation exceeds depreciation for financial reporting purposes, which is a controversial bulletin.
- 1959 Provoked by Spacek’s criticisms, the Institute (now known as the American Institute of Certified Public Accountants, or AICPA) appoints a special committee to review the role of research in establishing accounting principles. The committee proposes an Accounting Principles Board (APB) to succeed the Committee on Accounting Procedure. The APB comes into existence in 1959 as a senior technical committee of the Institute, and by the following year its 21 members include representatives from all of the Big Eight accounting firms, as well as accounting academics, financial executives, and other accounting practitioners. Dissents are again to be recorded. The APB was charged with ‘narrowing the differences in accounting practice,’ which meant ‘stop allowing so many optional treatments.’
- The Institute’s Council insists that all of the Big Eight firms be represented on the APB so that they will feel obliged to be sure that their clients follow its norms.
- The Institute also creates an Accounting Research Division that is to conduct research to support the APB *Opinions*. Eventually, 15 *Accounting Research Studies* are published under the aegis of the APB.
- 1961/62 The APB’s accounting research staff issues *Accounting Research Studies* 1 and 3 on ‘basic accounting postulates’ and ‘broad accounting principles.’ These were intended to constitute the conceptual basis for future APB *Opinions* that would, it was hoped, ‘narrow the areas of difference.’ But the ‘principles’ *Research Study* advocates current value accounting for inventories and fixed assets, which, the APB asserts in a

special *Statement*, is ‘too radically different from present [GAAP] for acceptance at this time.’ Therefore, *Studies* 1 and 3 fail in their mission to serve as the conceptual basis for future APB *Opinions*.

- 1962/63 After Congress enacts an ‘investment tax credit’ in order to stimulate the purchase of equipment and machinery by companies, the APB issues *Opinion* 2 in a close vote (with four Big Eight firms dissenting) to require that the ‘credit’ be subtracted from the asset cost, and not be included in current earnings. Under pressure from accounting firms, industry, and the Kennedy Administration, the SEC announces it will allow either accounting method to be used by companies. This decision by the SEC embarrasses the APB. The APB is similarly ‘defeated’ on accounting for the ‘credit’ on two subsequent occasions, in 1967 and 1971, because of intensive lobbying by industry.
- 1964 In *Opinion* 5, the APB establishes criteria for the capitalization of financing leases by lessees, but few lessees actually capitalize the cost and recognize the corresponding liability for long-term financing leases. The leasing industry opposed a stronger set of criteria.
- 1960s The US securities market began to become even more competitive, and the decade is one of numerous multinational and conglomerate mergers. The financial press begins following accounting controversies more closely, and the SEC Chairman begins criticizing the APB for not ‘narrowing the areas of difference,’ and suggests that, if the APB does not do so, the SEC would do so itself.
- 1966 APB issues *Opinion* 8, which establishes the principle that pension liabilities during the period of employee service be shown in balance sheets, but the application of the *Opinion* does not result in many companies reporting more pension liabilities.
- 1966/73/74/2002 The treatment of ‘unusual’ or ‘extraordinary’ items has always been fraught with difficulty. In *Opinion* 9, on reporting the results of operations, the APB finally endorses the SEC’s preferred ‘all-inclusive’ income statement, although it says that extraordinary items should be separately reported in the income statement. Previously, companies preferred to place extraordinary news that was bad in the earned surplus statement, and extraordinary news that was good in the income statement. Then, under *Opinion* 9, companies began rationalizing good news as ordinary and bad news as extraordinary. In *Opinion* 30, issued in 1973, the APB, to fix this abuse, establishes a ‘Discontinued Operations’ section of the income statement and defines ‘extraordinary’ so narrowly that the classification no longer exists, as a practical matter. Later, in *SFAS* 4, issued in 1974, the FASB designates gains and losses on the premature extinguishment of

debt as 'extraordinary.' Finally, in SFAS 145, issued in 2002, SFAS 4 is rescinded.

