

FINANCIAL ACCOUNTING
FOUNDATION

2001 ANNUAL REPORT

*Financial Accounting
Standards Board*

*Governmental Accounting
Standards Board*

HIGH-QUALITY FINANCIAL REPORTING



*Financial Accounting
Foundation*

The Financial Accounting Foundation, organized in 1972, is an independent, private-sector organization whose Trustees are responsible for overseeing, funding and appointing members of the Financial Accounting Standards Board, the Governmental Accounting Standards Board and their Advisory Councils.

*Financial Accounting
Standards Board*

The Financial Accounting Standards Board, which began operations in 1973, establishes standards of financial accounting and reporting for private-sector entities, including businesses and not-for-profit organizations. Those standards are officially regarded as authoritative by the Securities and Exchange Commission and the American Institute of Certified Public Accountants.

*Financial Accounting
Standards Advisory Council*

The Financial Accounting Standards Advisory Council consults with the FASB on technical issues, project priorities, selection of task forces and other matters likely to concern the FASB.

*Governmental Accounting
Standards Board*

The Governmental Accounting Standards Board, organized in 1984, establishes standards of financial accounting and reporting for state and local governmental entities. GASB pronouncements are recognized as authoritative by the American Institute of Certified Public Accountants.

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THE IMPORTANCE OF HIGH-QUALITY FINANCIAL REPORTING

High-quality financial reporting is essential to liquid and efficient capital markets. Investors, creditors and other users of financial statements rely on the availability of transparent, credible and comparable financial information. This applies to a wide range of organizations—from public companies to state and local governments. High-quality financial accounting and reporting standards contribute to the unparalleled success and competitive advantage of the U.S. capital markets.

FINANCIALLY CORRECT

Making the Case for High-Quality Financial Reporting

“Financial reporting ... is the beginning of every decision that we make ... We look at the numbers, try to evaluate the quality of the financial reporting and then figure out what that means for the bonds and stocks we’re looking at ...”

Warren E. Buffett

“High-quality financial reporting is perhaps the most important thing we can expect from companies. For investors to make good decisions ... buying stocks or bonds or making private investments, they need to know the truth.”

Abby Joseph Cohen



Our great economic system depends largely on high-quality financial reporting because it contributes to liquid and efficient capital markets.

Just how important is the subject of high-quality financial reporting to the investing public and the efficiency of capital markets? The FASB thought it was so important that it produced an educational video program to underscore the need for reliable, credible and comparable financial information. The result was a 40-minute production entitled *Financially Correct* that was made available to the public in October 2001.

Views from a Distinguished List of Participants

Ben Stein, author and entertainer, hosts the program and interviews several leaders in the financial reporting and investment worlds. Those sharing their views in the video program are Warren E. Buffett, Chairman and Chief Executive Officer, Berkshire Hathaway Inc.; Abby Joseph Cohen, Chair, Investment Policy Committee, Goldman, Sachs & Co.; Jeffrey E. Garten, Dean,

Yale School of Management and former Undersecretary of Commerce for International Trade; Judy C. Lewent, Executive Vice President and Chief Financial Officer, Merck & Co., Inc.; and Floyd Norris, Chief Financial Correspondent, The New York Times.

Warren Buffett puts the review of financial statements front and center in the investment decision-making process.

“Financial reporting for Berkshire Hathaway, and for me personally, is the beginning of every decision that we make in terms of capital. I’m punching out 10-Ks and 10-Qs every single day. We look at the numbers, try to evaluate the quality of the financial reporting and then figure out what that means for the bonds and stocks that we’re looking at, and thinking of either buying or selling.”

Abby Joseph Cohen commented on why reliable financial information is necessary to good decision-making.

“High-quality financial reporting is perhaps the most important thing we can expect from companies. For investors to make good decisions,

"The integrity of the whole society is undermined if financial information is misrepresented ... Because we live in a market society ... unless the markets can be trusted, then you have widespread corruption ..."

Jeffrey E. Garten

"Higher standards, when properly implemented, drive to excellence ... economists have studied and seen that where regulatory standards are the highest is where innovation is also the highest."

Judy C. Lewent

"We are in a situation now in our society where the temptations to provide 'bad' financial reporting are probably greater than they used to be. The need to get the stock price up, or to keep it up, is intense."

Floyd Norris



whether those investors are buying stocks or bonds or making private investments, they need to know the truth. And we think that when information is as clear as possible and is reported as frequently as makes sense, investors can do their job as best they can."

Other notable observations included *Jeffrey Garten's* thoughts on how a market society depends on trustworthy financial information.

"... The integrity of the whole society is undermined if financial information is misrepresented and isn't accurate or understandable. Because we live in a market society—and increasingly, the world does—unless the markets can be trusted, then you have widespread corruption ... and a market economy that doesn't function."

On the subject of the U.S. regulatory environment in connection with accounting standards, *Judy Lewent* stated that higher standards support not only corporate excellence but product innovation.

"Higher standards, when properly implemented, drive to excellence. I can draw a parallel to the pharmaceutical industry. If you look around

the world at where innovations come from, economists have studied and seen that where regulatory standards are the highest is where innovation is also the highest."

From a reporter's perspective, *Floyd Norris* talked about the temptation for companies to "manage" earnings in an effort to raise stock prices.

"We are in a situation now in our society where the temptations to provide 'bad' financial reporting are probably greater than they used to be. The need to get the stock price up, or to keep it up, is intense. So, the temptation to play games, the temptation to manage earnings—some of which can be legitimate and some of which cannot be—is probably greater than it used to be."

The public relies on clear, honest and complete information to assess the strengths and weaknesses of an organization—whether a corporation or municipality. Having an accurate snapshot of that organization's financials is essential to understanding its risks and rewards and making informed investment decisions.

FINANCIAL ACCOUNTING FOUNDATION

The Financial Accounting Foundation (FAF), organized in 1972, comprises 16 Trustees representing a broad range of professional backgrounds. Trustees share a common understanding of the importance of independent, private-sector accounting standard setting to the efficiency of the U.S. capital markets.

The FAF has responsibilities for the Financial Accounting Standards Board (FASB), the Governmental Accounting Standards Board (GASB) and their Advisory Councils, including oversight of the standard-setting process, selection of members and arrangements for financing.



“While the U.S. accounting system is generally recognized as the best in the world, the Enron collapse that unfolded in 2001 has reminded us all that there is still room for improvement.”



2001

January

February

Report of the FAF Chairman

In 2001, the U.S. economy struggled to recover from its first downturn in ten years and accounting-related issues became of paramount public concern, presenting new challenges to the financial system. But despite well-publicized corporate scandals, the U.S. capital markets have held up relatively well as evidenced by continued financial inflows and the strong dollar.

As overseers of U.S. accounting standard setting, the FAF has an important responsibility to support the national accounting system through the establishment of transparent, credible and comparable information available to investors. It also has a responsibility to make changes, where appropriate, to strengthen that system through its two Standards Boards.

While the U.S. accounting system is generally recognized as the best in the world, the Enron collapse that unfolded in 2001 has reminded us all that there is still room for improvement.

Call for Change We can learn much from the Enron debacle. It has provided an opportunity to evaluate and strengthen our existing national accounting system. Improving that system is a shared responsibility that calls for participation from companies, auditors, regulators, standard setters, investment analysts, academics and business ethicists.

While some reform is needed, any change also requires the participants to maintain high ethical

standards. This responsibility begins with today’s business leaders—chief executive officers, chief financial officers and other members of senior management. Good business ethics, along with a compensation system that rewards ethical behavior, are critical to restoring and reinforcing the public’s confidence in our system. It is our hope that the educational institutions charged with preparing our financial leaders will stress the importance of high ethical standards in business in strengthening America’s critical role in global finance.

As part of accounting preparation, there must be a focus on the importance of following the intent of an accounting standard in order for any system to be effective. If reliable information is not provided, investors pay a huge price and confidence in our capital markets suffers. Although there is a system in place to discipline those who mislead the public by failing to provide the necessary information that fairly and fully presents a company’s financial picture, the FAF is determined to do everything in its power to review and improve the policies and procedures within the FAF’s official mandate. We also will continue to participate, when and where appropriate, in the larger debate on how to strengthen all facets of the American accounting system.



“Because neutrality is so important to establishing high-quality financial accounting standards ...it is best accomplished by an independent, private organization that is insulated from daily political pressures and special interest groups.”

March

April

May



The FAF recognizes the need for the FASB to be more flexible in responding to change as well as to increase the efficiency of its standard setting without compromising the quality of its open due process. Therefore, in March 2002, the Trustees approved a proposal for public comment that includes reducing the FASB’s size from seven to five members, requiring a simple majority of 3-2 for the five-member board and shortening public comment periods. Those proposed changes, if approved, would transition over time and be achieved in an orderly manner while preserving the vital independence of private-sector standard setting. In the future, the FAF will consider other opportunities for change to gain efficiencies.

