

**TRANSPARENCY UNVEILED**  
**FINANCIAL CRISIS PREVENTION THROUGH ACCOUNTING REFORM**

A presentation by David Mosso  
For the American Accounting Association  
Financial Accounting and Reporting Section  
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**Slide 1** Title slide: Transparency unveiled

Mark-to-market accounting is accused of causing the recent financial meltdown. Critics blame Financial Accounting Standards Board (FASB) FAS 157 which, as you know, requires fair value measurement of some assets and liabilities, particularly those at the center of the meltdown.

I come to praise FAS 157, not to bury it.

FAS 157 is the only thing I will praise in the universe of generally accepted accounting principles (GAAP). FAS 157 is like the lone gold nugget in a miner's pan of mud and gravel. In a recently published book, and in today's remarks, I contend that the current accounting model and the current standard setting process are both anachronisms. They need to be redesigned and rebuilt for the twenty-first century.

I contend further that a properly rebuilt accounting system would go a long way toward preventing future financial crises, and would have gone a long way toward keeping the global crisis we now have and the Savings and Loan crisis of the late 1980's from reaching the level of severity that they did. A properly rebuilt system would bring a degree of transparency to business activities never before available to the capital markets. It would equip capital markets to be the first line of defense against threats of systemic meltdown.

**Slide 2** Troubles in the GAAP accounting model

Those are sweeping contentions, so I will get right to work on making my case. I will start by pointing out shortcomings in the GAAP accounting model as broadly defined by the conceptual framework of the FASB.

I helped build the conceptual framework model. It was a giant step forward in the development of the theory and practice of accounting. But the framework was built in word to word combat with the business community and the framework came out of combat with a bit of post traumatic stress

disorder, which is manifested by nightmares in the form of contorted accounting standards.

Every accounting standard adopted before and after the conceptual framework has gone through the same kind of combat as the framework itself. FAS 157 could be called the Iwo Jima of accounting warfare. It planted a flag on top of a hotly contested fair value hill symbolizing what should be, I contend, the beginning of a transition from an undisciplined legislative style accounting model to a disciplined economic measurement-based accounting model. But I am getting ahead of myself – first to the shortcomings of the GAAP model.

A GAAP balance sheet typically shows a total for assets and a total for liabilities, implying that all of the entity's assets and liabilities are included. Accountants know that is not so – operating leases and special purpose entities, for example, are devices for keeping assets and liabilities off the balance sheet. But non-accountants can look at a balance sheet and logically infer that “total” means “all.”

A GAAP balance sheet has a section typically called owners' equity. But many of the shareholders included in owners' equity are not owners, they are creditors, option holders for example. They are creditors who escaped from that dubious liability total. An investor looking at a financial ratio that includes owners' equity, such as return on equity or debt to equity, can be misled by spurious numbers.

A GAAP balance sheet is stated in US dollars, implying that the amounts making up a given total are legitimately addable and that the totals represent something definable in dollar terms as of a specified calendar date. They are not addable, of course, except in an apples and oranges sense, hash totals really, and they do not represent either a definable mass or a specific date. The GAAP model mixes fair value dollars as of a specified date with historical cost dollars from many different past dates, many different price levels, and many disparate allocation formulas.

A GAAP balance sheet delays the reporting of changing prices that would serve as early warning signals of financial stress. Further, the flexibility inherent in the GAAP model for jiggering income permits managers to further suppress the reporting of other kinds of bad news warning signals.

In sum, a GAAP balance sheet is not what it appears to be. It appears to be, and is used as if it were, a summation of an entity's financial health. In that vein, a balance sheet was once called a statement of financial condition. But we accountants finessed the appearance problem with a semantic head fake. We call a balance sheet a statement of financial *position*, which connotes not financial health, but whatever it is that falls out of the GAAP model.

The shortcomings in the GAAP model are symptoms of two more fundamental and interrelated flaws, namely, that the GAAP model does not have an operable objective and that the model fosters diversity of accounting results by nurturing choice of accounting methods. The FASB has a Concepts Statement on "Objectives of Financial Reporting" and that statement poses several broad objectives such as: Information that is useful in making investment decisions, and information that is useful in assessing an entity's cash flow prospects. Those are good objectives, but they are too broad to give sharp focus to an accounting system suitable for twenty-first century economies.