- 1967 APB issues highly controversial *Opinion* 11 on 'deferred tax accounting' by the thinnest majority, which 'narrows the areas of difference' on this contentious subject. Industry opposes the pronouncement.
- 1967 APB issues *Statement* 2, which is not mandatory, on segment reporting. Because the issue is so sensitive among companies, owing to the many conglomerate mergers, the APB feels it cannot compel companies to disclose segment revenues and profits. The Financial Executives Institute undertakes a major research study on the subject so as to persuade the SEC not to make any hasty rules on the sensitive subject.
- But in 1969, because of the APB's failure to issue an *Opinion*, the SEC adopts a segment reporting requirement for new issuers, and later extends it to all companies filing annual reports. Finally, in 1976, the FASB issues a standard on the subject.
- 1968 The SEC requires, for the first time, a Management's Discussion and Analysis of Operations (MD&A), which is a narrative discussion of the risks and uncertainties facing a company, including their implications for its future liquidity and solvency. In 1974, 1980 and later, the SEC expands the required disclosures to be contained in the MD&A.
- 1970 The APB issues *Opinions* 16 and 17 on business combinations and intangibles, following intense lobbying by industry and government either for or against 'pooling of interests' accounting and the mandatory amortization of goodwill over a defined useful life. 'Pooling of interests' is continued in specified circumstances, and the APB requires the amortization of intangibles over a very long life, 40 years, so as to minimize the amount of the amortization expense each year.
- 1970 The APB issues *Statement* 4, 'Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises.' This was originally intended to be an *Opinion*, which has a mandatory character, and was to be the successor to the APB's failed conceptual framework, *Accounting Research Studies* 1 and 3. By issuing a *Statement*, which is no more than advisory, the APB betrays the deep division of opinion among its members over the formulation of a conceptual framework.
- 1970/71 Three Big Eight accounting firms are so critical of the intense 'political' lobbying of the APB leading up to *Opinions* 16 and 17 that they announce they have lost confidence in the APB as a source of sound financial reporting. Criticisms such as these leads the Institute to establish the

Wheat Study Group on ‘the establishment of accounting principles’ and the Trueblood Study Group on the ‘objectives of financial statements.’

- 1971 The APB is successfully pressured by industry not to proceed with possible *Opinions* on accounting for marketable securities (opposed by the insurance industry), long-term leases (opposed by the leasing industry), and the costs of exploration and drilling of oil and gas (opposed by the petroleum industry). The leasing industry went to members of Congress to prevent the APB from taking action.
- 1971 This was the third occasion when industry prevents the APB from requiring that the ‘investment tax credit’ be amortized over the useful life of the purchased equipment and machinery instead of taken immediately into earnings. Congress passes legislation authorizing companies to use any method of accounting for the ‘credit’ which they prefer.
- 1971/72 The Wheat Study Group, appointed in 1971 by the Institute, recommends that an independent, full-time standard-setting body, the Financial Accounting Standards Board (FASB), which would be overseen by a Financial Accounting Foundation, should replace the part-time APB. The FASB would have a large research staff, would follow an elaborate due process, and would have a sizable budget financed by donations to the Foundation and the sale of publications. Dissents would be recorded. The Institute approves this recommendation in its entirety in 1972.
- 1972 John C. (Sandy) Burton, an accounting professor, becomes the first SEC Chief Accountant who had not served on the SEC’s accounting staff in the 1930s. He was therefore not imbued with the SEC’s philosophical attachment to historical cost accounting. Indeed, he was exposed to the teaching of Professor Philip W. Bell, who was a leading advocate of current cost accounting. Burton was to become an activist Chief Accountant during his term (1972-76). It was not until 1992 that the SEC next appointed a Chief Accountant from outside the Commission’s staff.
- 1973 After the APB hastily issues *Opinion* 31, which requires lessees to disclose certain rental data for non-capitalized leases, the SEC in *Accounting Series Release* 147 responds by requiring lessees to disclose the present value of financial leases and its impact on the lessee’s earnings. This SEC initiative provides a transition toward the FASB’s *SFAS* 13 three years later, which may have been made somewhat easier to issue because lessees had already been calculating and disclosing the present values of their financial lease commitments in footnotes.
- 1973 The FASB succeeds the APB on July 1, two days after the International Accounting Standards Committee is formed. Together with the establishment in the United Kingdom and Ireland of the Accounting

Standards Steering Committee in 1969/70, the formation of both the FASB and the IASC brings the term 'standard setting' into general use.