Independence and Broad-Based Funding

The public demands and deserves transparent financial reporting that provides comparable and reliable information. Because neutrality is so important to establishing high-quality financial accounting standards, we believe, as do many others, that it is best accomplished by an independent, private organization that is insulated from daily political pressures and special interest groups. We also believe that the FASB and GASB—both independent, private-sector organizations—provide the best platforms from which to serve the public interest.

Just as we welcome the views of all constituent groups, we encourage broad-based participation in our fundraising process. We trust that all constituents view this as an opportunity to support an independent standard-setting process—one that affords everyone a voice. Currently, two-thirds of the FASB’s funding comes from the sales of publications and licensing agreements. The balance is from contributions. Conversely, because the GASB has been in existence for a shorter period than the FASB, its funding is derived more from private contributions.

Despite past resistance from special interest groups and some members of Congress, the FASB has made substantial improvements to accounting, including requiring disclosure about retirement benefits and derivatives that provide better, more transparent information to investors.

FASB Completes Business Combinations

Project In looking back at the FASB’s activities in 2001, the Board had a productive year, issuing a total of four standards. Chief among the FASB’s accomplishments was completion of its work on business combinations, with the issuance of two important standards that provide investors with better information about mergers and acquisitions. Through both of those standards, companies are now required to provide more transparent information about the value of the investments made in acquisitions.



“... the FASB had a productive year, issuing a total of four standards. Chief among the FASB’s accomplishments was completion of its work on business combinations...”



June

July

August

International In 2001, the FASB made important progress in supporting convergence of global accounting standards by partnering with the International Accounting Standards Board (IASB) on a second phase of the business combinations project. This is the first project in which both organizations have worked together and it is off to a strong start. The FASB and IASB continue to meet on a regular basis to assist in advancing convergence of international accounting standards.

GASB’s Reporting Model Gains Momentum By year-end 2001, more than 100 governments had early implemented Statement 34, the GASB’s landmark reporting model for state and local governments, with thousands more scheduled to adopt the standard in 2002. Overall, response has been positive on the part of preparers and financial statement users, and we expect this to continue in the future.

The GASB continued its ongoing implementation guidance on Statement 34. As part of that effort, two new standards designed to further enhance the model were issued as well as publication of a second implementation guide.

The next major project on the GASB’s agenda will be addressing how state and local governments

account for other postemployment benefits, with an objective of replacing current “pay-as-you-go” accounting methods with an accrual model.

New Board Appointments Since publishing last year’s annual report, the FAF announced several new appointments to the organization.

In 2001, the FASB welcomed three new Board members: Gary S. Schieneman, Katherine Schipper and John K. Wulff. As mentioned in last year’s report, Katherine and John succeeded Gerhard G. Mueller and Gaylen N. Larson.

Gary, previously Director, Comparative Global Equity Analysis of Merrill Lynch & Co., was named to a two-year term as a member of the FASB, effective July 1, 2001. Through this appointment, Gary is completing the term of Anthony T. Cope, who resigned from the FASB in early 2001 to join the IASB. At Merrill Lynch, Gary was responsible for global accounting, financial reporting and related issues affecting cross-border investments. He brings a wealth of experience in accounting and international investment to the FASB.

The Foundation reappointed Edward J. Mazur to the GASB for a second five-year term that will commence July 1, 2002. Ed is Vice President for Administration and Finance at Virginia State University and a former state and federal controller. He has already made important contributions to the GASB, and we are confident that the



"The next major project on the GASB's agenda will be addressing how state and local governments account for other postemployment benefits..."



September

October

November

Board will continue to benefit from his broad experience.

In January 2002, James M. Williams, a Partner and National Director of Public Sector Accounting and Assurance Services with Ernst & Young LLP, was named to the GASB, effective July 1, 2002. Jim will succeed Edward M. Klasny, a retired Partner of Ernst & Young LLP, whose second and final term ends on June 30, 2002.

At Ernst & Young, Jim is responsible for monitoring and communicating information and guidance on current governmental developments to public-sector specialists throughout the firm and participates in public-sector engagements.

We are most grateful to Ed for his substantial contributions to the GASB and are pleased to announce Jim's appointment to that Board where he will bring important credentials in governmental accounting and leadership skills.

New FASAC Chairman Named In November 2001, the Foundation announced that it had named Richard J. Swift, the former Chairman, President and Chief Executive Officer of Foster Wheeler Ltd., as Chairman of the Financial Accounting Standards Advisory Council (FASAC), which took effect in January 2002. He succeeded Robert C. Butler, who retired in December 2001.

Dick has extensive experience—both as a leader of a major international corporation and as a participant in corporate governance and the

business community. His broad expertise should complement the activities of the FASB.

Dick joined Foster Wheeler in 1972 and rapidly rose through the ranks of that organization to become Chairman, a position he held until his recent retirement. He is a Director of Ingersoll Rand Company and serves as the Chairman of its audit committee.

On behalf of the Foundation, I extend our thanks to Bob Butler who did an outstanding job as FASAC Chairman and helped advance the mission of that organization.

Trustees It is with regret I report that in the spring of 2001, Greta E. Marshall, formerly Principal, The Marshall Group, passed away after having served the FAF since 1997. She was a vital member of the Board and a staunch supporter of accounting standards.

I would like to express my appreciation to the Trustees who completed their service to the FAF in 2001. They are John H. Biggs, Chairman and Chief Executive Officer, TIAA-CREF; Philip N. Duff, Partner, FrontPoint Partners; Nicholas G. Moore, Chairman, PricewaterhouseCoopers, Earle E. Morris, Chairman, Carolina Investors, Inc.; and William U. Parfet, Chairman and Chief Executive Officer, MPI Research. On behalf of the FAF, I extend a special thanks to Bill for his



“Because business structures have become more complex and less transparent and stock ownership has grown more diverse, there has never been a greater need for high-quality financial reporting.”



tireless efforts in fundraising that have been greatly appreciated by the entire organization.

The Foundation recently welcomed six new Trustees, and we are honored to have them join the FAF. They are Samuel A. DiPiazza, Jr., Chief Executive Officer, PricewaterhouseCoopers; William H. Hansell, Executive Director International City/County Management Association; Duncan M. McFarland, President, Chief Executive Officer and Managing Partner, Wellington Management Company; Frank C. Minter, Retired Vice President and Chief Financial Officer, AT&T International; Lee N. Price, President and Chief Executive Officer, Price Performance Measurement Systems, Inc.; and David A. Viniar, Chief Financial Officer, Goldman, Sachs & Co.

Financial Results Comments on the Foundation’s overall financial results are included in the Management’s Discussion and Analysis section of this annual report. We are, of course, concerned that 2001 gave us our fifth consecutive annual operating deficit. In the last two years of that period, investment results did not offset the negative operating returns. For 2001, the operating deficit was \$1,091,000 and investment losses brought the total reported shortfall to \$2,342,000. We are continuing to examine and broaden our fundraising capabilities and the Finance Committee of the Board of Trustees is reviewing revenue-enhancing and cost-savings opportunities for the long-term. On a more positive note, the Foundation’s financial position

remains strong as net assets of \$26,470,000 at the end of 2001 included \$25,090,000 in reserve fund investments.

Concluding Remarks During one of the most challenging years in recent memory, the FAF continued to exercise vigilance over the accounting standard-setting process. While the tragic Enron collapse underscored the importance of both maintaining high-quality accounting standards and accurately reporting financial information, it also was an event that helped focus the public’s attention on accounting and business ethics.

Despite some of the most trying of times, my appreciation and admiration has increased for our outstanding trustees, both Standards Boards and their hard-working staffs.

Because business structures have become more complex and less transparent and stock ownership has grown more diverse, there has never been a greater need for high-quality financial reporting. I remain confident that both Boards will be more committed and prepared than ever before to address the new challenges ahead.

Manuel H. Johnson
Chairman and President
Financial Accounting Foundation

FINANCIAL ACCOUNTING STANDARDS BOARD

Established in 1973, the Financial Accounting Standards Board (FASB) is an independent, private-sector organization whose mission is to establish and improve standards of financial accounting and reporting for both public and private enterprises. Those standards are essential to the efficient functioning of the economy because investors, creditors and other consumers of financial reports rely heavily on transparent, credible and comparable financial information. The FASB's standards are officially recognized as authoritative by the Securities and Exchange Commission and the American Institute of Certified Public Accountants.