At the time they were adopted, those broad objectives were groundbreaking and forward looking. They turned the GAAP model away from the then prevalent stewardship notion of accounting and re-oriented it toward economic decision making. The objectives paved the way for many subsequent improvements in GAAP. But they were not strong enough to be translated into a coherent accounting model with consistent recognition criteria and a single measurement method – they left us with vague recognition criteria and multiple measurement methods, in short, a choice-based model.

### **Slide 3** Accounting for wealth & health

In my view, a set of financial statements should be an economic model of an entity, designed as a tool for diagnosing financial health. Wealth and income are the essence of economic activity. Production, consumption, and accumulation of wealth make up the perpetual cycle of human economic activity. That cycle is the unwavering focus of business decision making. If accounting is supposed to be “the language of business,” as has often been said, it seems to follow that the economic cycle that is the focus

of business should also be the focus of accounting. Consequently, I would rebuild the accounting model around the following objective:

**Principle 1: The objective of accounting is to measure an entity's economic wealth and income for the purpose of diagnosing the entity's financial health.** Wealth in that sentence means an entity's economic net worth. Income in that sentence means change in wealth, or change in economic net worth. This formulation of the objective of accounting is the driver of what I will call the wealth measurement-early warning model. Five more basic principles follow from that objective and complete the structural components of my proposed new model.

**Slide 4** Five more basic principles

**Principle 2: Recognize all items of an entity's wealth, all assets and all liabilities, on a balance sheet that is made available to all parties with an interest in the entity's financial health.** This principle would be backed up by sharper definitions of assets, liabilities, and owners' equity than we now have in the GAAP model. A start toward that sharpening process is discussed at some length in my book. The tentative definitions

are too detailed to discuss here, but one key result is that they would eliminate the oxymoronic notion of “off-balance-sheet” liabilities, or assets. Operating leases would be recognized on lessor and lessee balance sheets. Assets and liabilities of so-called “special purpose entities” would be recognized on the balance sheets of their sponsoring entities except for tightly defined and legally circumscribed securitization pools with a super majority of independent share holders. Moreover, securitization pools, and all other kinds of investment pools, would have to issue balance sheets of their own to their shareholders, like those now issued by mutual funds and exchange traded funds, which they resemble.

Those changes and others would plug giant loopholes in the GAAP model that contributed to the current financial crisis. Another result of the tighter definitions is that goodwill would be removed from the balance sheet, taking away a bogus asset useful only for manipulating accounting results.

**Principle 3: Measure all assets and liabilities, and changes in them, at fair value.** This measurement principle is where FAS 157 comes into full bloom. I do not have time in today’s remarks to explore all of the many

merits of fair value, but I put some notes on fair value in the handout package. They may be useful to you in the classroom.

**Principle 4: Measure all equity share transactions at fair value with gain or loss in income for differences between the fair value of equity shares and the fair value of things exchanged for them.** This principle completes the fair value theme of the proposed model. In conjunction with a new standalone definition of owners' equity, no longer an undefined residual, this principle would eliminate the flim-flam that now permeates the owners' equity element.

**Principle 5: Disclose all commitments and contingencies that do not qualify as assets or liabilities, or are not measurable.** This is essentially the same as current GAAP, but the wealth measurement objective, with its early warning overtones, would likely call for additional disclosures.

**Principle 6: Display an entity's assets and liabilities separately on its balance sheet, without netting. Display changes in an entity's total wealth on its income statement with separate segments for realized**

**and unrealized components of income. Design and supplement the balance sheet and income statement to facilitate the diagnosis of an entity's financial health and the detection of signs of future financial stress.** For purposes of financial analysis, particularly to improve comparability, Principle 6 specifies some totals and some segmentations that are not part of the current GAAP model. Otherwise, the principle is consistent with current GAAP. The FASB and the IASB are working on financial statement display in the context of the current GAAP model and I assume that the results will substantially fit this new model. But again, the wealth measurement objective, with its early warning overtones, would likely call for some display differences.