- 1973 Within the AICPA, the APB is succeeded by the Accounting Standards Executive Committee (AcSEC), composed entirely of accounting practitioners. Its function is to issue *Statements of Position*, later only after approval by the FASB, providing guidance on industry accounting issues. In 2002, the FASB announces that, after a transition, the work of AcSEC is to be discontinued.
- 1973 In *Accounting Series Release* 150, the SEC announces that it will look to the FASB for leadership in setting accounting standards.
- 1973 The Trueblood Study Group, appointed in 1971 by the AICPA, issues a booklet, *Objectives of Financial Statements*, which advocates a 'decision usefulness' approach to the development of accounting standards. It is commended to the attention of the new FASB.
- 1974/75 FASB unanimously issues *Statement of Financial Accounting Standards* (SFAS) 2, on accounting for research and development costs, and SFAS 5, on accounting for contingencies, which signal the FASB's belief in the primacy of the 'asset and liability view' over the traditional 'revenue and expense view.' Under the 'asset and liability view,' the definitions of assets and liabilities govern the recording of revenues and expenses, not the other way round, as under the 'matching principle.'
- 1974/76/79 The 1970s are a decade of high inflation in the United States. FASB issues an exposure draft that would require companies to report price-level adjusted information in supplementary statements. But in 1976, under the leadership of Chief Accountant Burton, the SEC issues *Accounting Series Release* 190, which requires some 1,300 large, publicly traded companies to disclose the effects of changing replacement costs in a supplementary disclosure. This rebuff from the SEC embarrasses FASB and forces it to issue SFAS 33, in 1979, which requires some 1,500 large companies to disclose the effects of both current cost and constant dollar information in a supplementary format.
- 1975 The SEC's Division of Corporation Finance and Office of the Chief Accountant begin to issue *Staff Accounting Bulletins*, which represent the interpretations and practices followed by the Division and the Chief Accountant in administering the disclosure requirements of the federal securities laws. By 2004, more than 100 SABs have been issued.
- 1975/81 On a vote of 6-1, FASB issues SFAS 8, on accounting for foreign currency translation, which requires that translation gains and losses be reflected in earnings. The standard induces some major companies to minimize their

accounting exposure by hedging and thus risking economic exposure. Industry places pressure on FASB to revise the standard, which is achieved by *SFAS 52* in 1981, under which translation adjustments are excluded from earnings and instead placed in the shareholders' equity section of the balance sheet until the related transactions are consummated.