Financial Accounting Standards Advisory Council

The Financial Accounting Standards Advisory Council (FASAC) has responsibility for consulting with the FASB on the Board's technical agenda, project priorities, issues likely to require the attention of the FASB, selection and organization of task forces and other matters as may be requested by the FASB or its Chairman. The Council has more than 30 members representing the FASB's diverse constituency.

"If anything positive results from the Enron bankruptcy, it may be that this highly publicized investor and employee tragedy serves as an indelible reminder to all of us...that transparent financial accounting and reporting do matter..."



Edmund L. Jenkins, FASB Chairman

Q&A with FASB Chairman Edmund L. Jenkins

Why is high-quality financial reporting important to the FASB's work?

A. The U.S. capital markets continue to be the deepest, most liquid and most efficient markets in the world. The unparalleled success and competitive advantage of the U.S. capital markets are due largely to the high-quality and continually improving U.S. financial accounting and reporting standards. For more than a quarter century, the FASB has been a proud participant in establishing and improving accounting standards.

The focus of the FASB is on consumers—users of financial information, such as investors, creditors and others. We attempt to ensure that corporate financial reports give consumers an informative picture of an enterprise's financial condition and activities and do not color the image to influence behavior in any particular direction.

The public expects reliable financial reporting information and is much less willing to pay for uncertainty in the marketplace. By providing transparent, credible information, the risk premium is reduced and is much more desirable.

What can we learn from the recent Enron failure?

A. The FASB does not know many of the facts relating to Enron's financial accounting and reporting. Enron has publicly acknowledged in filings with the SEC, and the findings confirmed by the Special Investigative Committee of Enron's board of directors, that Enron did not comply with existing FASB standards in at least two areas. In addition, there may be other possible violations of existing requirements.

Throughout 2001 and into the new year, the FASB remained focused on various projects aimed at providing significant improvement to a variety of existing requirements including, among other items, accounting for special-purpose entities. The FASB has accelerated work on its consolidations project—specifically, the portion that addresses accounting for special-purpose entities, and plans to issue proposed guidance relating to special-purpose entities in the second quarter of 2002.

If anything positive results from the Enron bankruptcy, it may be that this highly publicized investor and employee tragedy serves as an indelible reminder to all of us—including reporting entities, auditors and regulators—that transparent financial accounting and reporting do matter and that the lack of transparency imposes significant costs on all who participate in the U.S. capital markets.



“...we caution Congress that any legislation mandating particular actions or procedures by the FASB can compromise the very independence they seek to enhance.”

What is the FASB’s reaction to recently proposed legislation in Congress that includes provisions concerning the FASB?

A. While we appreciate the legislators’ commitment to supporting and strengthening the FASB’s independence that is part of the proposed measures, we caution Congress that any legislation mandating particular actions or procedures by the FASB can compromise the very independence they seek to enhance.

Despite general support of a fee-based source of funding, to accept government-collected fees as a replacement of the current private-sector contributions to the not-for-profit Financial Accounting Foundation that has historically funded the FASB, such fee-based funding must be free of substantive conditions, be adequate in amount, and not be subject to the type of Congressional or executive branch review that invites interference with the technical decisions and independence of the FASB. The FASB’s standard setting must remain free of any type of Congressional or executive branch of government review that invites interference with its decisions made in an independent, open due process.

We are grateful for the lawmakers’ heightened interest in the functioning of our nation’s accounting system and look forward to working with them to ensure that the FASB can continue to efficiently and effectively fulfill its mission of establishing and improving accounting standards that, when followed, result in strong and healthy capital markets.

How is the FASB supporting convergence of international accounting standards?

A. The FASB has jointly agreed with the other standard setters and the International Accounting Standards Board (IASB) to commitments and protocols that mutually support efforts of cooperation and convergence of accounting standards that should create truly efficient global markets.

Central to the FASB’s participation in the development of international accounting standards is its commitment to increasing global comparability while maintaining the highest quality accounting standards in the U.S. In supporting convergence, the FASB’s goal is to ensure that international accounting standards are of the highest quality. To accomplish that goal, the FASB supports the IASB as the focal point for the development of international accounting standards. The FASB intends to participate as fully as possible in the IASB’s process while maintaining the highest quality standards domestically.

In September 2001, the FASB and the IASB agreed to work together on a second phase of the former’s business combinations project. The focus of this joint project is on procedures for applying the purchase method of accounting.



“Perhaps the best example of the timeliness and effectiveness of the EITF came in the wake of the unprecedented events that occurred in connection with the September 11 terrorist attacks on our nation and its financial core.”

What projects are on your current agenda and why are they important?

A. Two new projects were recently added to the FASB’s agenda: financial performance reporting, which seeks to improve the quality of information displayed in financial statements so that the public is better able to evaluate a company’s performance, and disclosures about intangible assets. The latter project will establish standards for improving disclosure of information about intangible assets, such as brand names and patents, that are not currently reported in financial statements. A third project on revenues and liabilities recognition is expected to be added to the Board’s agenda in April 2002.

In addition, an administrative project on the codification and simplification of U.S. accounting literature was launched in early 2002. This project addresses concerns raised by constituents about the quantity, complexity and lack of easy retrievability of U.S. accounting literature that includes guidance issued by the Emerging Issues Task Force (EITF), the American Institute of Certified Public Accountants (AICPA) and the Securities and Exchange Commission (SEC).

What accomplishments were made by the EITF in 2001?

A. Perhaps the best example of the timeliness and effectiveness of the EITF came in the wake of the unprecedented events that occurred in connection with the September 11 terrorist attacks on

our nation and its financial core. The EITF demonstrated its responsiveness and flexibility by providing Corporate America with the appropriate guidance it needed to comply with financial reporting requirements under the most difficult circumstances imaginable. And it did so with speed by addressing unique issues within a period of little more than one week, just in time for the close of the third quarter of 2001.

In addition, the EITF reached full or partial consensus on multiple revenue recognition issues such as arrangements relating to vendors and resellers and incentives/bonuses. The EITF continues its ongoing work in addressing issues that need immediate attention and that are often industry-specific and call for guidance that extends beyond the scope of existing U.S. accounting standards.

What are the next steps in minimizing the risk of future corporate failures?

A. History is a great teacher and we can always learn from corporate failures. One example of this can be traced to the mid-1990s cases involving Procter & Gamble and Gibson Greetings that



“As with any business failure that is linked to an accounting issue, it presents a standard-setting body with an opportunity to gather additional information and data, to talk with more constituents and to distill new facts...”

relate to derivatives. Lessons learned from those publicized events were added to and incorporated in the body of knowledge that the FASB had already accumulated at that time. Ultimately, the FASB enacted new and improved standards on derivatives that focused management on the risks being taken and that gave financial statement users more information on which to assess those risks.

As with any business failure that is linked to an accounting issue, it presents a standard-setting body with an opportunity to gather additional information and data, to talk with more constituents and to distill new facts that can be incorporated into better, more responsive and comprehensive accounting guidance.

As your term as Chairman nears completion, what do you consider your greatest contributions to the FASB?

A. I have very much enjoyed the opportunity to serve as the FASB Chairman, and I want to thank the Board members and staff for their strong support and dedication.

I believe we have significantly improved financial reporting over the past five years. Our standards on accounting for derivatives and business combinations, in particular, result in providing much improved information to investors.

The FASB’s strong support of moving toward a single set of global financial reporting standards and restructuring the International Accounting Standards Committee into an

independent, private-sector group were uniquely important efforts.

We also have made substantial progress in working with members of Congress and others in government service to gain a better understanding of and support for the importance of high-quality financial reporting and for the FASB’s independent, private-sector process for achieving those standards.

The past five years have been very active ones on all fronts, and we have made advances in many areas, both external and internal. There is no doubt that the coming years will be equally challenging, and I wish my successor, the Board and staff the very best as they work to provide investors with the best possible information for the capital allocation decisions they must make.

“... the Council devoted a significant portion of the agenda... to possible future FASB projects. FASAC discussed the Board’s proposals for projects on reporting financial performance and disclosures about intangibles.”

Richard J. Swift, FASAC Chairman



Financial Accounting Standards Advisory Council

One of the primary functions of the FASAC is to advise the Board on possible new agenda projects. The Board issued four final Statements in 2001, signaling the completion of several major projects or phases of those projects. As a result, the Council devoted a significant portion of the agenda at FASAC meetings to possible future FASB projects. FASAC discussed the Board’s proposals for projects on reporting financial performance and disclosures about intangibles. Subsequently, the Board added both projects to its agenda. Those new projects will require FASAC’s attention and input in 2002.

The Council also discussed a possible project on revenue and liability recognition issues. Council members responding to the 2001 annual survey ranked this topic as one of the highest priorities for the Board to address. In January 2002, the Board issued a proposal for a new agenda project on liability and revenue recognition. Responses to the proposal and discussion at a FASAC meeting will help the Board to decide whether to add this project to the agenda and to define the scope of the project if it is added.