Those six principles constitute a complete accounting model, a no-choice model centered on wealth.

### **Slide 5** Implementation imperatives

In addition to the need for sharper asset-liability-equity definitions for fleshing out Principle 2, there are two implementation imperatives for the new model to be fully effective.

The first imperative is that the six principles must be adopted as mandatory standards, not as non-authoritative concepts as in the current conceptual framework. Standards compel prompt decisions on the front line of accounting practice. Concepts compel nothing except debate without end.

The second imperative is that the six principles must be universally applicable to all entities in all industries, with no choice and no exceptions. I repeat the magic words: UNIVERSAL, NO CHOICE, NO EXCEPTIONS.

**Slide 6** Implications of new model.

There are three implications of adopting the proposed wealth measurement-early warning model that I will mention here, others later. First, the FASB conceptual framework would be obsolete except as historical background. That is because the six basic principles of the proposed model are the essence of what the FASB conceptual framework was trying to do. The six principles are concepts in the form of standards. Like the conceptual framework, they deal with every aspect of accounting –

objective, recognition, measurement, display, and disclosure – and they do so conclusively: universal, no choice, no exceptions.

-- Second, the entire body of existing accounting standards would be either eliminated or subsumed as application guidance for the six basic principles.

All existing standards dealing with cost allocations would be immediately

extinct. I propose, and in my book I outline a start toward, a

comprehensive recognition standard comparable in scope and detail to the

FAS 157 measurement standard. Thus, practitioners would have firm

guidance for making recognition decisions like they do now for making fair

value measurement decisions.

-- Third, comparability within and among entities would be vastly increased.

That is because all entities would be focused on the same objective,

measuring wealth, using the same comprehensive recognition and

measurement standards. All line items within a single entity's financial

statements would be wealth measures, as would similar items in all other

entities' statements. A financial analyst could be confident that calculations

involving two or more wealth measures from financial statements would

yield results in analytically valid economic values. In contrast, an analyst

using the GAAP model can only hope that by crossing apples with oranges

the resulting hybrid fruit will have some analytic value.

There are other implications of the proposed model that I will discuss later. For now I want to explain how the model can help moderate or even prevent financial crises, both at the entity level and at the industry-wide or nation-wide levels.

### **Slide 7** Crisis prevention

If all assets and liabilities were put on the balance sheet at fair value, as in my proposed model, the owners' equity section of the balance sheet would represent the economic net worth of an entity, its total wealth. Economic net worth, or just net worth for short, is the essence of an entity's financial health. Net worth exists in fact whether or not it is measured. No matter how much it is obscured by the GAAP model, net worth encapsulates the earning power and the staying power of an entity. Consequently, net worth is the epicenter of any financial crisis. Shrinking net worth is the ultimate warning signal of impending financial stress. Zero net worth is the ultimate signal of "the end is near!" Net worth reported regularly over time would be, in current jargon, a stress test, a rolling stress test open for all to see as

it rolls forward and easy to test for survivability under extreme economic assumptions.

In contrast, GAAP net equity is only loosely related to financial health and often gives off false signals. GAAP net equity is likely to be positive long after economic net worth hits zero. That is partly because GAAP defers the effect on an entity of most price changes. Those price changes are the early warning signals of potential realized gains and losses with future cash consequences. Moreover, by virtue of its rubbery application choices, GAAP enables managers of a sinking entity to buy time, for hope to triumph over reality, by manipulating GAAP in such a way as to put a smiley face on the entity's financial statements. GAAP at its un-manipulated best is nothing but a, too late, trailing indicator of financial stress. GAAP at its manipulated worst is an erratic indicator of management desperation.