- 1975 By a vote of 5-2, FASB issues *SFAS 12*, on accounting for marketable securities, which requires that unrealized holding gains and losses on marketable equity securities classified as current be taken into earnings, but that such gains and losses on marketable equity securities classified as noncurrent be included in the shareholders' equity section in the balance sheet. This *SFAS*, which was approved by a 5-2 vote, reveals the board's reluctance to reflect upward revaluations of noncurrent assets in earnings.
- 1975-81 Because of the Arab Oil Boycott and rising crude oil prices, Congress passes the Energy Policy and Conservation Act of 1975, which instructs the SEC to require all oil and gas companies to adopt the same accounting method instead of some using 'successful efforts costing' and others using 'full costing' in their financial statements. In 1977, FASB issued *SFAS 19* by a 4-3 vote, which concludes that only 'successful efforts costing' is appropriate. Then the small oil and gas producers, which had all been using 'full costing,' protested vigorously and enlisted support in Congress and from the Departments of Energy and Justice and the Federal Trade Commission. Finally, in *Accounting Series Release 253*, issued in 1978, the SEC says it favors 'reserve recognition accounting,' a version of current value accounting. Then the major oil and gas producers objected, and finally the SEC settled for a lengthy disclosure in the footnotes. Oil and gas companies continue to be able to use either 'successful efforts costing' or 'full costing' in their financial statements.
- 1976 After considerable pressure from the leasing industry, FASB, on a vote of 5-1, issues *SFAS 13*, which establishes benchmarks for mandating the capitalization of long-term financing leases on lessees' books. The *SFAS* is amended numerous times, as the FASB seeks to close loopholes, but the standard nonetheless proves to be ineffective in requiring that most long-term leases be capitalized.
- 1976/77 Two Congressional reports recommend that the SEC no longer rely on the FASB for accounting standards but instead issue the standards itself.
- 1977 By a 5-2 vote, FASB issues *SFAS 15*, on accounting by debtors and creditors for troubled debt restructurings, which, in effect, allows financial institutions that agree with debtors to modify the terms of their long-term loan agreements (lengthening the term and reducing the interest rate) to avoid recording a loss on the restructuring. This pronouncement was

approved by a vote of 5-2 after the banking industry argued that a requirement to recognize a loss in such circumstances would lead to a reluctance by banks to renegotiate such loans, thus leading to a higher rate of business failure. This *SFAS*, which served as a basis by which government prolonged and deepened the financial crisis faced by banks and savings and loan institutions in the 1980s, was said by many to be the worst standard ever issued by FASB. *SFAS* 15 was an attempt to avoid recognizing the current value of the renegotiated loan on the books of the financial institution.

- 1977 Responding to criticisms from within the accounting profession, the Financial Accounting Foundation's trustees strengthen FASB's due process procedures and impose a 4-3 majority, instead of a super-majority of 5-2, to approve its standards. It was believed that the required 5-2 majority was holding back FASB approval of several standards (notably 19 and 34). One change in the board's due process is to open its meetings to public observation ('in the sunshine').
- 1978-84 FASB issues its *Concepts Statements* on objectives, qualitative characteristics, elements (definitions), and recognition and measurement, constituting its conceptual framework for business enterprises. As the issues became more specific, eventually dealing with the sensitive and practical matters of recognition and measurement, the board could only agree to be general and not prescriptive. This reflected the fact that each of the board members has his own individual conceptual framework, which became evident when the 'hard core' issues of recognition and measurement were taken up. The result of the board's conceptual framework discourages those who had hoped that it would point the board toward a resolution of its most difficult standards issues.
- 1979 FASB issues *SFAS* 34 by a 4-3 vote, requiring that companies capitalize interest cost for certain self-constructed assets. The *SFAS* was issued to correct an abuse. In 1974, at a time of rising inflation and interest rates, a number of companies began capitalizing, rather than expensing, their interest cost, so as to report higher earnings. The SEC immediately placed a moratorium on this practice until FASB could decide whether it was a proper accounting practice. Previously, interest cost capitalization was practiced only by regulated public utility companies providing electricity and gas services.
- 1985/87/90/96 On four occasions, as the flexibility to produce favorable earnings grows in importance to chief executive officers, industry places pressure on the FASB to be more responsive to its objections. Attempts are made to place more industry representatives on FASB and to exercise more control over the FASB's agenda of projects. In 1990, industry succeeds in persuading the Financial Accounting Foundation's trustees to change the majority

required to approve standards from 4-3 to 5-2, hoping to slow down the pace of the board. In 1996, SEC Chairman Arthur Levitt, reacting to pressure from the Financial Executives Institute, forces the Foundation to add four 'public interest' members to its board of trustees.

- 1985 By a 4-3 vote, FASB issues *SFAS 87* on employers' accounting for pension plans after 11 years of study on the large and complicated pensions project: three discussion memoranda, six exposure drafts, four public hearings, and six standards. While constituting an improvement on pension accounting practice, it significantly understates the full accounting impact of company pension plans by a variety of 'smoothing' rules and an extended adoption period. Also, the standard appears at a time of strong stock and bond markets. Industry had successfully lobbied the FASB to dampen the effect of volatility on companies' earnings as a result of market value fluctuations.
- 1987 On a 6-1 vote, FASB issues *SFAS 94*, which requires parent companies to consolidate its subsidiaries with 'non-homogeneous' operations, such as the finance subsidiaries of manufacturing parents. The FASB also endorses the notion of "control" for determining when investee companies should be consolidated, but the board put off implementing the notion. It makes several attempts to implement it in the 1990s but could not agree on an adequate and workable approach for doing so.
- 1987 By a 4-3 vote, FASB issues *SFAS 95*, which requires companies to publish a cash flow statement, replacing the Statement of Changes in Financial Position (funds statement). The *SFAS* implements a recommendation in *Concepts Statement 5*. FASB allows companies to use either the direct or indirect method of presentation.
- 1987/92 By a 5-2 vote, FASB issues *SFAS 96*, which establishes an 'asset and liability' approach for determining deferred tax liabilities but prohibits the recognition of tax benefits expected to be realized in future years. After issue of the *SFAS*, FASB concludes that the standard is unworkable and too complex, and it postpones the effective date of *SFAS 96* three times. Finally, in 1992, FASB unanimously issues *SFAS 109*, which allows deferred tax assets to be recognized in many situations.
- 1990 FASB unanimously issues *SFAS 106*, accounting for post-retirement health care costs. This standard was strongly opposed by industry; companies did not want to show a liability for the contractual commitments they had given over the years to cover employee health care during their retirement years. General Motors recognized a first-time expense and liability of \$20.8 billion, which constituted 77 percent of its shareholders' equity at the end of the previous year. The shareholders' equity balances of Chrysler, Ford Motor, AT&T and IBM were also hit

hard by the newly recognized liability. Many regard *SFAS 106* as the best standard FASB ever issued, as it forced companies to face up to the true cost of their obligations for health care benefits they had granted to employees over many years. It gave rise to the maxim, 'you manage what you measure.'

- 1993 On a 5-2 vote, FASB issues *SFAS 115* on accounting for investments in certain equity and debt securities. Although the SEC argued strongly for fair value accounting, with all gains and losses taken to earnings, the banking industry vociferously opposed this solution because of the resulting volatility in their earnings from year to year. A 'political' compromise was thus forced on the board: 'trading securities' v. 'available for sale securities.' Both would be fair-valued in the balance sheet, but the unrealized gains and losses on 'available for sale securities' would be parked in shareholders' equity, and not taken to earnings.
- 1995 In another application of fair value, FASB issues *SFAS 121*, by a 5-2 vote, (1) required companies to recognize the impaired values of assets, but, at the same time, (2) stopped companies from over-accruing provisions ("big bath") that would artificially ensure future reported profits. *SFAS 121* (which is superseded in 2001 by *SFAS 144*) provides a series of decision rules for such writedowns, including use of the fair value of the impaired assets or, in the absence of a fair value, the present value of their future expected cash flows.
- 1995 By a 5-2 vote, FASB issues *SFAS 123* on accounting for employee stock options. This standard also involves an estimate of fair value, by the use of option pricing models. But an unprecedented 'political' lobbying campaign by small, high technology companies, which secures the active support of key members of Congress, prevents FASB from requiring the recognition of the stock option expense in companies' income statements. Instead, the amount of the expense, but only for options recently granted, is to be disclosed in a footnote to the financial statements. Had FASB persisted in issuing a standard requiring the expense to be shown in the income statement, Congress may have passed legislation putting FASB, in effect, out of business.
- 1997 By a 5-2 vote, FASB issues *SFAS 130* on the reporting of 'comprehensive income,' followed up on *Concepts Statement 3* to require the reporting of 'comprehensive income,' which would include those gains and losses not yet recognized in earnings. It proposes this disclosure either in a separate statement of 'comprehensive income' or in an additional section in the income statement. Industry, however, did not want such gains and losses to be given a high profile, and it successfully lobbies FASB to offer a third alternative: disclosure in the Statement of Changes in Shareholders' Equity, a statement that financial statement readers seldom examine

carefully. The final standard includes all three alternatives, and most companies have opted to ‘hide’ the ‘other comprehensive income’ in the Statement of Changes in Shareholders’ Equity.

- 1997 A practice begins, by Amazon.com and then other high technology companies, of emphasizing ‘pro forma income,’ by which certain negative items, such as goodwill amortization and impairment charges, are placed ‘below the line,’ although they are necessarily included in GAAP earnings. The SEC’s Chief Accountant and others criticize this practice of emphasizing the positive and de-emphasizing the negative in earnings, thus biasing a company’s reporting. The Sarbanes-Oxley Act of 2002 requires that any such ‘pro forma income’ be explicitly reconciled to GAAP earnings in a prominent place.
- 1998 FASB unanimously issues *SFAS 133* on accounting for derivative instruments and hedging activities. Industry fought hard against FASB’s fair value proposals in the standard. Legislative bills were introduced in both the Senate and the House, and committees held hearings, all to persuade FASB to back down. In the end, FASB succeeds in overcoming the opposition and issues a fairly strong standard on an enormously complex subject.
- 2002 On unanimous votes, FASB issues *SFAS 141* on accounting for business combinations and *SFAS 142* on accounting for goodwill and other intangibles. The SEC’s accounting staff, complaining that 40 percent of its time is spent on the business combinations issue, succeeds in persuading FASB to add the subjects to its agenda. For some time, FASB had wanted to ban the ‘pooling of interests’ treatment of business combinations, which had been seriously abused by acquisition-minded companies. In its exposure draft, FASB resolved to disallow ‘pooling of interests’ and to reduce the maximum life for amortizing goodwill and other intangibles to 20 years (from 40 years, set in *APB Opinion 17* in 1970). Industry objected strongly to this combination of proposals, including especially the required amortization of goodwill, and appealed to Congress for support. Congress intervened and forced the FASB to accept an annual impairment test for goodwill instead of amortization. Therefore, *SFAS 141* disallows use of the ‘pooling of interests’ method, and *SFAS 142* imposes a mandatory impairment test for goodwill at least once a year, and disallows amortization. Under *SFAS 142*, other intangible assets may be amortized or be made subject to an annual impairment test.
- 2002/03 The SEC Chairman and others call for a return to ‘principles-based standards’ to overcome the current emphasis in the FASB’s standards on length and detail. The Sarbanes-Oxley Act of 2002 instructs the SEC to study the merit of principles-based accounting standards. Both FASB and the SEC respond positively, but it has been the SEC’s accounting staff that

has, over the years, pressed FASB to issue more and more detailed rules, and there is no sign that the staff is changing its approach. The highly litigious environment in the United States is another reason for the detailed accounting standards.

- 2002/03 The Sarbanes-Oxley Act of 2002 requires that FASB be financed henceforth by fees assessed against publicly traded companies, instead of by donations from the interested parties in the private sector. The purpose of this change is to enhance FASB's independence. The Act also charges the SEC with designating a private-sector standard setter that meets the criteria for establishing accounting principles that are to be regarded as 'generally accepted' for purposes of the securities laws. In April 2003, the SEC announces that it will continue to recognize pronouncements of FASB as being 'generally accepted' for purposes of filings with the Commission.
- 2004 FASB issues an exposure draft to converge with the International Accounting Standards Board's *IFRS 2* on share-based payment. As in 1993/94, the small, high technology industry vigorously opposes a required expensing of employee stock options in the income statement, and it has engaged the strong support of more than 100 members of Congress to support its position against the FASB.