Several years ago, FASAC established the tradition of convening an annual administrative meeting attended by Council members only. The meeting provides the opportunity for members to discuss and evaluate the Council’s effectiveness as an advisor to the FASB and suggest improvements. At the 2001 meeting, Council members suggested that in addition to the Board’s agenda, FASAC also should focus on the FASB’s strategic issues. One strategic issue, the FASB’s activities with the International Accounting Standards Board, already is discussed regularly at FASAC meetings. Other strategic issues raised include the Board’s conceptual framework and standards overload. Each of those topics garnered time on the FASAC agenda during the year.

The Council held two educational sessions on the FASB’s conceptual framework. One session addressed the basics about the conceptual framework: what it is, why it is needed and how the Board uses it. Another session related specifically to liability and revenue recognition issues under the framework.

On standards overload, Council members expressed concerns to the Board about several issues, including an increase in the volume and sources of accounting rules, the complexity and detail of those rules and the inability to retrieve all the rules on a particular subject from a single source. The 2001 annual survey also

solicited comments on the issues related to standards overload. Early in 2002, the Board agreed to undertake several initiatives in response to concerns about the issues.

Despite the time devoted to the Board’s future agenda, the Council did not neglect the Board’s active projects. Other projects discussed in 2001 included asset impairment, asset retirement obligations, various phases of the business combinations project, consolidations and liabilities and equity.

At the end of 2001, Bob Butler retired after nearly five years as FASAC Chairman. The leadership, insight and thoughtfulness that Bob brought to the FASAC meeting table will be very much missed by both the Board and the Council. At the March 2002 meeting, new FASAC Chairman Richard J. Swift welcomed new and returning members to the ranks of FASAC. New members make up one-third of the 33-member Council, and with several new projects on the Board’s agenda, 2002 promises to be a busy year for FASAC.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD

The Governmental Accounting Standards Board (GASB) was organized in 1984 by the Financial Accounting Foundation to establish standards of financial accounting and reporting for state and local governmental entities. Its standards guide the preparation of external financial reports of those entities. The GASB's function is important because external financial reporting can demonstrate financial accountability to the public and is the basis for investment, credit and many legislative and regulatory decisions. The GASB's authority for its standards has been recognized under Rules of Conduct of the American Institute of Certified Public Accountants. Also, legislation in many states requires compliance with GASB standards.

Governmental Accounting Standards Advisory Council

The Governmental Accounting Standards Advisory Council (GASAC) is responsible for consulting with the GASB on the Board's technical agenda and other matters as may be requested by the GASB or its Chairman, including selection and organization of task forces. The Council has 28 members who represent GASB's broad constituency.

Tom L. Allen, GASB Chairman



“The effectiveness of our governmental system is improved by the transparency and credibility of its financial reporting. That credibility extends to taxpayers, government service recipients, investors, creditors and governing boards...”

Q&A with GASB Chairman Tom L. Allen

Why is high-quality financial reporting important to state and local governments?

A. The GASB’s mission statement perhaps says it best: “Accounting and financial reporting standards are essential to the efficient and effective functioning of our democratic system of government.” This statement is a preface to recognizing the role financial reporting plays in a government’s demonstration of its public accountability and provides the means for financial statement users to assess that accountability. The effectiveness of our governmental system is improved by the transparency and credibility of its financial reporting. That credibility extends to taxpayers, government service recipients, investors, creditors and governing boards elected to represent its citizens.

Another key user of government financial statements relates to other governments that provide resources and/or oversight to another level of government, such as states, to the local jurisdictions within their borders, or the federal government that provides resources restricted for specific purposes. High-quality financial reporting is essential in enabling governments to work together to ensure that resources are directed to targeted service recipients.

What were the GASB’s major achievements during 2001?

A. Major achievements in 2001 were built on Statement 34’s new reporting model, designed to improve the financial reporting of governments.

Two new standards enhancing that model were issued as well as a second implementation guide covering all model-related standards. One of those new standards, Statement 38, represented a comprehensive review and improvement of the GASB’s note disclosure requirements.

Early in 2001, a series of user guides were developed to help constituents better understand and use information provided by financial statements prepared in compliance with the new model. By year-end, almost 20,000 of these guides were distributed to a spectrum of financial statement users.

Significant advancements were made on current technical agenda topics, including reporting the cost of health care and other postemployment benefits (OPEB), reporting affiliated organizations and investment risk disclosures.

As we begin 2002, we are in the first year of Statement 34’s implementation. What progress is being made in its adoption?

A. With the controversy surrounding issuance of Statement 34 behind us, discussing the experiences of those who have implemented the



“Early implementers have ranged from some of the smallest municipalities to very large entities such as the City of New York. Though nearly all early implementers have been local governments, Oklahoma and Michigan also have completed the process.”

standard is my favorite topic. Those experiences validate the work the GASB and its constituents did on the reporting model. By March 2002, close to 200 governments have early implemented and most comments have been very positive. Early implementers have ranged from some of the smallest municipalities to very large entities such as the City of New York. Though nearly all early implementers have been local governments, the states of Oklahoma and Michigan also have completed the process.

Local media coverage of the new financial statements benefits has been positive. To quote Oklahoma Governor Frank Keating, “These new standards will give the people of Oklahoma the clearest picture in history of just where the state government stands, and where their tax dollars are spent.”

I also would like to pay tribute to the government finance officials and their auditors for their willingness to early implement the standard and to participate in training efforts to assist the thousands of governments that will be following them. Their experiences also have been valuable to the GASB as they have made us aware of issues that needed to be addressed in implementation guides and subsequent standards.

During recent years, GASB members and staff participated in over 100 training sessions per year to assist governments in their preparation of implementing Statement 34. We also improved our technical inquiry system to enable us to better answer the increasing number of questions that arise in connection with 2002 being the first year of required implementation of Statement 34

for phase-one governments. June 30, 2002, marks the fiscal year-end of many of the larger governments, which are part of that first phase.

What are the major challenges facing the GASB in 2002 and beyond?

A. The challenges fall into three broad categories: providing assistance to governments making the significant changes called for in the new financial reporting model, addressing the challenging issues on our current technical agenda and addressing the broader needs of financial reporting anticipated in GASB Concepts Statement No. 1, *Objectives of Financial Reporting*.

The GASB’s technical inquiry system will be in high demand as more governments undertake the implementation of Statement 34. Our challenge will be to provide timely responses while adequately staffing the projects on our current technical agenda.

Our current focus is on reporting the cost of promised health care and OPEBs. This project was on the agenda of every Board meeting in 2001 as we prepared to issue two Exposure Drafts by June 2002. It also is anticipated that an Exposure Draft expanding disclosure



“The primary reason the GASB... worked so hard to develop a new reporting model for governments was that there was a need to provide an overall assessment of a government’s financial health and to better focus on the actual cost of providing governmental services.”

requirements for deposit and investment risks will be issued in June.

In 2001, an Exposure Draft was issued and two public hearings were held on reporting college and university foundations and other affiliated organizations. The Board anticipates issuing a final standard on this issue in 2002. An Exposure Draft also is anticipated for the asset impairment project, and our environmental liabilities project will be a key focus during the latter part of 2002.

The third challenge is meeting expectations of better governmental accountability reporting articulated in the GASB’s first two Concepts Statements. Some of these expectations cannot be met through more traditional financial reporting, which reflects existing standards. While few have disputed the value of performance-based reporting, many constituents have expressed concerns about the GASB’s possible consideration of these nontraditional and often nonfinancial elements.

What will the GASB’s other postemployment benefits (OPEB) project address?

A. The primary reason the GASB and its constituents worked so hard to develop a new reporting model for governments was that there was a need to provide an overall assessment of a government’s financial health and to better focus on the actual cost of providing governmental services. To accomplish this, the new financial statements call for the reporting of all of the government’s assets/resources and liabilities/commitments. A significant commitment not addressed in prior standards or in the new reporting model is that

some governments provide employees’ health care and other benefits after they leave the employment of the government.

Much progress has been made on this project, which will be accounted for in a manner similar to the defined benefit retirement commitment most governments make to their employees. Differences in these two commitments are being carefully considered by the GASB before releasing Exposure Drafts. The GASB is closely reviewing the impact of a proposed new standard on the thousands of small OPEB plans that are not part of statewide cost-sharing plans and would be required to provide actuarial information.

What is the status of the GASB’s service efforts and accomplishments (SEA) project?

A. The GASB’s SEA project was not on the Board’s technical agenda in 2001 and will not be in 2002. That does not mean SEA, often referred to as performance measurement, is not an important issue, and the GASB continues its staff research efforts thanks to a Sloan Foundation grant. With the help of this funding, the GASB established its information sharing SEA website that continues to receive over 5,000 visits per month.



“Broader awareness of the importance of financial reporting standards and the need for compliance with those standards will strengthen our resolve to efficiently and effectively address issues.”

In 2002, the staff will publish its research results on how performance measurement information is used by governments, how that information is communicated to various constituencies and how they have been able to use it. In addition, the staff—working closely with its advisory task force—will publish a set of suggested methods and criteria for effectively communicating performance measures information. Through experimentation, the staff will evaluate its effectiveness and usefulness in external financial reporting and will present those findings to the Board in 2004 for future agenda consideration. In addition, the GASB is well aware of concerns of some of our constituencies regarding this issue and will have thorough and open discussions before it would consider adding an SEA-related project to its agenda.

How will heightened awareness of financial reporting standards impact the GASB?

A. Broader awareness of the importance of financial reporting standards and the need for compliance with those standards will strengthen our resolve to efficiently and effectively address issues. While the circumstances that resulted in recent accounting concerns do not directly involve the GASB, past events resulting in similar increased awareness have related to governmental entities.

Recent examples include the GASB’s work in addressing the reporting of affiliated organizations, such as college and university fundraising

foundations, which often are not reported in the financial statements of the college or university. This work will result in the issuance of a final standard in 2002. In January 2002, we met with our liaison AICPA committee and with GASAC, our advisory council, and sought their input in identifying any commitments for which governments may be liable that are not reflected in financial statements. If issues are identified, they will receive accelerated consideration by the GASB.

“Key among the Council’s accomplishments was implementation of a more streamlined and efficient approach to enhancing the 28-member group’s advisory assistance to the GASB.”

Harvey C. Eckert, GASAC Chairman



Governmental Accounting Standards Advisory Council

During 2001, the GASAC continued its role as an active participant in and supporter of GASB-related matters. Key among the Council’s accomplishments was implementation of a more streamlined and efficient approach to enhancing the 28-member group’s advisory assistance to the GASB. Among changes adopted in 2001 was creation of leaner and more issue-centered task force and committee groups. The new approach allows for greater utilization of time, talent and resources.

Led by GASAC Chairman Harvey C. Eckert, the Council moved to holding one-and-a-half-day meetings three times a year. During the first half-day session, core committees, comprising the Agenda and Communications and Public Relations groups, identified key issues, developed planning strategies on how to address those issues and received input from the full Council. The new procedure has received positive feedback and has increased Council member interaction.

The GASAC meets annually in conjunction with a national conference of one of its sponsoring or related organizations.

One of the most important events of 2001 was the GASAC’s participation in the annual conference of the International City/County Management Association (ICMA), held in Salt Lake City. The conference provided GASAC members an opportunity to meet with some 3,000 attendees from across the nation. In connection with that conference, GASB Chairman Tom Allen and GASAC Chairman Harvey Eckert made presentations on the GASB to the ICMA’s Executive Committee and at a general session and received enthusiastic response.

The GASAC was pleased to welcome new members in January 2002. One of the year’s highlights will be participation in the joint meeting with the Association of School Business Officials International in Phoenix in October 2002.

At its initial 2001 meeting, the Council engaged in exercises to fulfill the Objectives and Principal Duties. Each committee and all GASAC members had an opportunity to discuss agenda items and other concerns of their constituent organizations.

An important aspect of the GASAC’s work in 2001 and early 2002 centered on its contributions to providing advice on the GASB’s technical agenda. Council members shared constituent organizations’ views on existing and potential agenda items and participated in a prioritization-ranking exercise. Among the areas of greatest interest to GASAC members were the current agenda topics of other

postemployment benefits (OPEB), investment risk disclosures, asset impairment, the GASB’s conceptual framework, communications methods and environmental liabilities. Topics of high interest not currently on the GASB’s active technical agenda included financial instruments, updated implementation guides and fiduciary responsibilities. During 2001, the Council also discussed and continued to support research on service efforts and accomplishments. GASAC members, however, ranked service efforts and accomplishments as a very low standard-setting priority.

To help educate constituent organizations about the GASB’s next major project, OPEB, the Council produced and distributed a plain language article on this subject. The GASAC will continue its communications efforts on OPEB in 2002.

The GASAC’s commitment to supporting the GASB’s work is greatly appreciated by the Board and the FAF. Through the GASAC’s thoughtful counsel, improvements to governmental accounting are being advanced to better serve the public interest.

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Financial Accounting Standards Advisory Council

About FASB Members

Members of the Financial Accounting Standards Board serve full time and are required to sever all ties with the institutions they served previously. *Mr. Jenkins* was the Managing Partner of the Professional Standards Group of Arthur Andersen, LLP's worldwide practice; *Mr. Crooch* was a Partner and Director of the International Professional Standards Group at Arthur Andersen, LLP; *Mr. Foster* was the Vice President and Treasurer of Compaq Computer Corporation; *Mr. Schieneman* was the Director, Comparative Global Equity Analysis of Merrill Lynch & Co.; *Ms. Schipper* was the L. Palmer Fox Professor of Business Administration at Duke University's School of Business; *Mr. Trott* was Head of the Accounting Group of KPMG's Department of Professional Practice; and *Mr. Wulff* was the Chief Financial Officer of Union Carbide Corporation.

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About GASB Members

Mr. Allen serves the GASB full time. All other members serve part time. Prior to joining the GASB, *Mr. Allen* was the State Auditor of Utah; *Ms. Green* was the Vice President for state studies of New York's Citizens Budget Commission; *Mr. Holder* is the Ernst & Young Professor of Accounting at the University of Southern California; *Mr. Klasny* is a retired Partner of Ernst & Young LLP; *Mr. Mazur* is the Vice President for administration and finance of Virginia State University; *Mr. Reilly* is the retired Finance Director and Comptroller of Madison, Wisconsin; and *Mr. Tracy* is the Director of Audits for the City of Portland, Oregon.

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2001 DOCUMENTS

Financial Accounting Standards Board

Statement No. 141, *Business Combinations*

Statement No. 142, *Goodwill and Other Intangible Assets*

Statement No. 143, *Accounting for Asset Retirement Obligations*

Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*

Exposure Draft, *Accounting in Interim and Annual Financial Statements for Certain Costs and Activities Related to Property, Plant, and Equipment*

Exposure Draft, *Rescission of FASB Statements No. 4, 44, and 64 and Technical Corrections*

Technical Bulletin No. 01-1, *Effective Date for Certain Financial Institutions of Certain Provisions of Statement 140 Related to the Isolation of Transferred Financial Assets*

Special Report, *Business and Financial Reporting, Challenges from the New Economy*

Governmental Accounting Standards Board

Statement No. 37, *Basic Financial Statements— and Management's Discussion and Analysis— for State and Local Governments: Omnibus*

Statement No. 38, *Certain Financial Statement Note Disclosures*

Exposure Draft (Revised), *The Financial Reporting Entity—Affiliated Organizations*

Implementation Guide, *Guide to Implementation of Statement 34 and Related Pronouncements*

Presentation

The Foundation's financial statements are presented in accordance with FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*. The Statements of Activities segregate program expenses of the Standards Boards from support expenses of the Foundation. Program expenses include salaries, benefits and other operating expenses for the Board members and research staffs, and expenses for the publications, distribution, production, marketing and library departments of the Foundation. Support expenses include costs for the public relations, finance, human resources, office management, computer systems, fund raising and general administration areas of the Foundation. This presentation is consistent with the single program concept of the Foundation, which is to establish and improve standards of financial accounting and reporting for private sector and state and local governmental entities.

Overall Financial Results

The year 2001 resulted in the Foundation's fifth consecutive annual operating deficit and investment returns in each of the last two years were not sufficient to offset the deficits.

For 2001, the Foundation reported a decrease in unrestricted net assets of \$2,342,000. This decrease reflects the operating deficit for the year of \$1,091,000, and net investment losses of \$1,251,000. Impacted by poor financial market results, reserve fund investment losses totaled \$1,375,000 in 2001, compared to

Contributions

Contributions for 2001 and 2000 are shown in the table below

	FASB		GASB		Total	
	2001	2000	2001	2000	2001	2000
<i>(dollars in thousands)</i>						
Gross contributions	\$ 6,624	\$ 6,314	\$ 2,285	\$ 2,296	\$ 8,909	\$ 8,610
Sales value of subscriptions provided to contributors	(1,511)	(1,511)	-	-	(1,511)	(1,511)
Net contributions	\$ 5,113	\$ 4,803	\$ 2,285	\$ 2,296	\$ 7,398	\$ 7,099

Under a new fund-raising program initiated in 2000, and continuing throughout 2001, the Trustees participated in the solicitation of certain contributions for the benefit of the Foundation, rather than for specific support of either Board. This granted the Trustees discretion in allocating certain contributions.

Gross contributions to FASB increased \$310,000 in 2001 to \$6,624,000. Contributions associated with the financial reporting video were \$347,000 greater in 2001. All of the amounts recognized as contribution revenues for this project have also been included in other operating program expenses. Industry and bank contributions decreased \$17,000 to \$2,014,000. Support from the

\$228,000 for 2000. Investment income from cash equivalents and short-term investments totaled \$124,000 in 2001, lower than 2000's income of \$242,000. Total net operating revenues increased 5.0% for the year, while total expenses grew 5.6%.

Salaries and benefits continue to comprise a substantial portion of total expenses, over 75% for each of the last two years. Total salaries increased by \$469,000, or 3.3%, in 2001, reflecting merit increases for employees and temporary Board member vacancies for the FASB which have been filled. Employee benefit costs increased by \$542,000, or 25.1%, due mainly to actuarially determined pension income being \$394,000 lower in 2001 under one of the Foundation's defined benefit pension plans. Similarly, actuarial expense for the Foundation's postretirement health care plan was much higher in 2001.

Total occupancy and equipment expenses in 2001 were \$35,000, or 2.0%, higher than 2000. Depreciation and amortization expenses decreased \$28,000, or 5.6%, in 2001.

Other operating expenses increased \$216,000, or 6.8%, in 2001. The principal reason for the increase is non-recurring costs related to the FASB video project on high-quality financial reporting. The majority of the video expenses are offset by designated grants included in the FASB's net contributions for 2001. Operating costs in several other areas were lower in 2001 than they were in 2000.

A more detailed discussion of the Foundation's sources of revenues follows.

public accounting profession decreased slightly for the second consecutive year, from \$3,608,000 in 2000 to \$3,544,000 in 2001. Contributions from investment firms and other supporters increased by approximately \$61,000 and the value of contributed services was \$18,000 lower for FASB in 2001.

Total contributions to GASB decreased \$11,000 during 2001 to \$2,285,000. The Alfred P. Sloan Foundation gave \$227,000 in late 2000 as their first installment under a new three-year conditional commitment to provide \$682,000 in support of the GASB's project on reporting performance measures. Having met the criteria for this program, a total of \$141,000 of Sloan funds were recog-

nized as contribution revenues during 2001. The public accounting profession contributed \$570,000 during 2001, a \$25,000 decrease from the 2000 level. Similarly, state government support declined \$62,000 in 2001 to \$938,000. Securities, insurance and investor organizations and other supporters contributed \$199,000 in 2001, a decrease of \$22,000 from 2000. The Government Finance Officers Association contribution increased \$93,000 to \$157,000, reflecting an adjustment related to previous periods applied by this supporter in 2000. In addition to the above, the new fund-raising program launched in 2000 resulted in \$271,000 of Foundation contributions being allocated to GASB for 2001, which compares to \$268,000 for 2000.

Subscription and Publication Sales

Total net subscription and publication sales were \$14,739,000 in 2001, \$761,000, or 5.4%, higher than 2000's amount of \$13,978,000. Total subscription and publication sales increased \$556,000 or 3.5% in 2001, while direct costs of publications decreased \$205,000, or 9.9%. A portion of the subscription and publication sales for both the FASB and GASB is dependent upon the results of activities of the Boards' respective technical agendas.

FASB subscription and publication sales increased \$805,000 in 2001. Revenues earned from electronic licensing and royalty arrangements increased by approximately \$796,000, reflecting increases in the number of users under existing agreements. Sales of Statements, Interpretations and Technical Bulletins decreased by approximately \$50,000. Sales of Exposure Drafts and Discussion Memorandums decreased by approximately \$121,000, due to fewer documents and a shift by the Board toward making certain drafts available free of charge through the FASB website. In addition, sales of *Original Pronouncements*, *Current Text* and other annual bound volumes decreased by approximately \$34,000. Sales derived from FASB's basic, comprehensive and loose-leaf subscription services declined by approximately \$64,000, or 1.0%, in 2001. Sales of research and special reports, along with revenues garnered from seminars, public records and other miscellaneous sources, were approximately \$278,000 higher in 2001 due to larger payments under publications agreements with major public accounting firms.

The direct costs of \$1,586,000 to produce and distribute FASB publications were \$117,000 lower in 2001 due to lower expenses associated with loose-leaf subscription products.

GASB subscription and publication sales decreased \$249,000, or 12.2%, in 2001. Sales of Statements, Special Reports and other final documents decreased by about \$109,000. These document sales relate mainly to publications associated with the standards on the new reporting model for governmental entities that was intro-

duced in 1999. GASB revenues in 2001 were further affected by a delay in the publishing of the second of two versions of the *Codification* and *Original Pronouncements* annual editions, which impacted the timing of shipments and contributed to \$222,000 of fewer sales for these products vs. 2000 amounts. These annual editions were issued in two versions due to the incorporation of Statement No. 34 on the new reporting model and the multiple implementation dates of that standard. Revenues from electronic licensing and royalty agreements increased by approximately \$51,000. Revenues earned from miscellaneous sources were approximately \$40,000 greater for GASB in 2001.

Direct costs of \$282,000 to produce and distribute GASB publications decreased \$88,000 from 2000, resulting primarily from higher 2000 printing and distribution costs for documents associated with the standards on the reporting model.

Investment Income and Losses

Cash Equivalents and Short-Term Investments

Investment income from cash equivalents and short-term investments decreased \$118,000 in 2001, due to a significant decrease in the interest rate yields available for these funds and sharply lower cash balances available for investment.

Reserve Fund Investments

The reserve fund was established at the end of 1981 to provide for the continuation of operations in the event of unforeseen contingencies or a prolonged business downturn. The fund is also intended to finance major capital expenditures. Reserve fund assets are unrestricted but require Board of Trustee approval for use in continuing operations. In order to meet working capital requirements, \$800,000 was transferred from the reserve fund to operating cash during the second quarter of 2001.

Reserve fund investments are maintained within the guidelines of the investment policy established by the Foundation's Finance Committee. At December 31, 2001, approximately 70 percent of the fund's market value was invested in an equity index fund, with the balance invested in a fixed income index fund. The transfer to operating cash of \$800,000, together with investment losses of \$1,375,000 for 2001 (including investment management fees of \$58,000), reduced the reserve fund balance to \$25,090,000 at December 31, 2001.

STATEMENTS OF ACTIVITIES

Financial Accounting Foundation

<i>Years Ended December 31 (dollars in thousands)</i>	2001	2000
Operating revenues:		
Net contributions:		
FASB	\$ 5,113	\$ 4,803
GASB	2,285	2,296
	7,398	7,099
Subscription and publication sales:		
FASB	14,818	14,013
GASB	1,789	2,038
	16,607	16,051
Less – Direct costs of sales:		
FASB	1,586	1,703
GASB	282	370
	1,868	2,073
Net subscription and publication sales	14,739	13,978
Net operating revenues	22,137	21,077
Program expenses:		
Salaries and wages:		
FASB	9,296	9,225
GASB	2,371	2,222
Administrative	1,471	1,337
	13,138	12,784
Employee benefits (Note 3)	2,260	1,750
Occupancy and equipment expenses (Note 5)	1,031	1,018
Other operating expenses	1,916	1,642
Total program expenses	18,345	17,194
Support expenses:		
Salaries and wages	1,724	1,609
Employee benefits (Note 3)	438	406
Occupancy and equipment expenses (Note 5)	784	762
Depreciation and amortization	475	503
Other operating expenses	1,462	1,520
Total support expenses	4,883	4,800
Total expenses	23,228	21,994
Operating revenues less than expenses	(1,091)	(917)
Short-term investment income (Note 2)	124	242
Reserve fund investment losses (Note 2)	(1,375)	(228)
Decrease in unrestricted net assets	(2,342)	(903)
Net assets at beginning of year	28,812	29,715
Net assets at end of year	\$26,470	\$28,812

See notes to financial statements.

STATEMENTS OF FINANCIAL POSITION

Financial Accounting Foundation

As of December 31 (dollars in thousands)

	2001	2000
Current Assets:		
Cash and cash equivalents	\$ 1,363	\$ 1,624
Short-term investments (Note 2)	2,003	2,713
Contributions receivable	1,371	1,895
Subscription, publication and other receivables, net of allowance for doubtful accounts of \$73,000 and \$65,000	2,590	1,194
Inventories	181	220
Prepaid expenses and other current assets	103	131
Total current assets	7,611	7,777
Noncurrent Assets:		
Prepaid pension costs (Note 3)	1,590	1,250
Furniture, equipment and leasehold improvements, at cost net of accumulated depreciation and amortization (Note 4)	864	1,029
Reserve fund investments (Note 2)	25,090	27,267
Total noncurrent assets	27,544	29,546
Total Assets	\$35,155	\$37,323
Current Liabilities:		
Accounts payable and other current liabilities	\$ 858	\$ 630
Accrued payroll and related benefits	548	457
Unearned publication and other deferred revenues	4,148	4,246
Total current liabilities	5,554	5,333
Noncurrent Liabilities:		
Accrued postretirement health care costs (Note 3)	1,655	1,570
Accrued rent expense (Note 5)	1,476	1,608
Total noncurrent liabilities	3,131	3,178
Total Liabilities	8,685	8,511
Net Assets – Unrestricted	\$26,470	\$28,812

See notes to financial statements.

STATEMENTS OF CASH FLOWS

Financial Accounting Foundation

Years Ended December 31 (dollars in thousands)

	2001	2000
Cash flows from operating activities:		
Cash received from contributors	\$ 9,293	\$ 7,646
Cash received from publication sales	13,602	15,361
Interest and dividend income received	838	1,164
Cash paid to suppliers and employees	(24,538)	(23,944)
Net cash (used in) provided by operating activities	(805)	227
Cash flows from investing activities:		
Proceeds from sales or maturities of reserve fund investments	\$ 4,963	\$ 11,061
Purchases of reserve fund investments	(4,819)	(11,929)
Proceeds from maturities of short-term investments	2,550	2,800
Purchases of short-term investments	(1,840)	(2,171)
Purchases of furniture, equipment and leasehold improvements	(310)	(186)
Net cash provided by (used in) investing activities	544	(425)
Net decrease in cash and cash equivalents	(261)	(198)
Cash and cash equivalents at beginning of period	1,624	1,822
Cash and cash equivalents at end of period	\$ 1,363	\$1,624
Reconciliation of change in net assets to net cash (used in) provided by operating activities:		
Decrease in unrestricted net assets	\$(2,342)	\$ (903)
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Depreciation and amortization	475	503
Unrealized losses on reserve fund investments	1,867	1,229
Losses (gains) on sales of reserve fund investments	166	(139)
Provision for losses on accounts receivable	8	22
Increase in contribution, subscription, publication and other receivables	(880)	(527)
Decrease (increase) in inventories	39	(2)
Increase in prepaid expenses and pension costs	(312)	(513)
Increase in accounts payable, accrued expenses and postretirement benefits	404	110
(Decrease) increase in unearned publication and other deferred revenues	(98)	519
Decrease in accrued rent expense	(132)	(72)
Total adjustments	1,537	1,130
Net cash (used in) provided by operating activities	\$ (805)	\$ 227

See notes to financial statements.

1 Nature of Activities and Summary of Significant Accounting Policies

Nature of Activities

The Financial Accounting Foundation, organized in 1972, is an independent, private-sector organization. The Foundation's Board of Trustees is responsible for overseeing, funding and appointing members of the following Boards and Councils:

- The Financial Accounting Standards Board, which establishes standards of financial accounting and reporting for private-sector entities, and the Financial Accounting Standards Advisory Council.
- The Governmental Accounting Standards Board, which establishes standards of financial accounting and reporting for state and local governmental entities, and the Governmental Accounting Standards Advisory Council.

The Foundation is incorporated under Delaware General Corporation Law to operate exclusively for charitable, educational, scientific and literary purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code. The Foundation obtains its funding from contributions and publication sales.

Accounting Policies

A summary of the Foundation's significant accounting policies follows.

Presentation

The financial statements have been prepared pursuant to accounting principles generally accepted in the United States of America and are presented pursuant to FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*. The statements of activities are based on the concept that standard setting is the sole program of the Foundation. The statements set forth separately, where appropriate, revenues and certain program expenses of the Standards Boards, giving recognition to their distinct responsibilities as described in the Foundation's Certificate of Incorporation and By-Laws. Program expenses include salaries, benefits and other operating expenses for the Board members and research staffs, as well as expenses for the publications, distribution, production, marketing and library departments of the Foundation. Foundation services for public relations, finance, human resources, office management, computer systems, fund-raising and general administration are reflected as support expenses in the accompanying statements of activities. Fund-raising expenses totaled approximately \$218,000 in 2001 and \$283,000 in 2000.

The preparation of financial statements requires management to make estimates and assumptions that may affect the reported amounts of 1) assets and liabilities at the date of such statements and 2) revenues and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

Contributions

The Foundation reports all contributions as an increase in unrestricted net assets, as certain donor-imposed restrictions on contributions received in 2001 and 2000 were met by December 31, 2001. Gross contributions to the FASB are reduced by the sales value of complimentary subscriptions provided to certain contributors, which are reclassified as subscription and publication sales.

A large number of people have contributed significant amounts of time to the activities of the Foundation, the Standards Boards and the Advisory Councils without compensation. These individuals include certain members of the Foundation's Board of Trustees and members of the following groups: FASAC and GASAC, the FASB's Emerging Issues Task Force and various other FASB and GASB task forces on technical projects. Many others contribute to the Standards Boards' processes by sending comment letters, appearing at public hearings and participating in field tests. Members of the Board of Trustees are eligible for compensation, with the option of waiving their right to be compensated. The financial statements reflect the value of contributed services, principally waived Trustee compensation, that meet the recognition criteria of FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*. The value of contributed services recognized in the statements of activities was \$140,000 and \$158,000 in 2001 and 2000, respectively.

In December 1997, the GASB received a conditional commitment to contribute approximately \$360,000 over a three-year period, beginning in March 1998, to fund research activities leading to the consideration of a technical project on performance measures of state and local governments. In the fourth quarter of 2000, GASB received a second conditional commitment to contribute \$682,000 over a three-year period, beginning in January 2001, for the same project. Conditional promises to contribute are recognized as revenues when the conditions on which they depend are substantially met. Accordingly, contributions for 2001 and 2000 include \$141,000 and \$136,000, respectively, relating to these conditional commitments.

Contributions for FASB for 2001 and 2000 include \$353,000 and \$6,000, respectively, relating to funds received to develop a video program on the subject of high-quality financial reporting.

Subscription Plans, Loose-Leaf Services and License Agreements

Revenues from these sources are deferred and recognized over the life of the applicable subscription, loose-leaf service or license period. Ongoing costs of fulfillment and production of updates are charged to expense as incurred.

Cash and Cash Equivalents

For financial statement purposes, the Foundation considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. The carrying value of these investments approximates fair value due to the relatively short period to maturity.

Investments

The Foundation's investments are reported at fair value, with values determined using net asset amounts as reported by the custodian. See Note 2 for further information regarding investments.

Inventories

Some publications, and certain other items for resale, are included in inventories and carried at the lower of cost or market, with cost determined by the first-in, first-out method.

Furniture, Equipment and Leasehold Improvements

Furniture, equipment and leasehold improvements are stated at cost, less accumulated depreciation and amortization computed under the straight-line method. Furniture and equipment are depreciated over their estimated useful lives. Leasehold improvements are amortized over the shorter of their estimated useful lives or the remaining term of the office lease.

2 Investments and Investment Income (Losses)

Investments are as follows:

<i>At December 31</i>	2001	2000
Short-term:		
Investment company mutual funds	\$ 2,003,000	\$ 2,713,000
Reserve fund:		
Common trust funds:		
Equity index fund	\$17,433,000	\$18,224,000
Fixed income index fund	7,555,000	8,928,000
Money market fund and other securities	102,000	115,000
	\$25,090,000	\$27,267,000

Investment income (losses) consist of the following:

<i>Year ended December 31</i>	2001	2000
Short-term:		
Interest, including return on cash equivalents	\$ 118,000	\$ 234,000
Net unrealized gains	6,000	8,000
Total short-term	\$ 124,000	\$ 242,000
Reserve fund:		
Interest and dividends	\$ 715,000	\$ 923,000
Net realized and unrealized losses	(2,032,000)	(1,090,000)
	(1,317,000)	(167,000)
Less: advisory fees	(58,000)	(61,000)
Total reserve fund	\$(1,375,000)	\$ (228,000)

Reserve fund assets are maintained within the investment policy established by the Foundation's Finance Committee and are unrestricted, but require Board of Trustee approval for use in operations. During 2001, \$800,000 was transferred from the reserve fund to operating cash to meet working capital requirements.

3 Employee Benefits

Employee benefits expense consists principally of payroll taxes, health care benefits for active and retired employees, and pension costs. The following amounts were charged (credited) to operations pursuant to the Foundation's pension plans and postretirement health care plan for the periods presented:

<i>Year ended December 31</i>	2001	2000
Defined contribution pension expense	\$1,022,000	\$1,024,000
Defined benefit pension income	(163,000)	(560,000)
Postretirement health care expense	208,000	161,000
	\$1,067,000	\$ 625,000

NOTES TO FINANCIAL STATEMENTS CONTINUED

The principal actuarial assumptions used for 2001 and 2000 to determine costs and benefit obligations for the defined benefit pension plans and the postretirement health care plan are as follows (not all assumptions are applicable to all plans):

<i>At December 31</i>	2001	2000
Discount rate	7.0%	7.25%
Rate of increase in compensation levels	5.0%	5.0%
Long-term rate of return on assets	9.0%	9.0%
Health care cost trend rate	8.0%	8.5%

The health care cost trend rate declines gradually to an ultimate level of 5.0 percent after 2006.

Pension Plans

The Foundation sponsors defined contribution and defined benefit pension plans for its employees. Employer contributions under the defined contribution plan are based on employees' current earnings. The defined benefit plans are designed to supplement the pension benefit provided by the defined contribution plan only if the employee's targeted pension benefit is deemed not to have been met. The targeted pension benefit is an amount equal to 2% of an employee's highest five-year average salary, multiplied by the years of credited service, up to 20 years. Employees do not contribute to the plans and pension benefits under the plans vest after five years of service.

The components of net periodic pension income for the defined benefit plans in 2001 and 2000 were as follows:

<i>Year ended December 31</i>	2001	2000
Service cost	\$ 64,000	\$ 34,000
Interest cost	504,000	416,000
Expected return on plan assets	(742,000)	(784,000)
Amortization of prior period net losses (gains)	3,000	(234,000)
Amortization of prior service cost	8,000	8,000
Defined benefit pension income	\$(163,000)	\$(560,000)

The change in plan assets and benefit obligations, funded status and reconciliation to amounts reported in the statements of financial position are as follows:

<i>Year ended December 31</i>	2001	2000
Change in plan assets		
Fair value of plan assets, beginning of year	\$8,384,000	\$8,829,000
Actual return on plan assets	(606,000)	(227,000)
Benefits paid	(269,000)	(218,000)
Fair value of plan assets, end of year	7,509,000	8,384,000
Change in benefit obligation		
Projected benefit obligation, beginning of year	7,079,000	5,665,000
Service cost	64,000	34,000
Interest cost	504,000	416,000
Actuarial losses, net	717,000	1,182,000
Benefits paid	(445,000)	(218,000)
Projected benefit obligation, end of year	7,919,000	7,079,000
Funded status of plans	(410,000)	1,305,000
Unrecognized net losses (gains)	1,805,000	(12,000)
Unrecognized prior service cost (credit)	195,000	(43,000)
Prepaid pension cost	\$1,590,000	\$1,250,000

The projected benefit obligation and accumulated benefit obligation for one of the plans above, which is unfunded, was \$328,000 and \$186,000, respectively, as of December 31, 2001, and \$642,000 and \$245,000, respectively, as of December 31, 2000. Benefits paid under the unfunded plan aggregated \$176,000 in 2001. No benefits were paid under the unfunded plan during 2000.

Gains and losses subsequent to December 31, 1984, after the adoption of FASB Statement No. 87, that result from changes in actuarial assumptions and because actual experience differs from that assumed are amortized over a ten-year period. Prior service cost from plan amendments is being recognized over the employees' remaining service periods.

Health Care Plan

The Foundation sponsors a postretirement health care plan for all employees. Employees retiring after reaching age 55 with at least 10 years of service receive a one-time opportunity to elect continued coverage under the health care plan then in effect for active employees. The cost of continued coverage is then shared between

the Foundation and the retiree, with the Foundation paying the amount up to its cost for the employee's coverage immediately prior to retirement. Premium increases for any reason beyond that point are borne by the retiree. Decreases in premiums for any reason, including Medicare integration at age 65, would reduce retiree cost first, then the Foundation's cost.

The components of net periodic postretirement health care expense for 2001 and 2000 are as follows:

<i>Year ended December 31</i>	2001	2000
Service cost	\$ 62,000	\$ 55,000
Interest cost	135,000	118,000
Amortization of losses	45,000	22,000
Amortization of prior service credit	(34,000)	(34,000)
Net periodic postretirement health care expense	\$208,000	\$161,000

The change in benefit obligation, funded status and reconciliation to amounts reported in the statements of financial position are as follows:

	2001	2000
<i>Change in benefit obligation</i>		
Accumulated benefit obligation, beginning of year	\$ 1,933,000	\$ 1,624,000
Service cost	62,000	55,000
Interest cost	135,000	118,000
Actuarial losses	79,000	251,000
Benefits paid	(123,000)	(115,000)
Accumulated benefit obligation, end of year	2,086,000	1,933,000
Funded status of plan	(2,086,000)	(1,933,000)
Unrecognized net losses	485,000	451,000
Unrecognized prior service credit	(54,000)	(88,000)
Accrued postretirement health care cost	\$(1,655,000)	\$(1,570,000)

The Foundation funds retiree health care benefits on a cash basis. Gains and losses that occur because actual experience differs from that assumed, and from changes in actuarial assumptions, are amortized over 10 years. The change in the unrecognized prior service credit reflects the impact of plan amendments and revisions in the measurement of benefit obligations for certain retirees.

A one-percentage-point change in the assumed health care cost trend rate would have the following effects:

	<i>1-Percentage-Point Increase</i>	<i>1-Percentage-Point Decrease</i>
Increase (decrease) in total amount of service and interest costs	\$18,000	\$(16,000)
Increase (decrease) in accumulated postretirement benefit obligation	125,000	(113,000)

4 Furniture, Equipment and Leasehold Improvements

<i>At December 31</i>	2001	2000
Furniture and equipment	\$4,509,000	\$4,255,000
Leasehold improvements	2,343,000	2,288,000
	6,852,000	6,543,000
Accumulated depreciation and amortization	(5,988,000)	(5,514,000)
	\$ 864,000	\$1,029,000

5 Lease Commitments

The Foundation occupies office space pursuant to an operating lease. Total rental expense for office space and equipment was \$1,585,000 and \$1,567,000 in 2001 and 2000, respectively. The operating lease for the Foundation's office space commenced April 15, 1988 and expires on September 30, 2006. Accrued rent expense for escalating minimum lease payments and rent abatement amounted to \$1,476,000 and \$1,608,000 at December 31, 2001 and 2000, respectively, and is included in noncurrent liabilities in the accompanying statements of financial position. The accrued rent expense is being amortized over the remaining life of the operating lease.

Future minimum payments under the operating lease for office space, including the Foundation's pro rata share of real estate taxes and other operating expenses, are summarized as follows:

<i>Year ended December 31</i>	
2002	\$1,866,000
2003	1,866,000
2004	1,866,000
2005	1,866,000
2006	1,397,000
Total minimum lease payments	\$8,861,000

The management of the Financial Accounting Foundation is responsible for the preparation of the accompanying financial statements. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Management maintains a system of internal controls designed to ensure the integrity and objectivity of the financial reporting process.

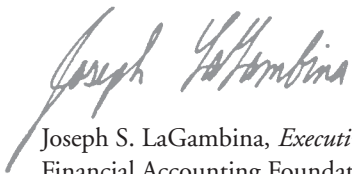
The Trustees of the Foundation, through the Audit Committee, oversee 1) financial and accounting policies, practices and reports, 2) the system of accounting and internal controls and the competence of persons performing functions within that system and 3) the scope and results of independent audits and any comments addressing the adequacy of internal controls and quality of financial reporting. The independent auditors render an objective, independent opinion on the financial statements prepared by management and have direct access to the Audit Committee with and without the presence of management.

In response to recommendations in recent years of the Blue Ribbon Committee of the New York Stock Exchange and the National Association of Securities Dealers, and related regulations of the Securities and Exchange Commission, the Audit Committee of the Foundation has adopted a formal charter to govern its operations. The charter identifies the key functions, objectives, operating practices, membership requirements and duties and responsibilities of the Committee. The charter is available through the office of the Executive Vice President.

The Trustees have also adopted, and monitor, personnel policies designed to ensure that employees of the Foundation are free of conflicts of interest.



Manuel H. Johnson, *Chairman and President*
Financial Accounting Foundation



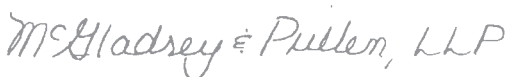
Joseph S. LaGambina, *Executive Vice President*
Financial Accounting Foundation

Board of Trustees
Financial Accounting Foundation

We have audited the accompanying statements of financial position of the Financial Accounting Foundation as of December 31, 2001 and 2000, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Financial Accounting Foundation as of December 31, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



New Haven, Connecticut
February 22, 2002

**Financial Accounting
Foundation**

Financial Accounting Standards Board
www.fasb.org

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Board
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