Economic net worth and its supporting cast of integrated financial statements would give the word transparency a new meaning. In present discourse, calls for more transparency usually translate into more pages of footnotes, more truckloads of statistics, more regulations, more regulators, and a reshuffled chart of oversight organizations. Financial statements that

measured economic net worth, by comparison, would be a crystal palace of transparency. Such statements would lift the veil that the GAAP model holds over entities' economic activity. Such statements would reveal concise summations of entities' health, much clearer than any combination of GAAP financial statements and regulatory statistics. Economic net worth is the window into an entity's financial health and therefore into its stress tolerance. Financial statements focused on net worth would provide a set of diagnostic tools never before available to the capital markets.

With those diagnostic tools, capital markets would quickly spot the early warning signals causing an entity's shrinking net worth. Market response would pressure the entity into shaping up, merging, or dying. Thus, I firmly believe that capital markets would supply most of the oversight muscle needed to keep financial crises in check. If not, regulators would have these same diagnostic tools to help shape a prompt regulatory response.

## **Slide 8** Troubles in the Standard Setting Process

I will turn now to the accounting standard setting process and why it too needs to be stripped down and rebuilt. First, the shortcomings of the current process:

The current process is outrageously slow in resolving accounting problems. From an investor protection standpoint, it is more than outrageous, it is malevolent.

The current process is rife with conflicts of interest. Corporate entities, the regulated parties, dominate the processes of the regulator. They stymie progress as long as possible and weaken the final outcomes of standard setting projects.

The current process is narrowly focused on particular transaction types. Thus standard setting effort does not transfer readily from one transaction type to another. New transaction types spring up faster than old types can be resolved.

The current process makes auditors vulnerable to being impressed into service as advocates for their clients instead of as arms-length examiners

with skin in the game. There are no penalties, no skin, for squeezing slime through GAAP loopholes, so clients lean on auditors to find loopholes and to defend them in regulatory forums.

Those flaws in the standard setting process flow primarily from the fact that the GAAP accounting model is, as I described earlier, directionless and choice based.

**Slide 9** The existing process

The current standard setting process goes something like this:

- The process starts with fuzzy GAAP objectives, which lead to –
- Choices among recognition, measurement, and display methods, which in turn lead to-
- Debate within and among standard setters, reporting entities, financial analysts, educators, and others about which choice to make, and –
- If the choice that most threatens the status quo appears to be winning the debate, that leads to –
- Lobbying of government overseers by corporate reporting entities, often leading to –

--Government interference which, along with all of the foregoing infirmities, leads to –

--Compromised accounting standards with deficiencies that cause –

--Recycling of many issues into future standard setting projects, and thus we have–

--A process without end for any complex accounting issue, and –

--A process overall with an insatiable appetite for consuming time and thereby failing to address myriads of problems that fester until they become too rancid to ignore.

**Slide 10** The proposed process

The wealth measurement-early warning model offers a way to turn the standard setting process around, from a protracted debate process to a quick response process. Quick response is possible because the six basic principles, adopted as standards, and the two comprehensive application standards for recognition and measurement would be in place - universal, no choice, no exceptions. They would be tight enough to guide most practice decisions without referral to standard setters. Further, they would provide a rich and ever-expanding context for resolving new transactions

with minimal deliberation and minimal lapse of time. Here is a sketch of a standard setting process driven by the proposed model:

--The process would start with the clear and unwavering objective of measuring wealth, which compels –

--Recognition of all assets and liabilities immediately as they arise in business activities, those are entity level decisions, and -

--Measurement by the entity of all assets and liabilities at fair value. That in most cases is the end of the process because both basic principles and application guidance are pre-determined, however, -

--Challenges of entity level decisions could be appealed to the standard setting body, which could usually –

--Settle the challenges promptly with minimal due process given the extensive and then-to-be growing body of guidance, but in tougher cases the standard setter could -

--Freeze practice with interim standards to prevent proliferation of questionable practices while deliberating the disputed issues.

To pull all of this together, a most important result of the focus on wealth is that it would completely eliminate choice of accounting methods. It would limit choice to the determination of the best ways to identify items of wealth

and the best ways to measure their fair value. The wealth measurement objective would convert accounting practice and standard setting into an economic measurement discipline in contrast to the legislative style, debate society format that characterizes current GAAP. Wealth measurement does not require extensive due process because wealth is universally understood, it is tangible or definable, and its estimated fair value is derivable from and testable in the market, and it is also challengeable and testable by other independent estimators.

Since wealth is universally understood, political tampering would be discouraged. Politicians would not as readily tamper with verifiable measures of wealth that are market based and auditor confirmed and widely understood. Political tampering with current GAAP is easy because nobody understands the intricacies of GAAP except for a few expert accountants and even they cannot prove that one GAAP method is conclusively better than another. GAAP is a geek language, decipherable only by an initiated inner circle. Wealth is a universal language, understood by everyone.

The proposed quick response standard setting process would enhance the early warning features of the proposed accounting model by solving emerging accounting issues quickly and decisively. Problems that might, under GAAP, have their early warning signals muffled while they grow into malignancies, would not be allowed to go unattended for years on end.

### **Slide 11** Standard Setting Processes Compared

You probably cannot read this next slide on the screen, but you have a hard copy in the handouts. The slide summarizes the points I have just made, comparing the standard setting processes under the GAAP model and the wealth measurement-early warning model.

That ends my story on why and how I would redesign and rebuild the current accounting system – both the current GAAP accounting model and the current GAAP standard setting process. I need help in getting this message through the dense fog of self interest and business-as-usual mind-sets, so if any of you are inclined to spread the word through your classrooms or otherwise, do so with my sincere thanks.

There follow some separate remarks: “Notes on Fair Value” and “Federal Accounting Standards.”

## NOTES ON FAIR VALUE

A presentation by David Mosso  
For the American Accounting Association  
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Hardly a day went by over the last two years without one or more commentaries in the news media about “mark-to-market” accounting. Pundits were either strongly opposed or strongly supportive, but all of the commentary was in the context of the present limited application of FAS 157 under the GAAP model. In my proposed wealth measurement-early warning model, fair value is comprehensively applicable to all assets and liabilities, not just assets and liabilities that happen to appear on a GAAP balance sheet. The proposed model would put into its asset and liability elements all lease payables and receivables, most special purpose entities, options on an entity’s own stock, most preferred stock, intangible assets when reasonably measurable, and any other strays hiding in the shadows. Then there is one subtraction – goodwill.

In the context of the proposed wealth measurement-early warning model, it can be said that:

--Fair values are always wrong. Fair values are estimates and even a quotation taken from an active market will likely be wrong after the next trade. Nonetheless --

--Fair values are always relevant. Strategic and operating business decisions as well as investment and credit decisions are all centered on wealth. Wealth is the essential measure of financial health, hence of financial stress. Historical cost may sometimes be relevant to business decisions, project evaluation for example, but it is never centrally relevant to an entity's financial health at any given date.

--Fair values are always on target. Business entities, their auditors, and financial analysts who try to estimate the fair value of an entity's assets and liabilities will all be aiming at the same target - fair exit value as defined by FAS 157. Different estimators will get different answers, but all good faith estimates should cluster in and around the common bulls-eye. If a decision maker needs something other than an exit value, replacement cost for example, FAS 157 is a jumping off point, a baseline value for all estimators to work from.

--Fair values are always insightful. The process of estimating fair value is at least as important as the result. Except for active markets like the stock exchanges, fair value estimators must look to a variety of inputs for their estimation models. Analysis of temporal variances of particular inputs, interrelationships among inputs, and the discovery of new inputs and new sources, all provide economic insights that are helpful not only in estimating fair value but in management and investment decision making.

--Fair values are always understandable. Fair value provides a medium of communication among all market participants - managers, investors, regulators, media commentators, and the public at large. The GAAP accounting model is a mystery to all but the most learned of accountants and analysts. GAAP is a geek language, decipherable only by the initiated inner circle. Wealth is understood by everyone.

--Fair values are always self-policing. Fair value estimates rest on assumptions about future events. The resulting estimates can be varied intentionally or inadvertently by stretching the magnitude of key assumptions. But there are constraints. Auditors provide a first check on management estimates. