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Why Is the FASB Making Too Many Accounting Rules?

The most prolific rule-making body that affects every publicly held U.S. corporation resides not in Washington but in Stamford, Conn. And it is not a government agency.

Since it was founded in 1973, the Financial Accounting Standards Board (FASB) has issued a third more pages of new accounting rules than its predecessor bodies wrote over 30 years. The accountant's rule book has expanded at an annual average of 13%.

The FASB's rules on one topic alone, accounting for leases, now amount to a 226-

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page book. The original set of rules, issued in 1976, has already been modified seven times and reinterpreted six times and relief is not yet in sight. Each interpretation seems to feed the demand for more.

Then there are the voluminous rules on accounting for inflation. Statement 33, "Financial Reporting and Changing Prices" (60 pages), has been followed by three more statements explaining how the

new rules apply to special assets in the mining, oil and gas, timber and real estate industries. More are expected to come.

As a result of all this rule-making, publicly held corporations are faced with longer and more complicated financial statements and higher accounting and auditing costs. It is harder to compete against other forms of business organizations that need not meet such stringent reporting requirements. In short, while the FASB has been devising ways of accounting for inflation, businessmen and investors have been suffering from the inflation of accounting.

Ironically, the FASB was set up in the first place to protect the private sector from complex rules that might have been written by the Securities and Exchange Commission or other government agencies. The SEC still holds the authority to write accounting rules for publicly held corporations, and through much of the Seventies it threatened to exercise that authority unless the FASB took action on its own—particularly in the areas of inflation accounting, leasing and capitalization of interest. SEC pressures have since subsided, yet the proliferation of FASB rules goes on.

One reason, perhaps, is that the public accountants, who dominate the FASB with three out of seven members drawn from the ranks of ex-partners of CPA firms, are hardly hurt by the increase in demand for their services.

Bureaucratic imperatives could also account for proliferating rules. In the absence of explicit performance criteria such as profit for corporate managers, rule-making bodies have little to show for their efforts except the paper work they publish.

Defenders of the FASB will argue that the growing complexity of accounting merely reflects the growing complexity of business. Burgeoning foreign trade and investment in a world of floating exchange rates generated calls for currency translation rules. More complicated accounting methods may indeed be necessary to control larger and more diverse business organizations.

But just as in many government regulations, it is not easy to determine if the benefits of a proposed accounting rule exceed the associated costs. After years of controversy, it is still unclear what, if any, rules for translating financial statements from foreign currencies will yield a net social benefit.

Several steps would help keep accounting rules in line. The first would be to require unanimity, among the members of the FASB before a new accounting standard can be issued. This requirement, instead of the present decision-making by a simple majority, would limit the issuance of new standards to those that have a good chance of receiving broad support. How can four members of the board be so sure that the capitalization of interest costs, for example, is socially desirable, when they cannot convince three of their own colleagues?

Another step would be to cut the budget and staff of the FASB, say, by 50%. The FASB now has a staff of over 100, while the Accounting Principles Board, its predecessor, had a staff of less than 10.

Finally, given its record, the FASB could take a more modest view of its ability to discriminate good from bad proposals for new and untried accounting methods. In the "market for accounting methods" individual firms choose the accounting methods most advantageous to them and the investors choose the firms who use the accounting methods they prefer. The FASB could place greater reliance on broad acceptance of accounting methods in this market before codifying them into accounting rules.

The above proposals are bound to invite the bogey of the government's entry into the making of accounting rules. However, it is easier for the government agencies to threaten the FASB with their own entry into the arena than to take up the arduous task of writing and administering detailed accounting rules. The Securities and Exchange Commission has recently abandoned a three-year-old, ill-advised effort to require oil and gas firms to report unverifiable data on their reserves, a matter on which the SEC had earlier overruled the FASB. In the future, the FASB can surely afford to be bolder in the face of external pressure and refuse to issue accounting rules that are either too detailed or too costly to implement.

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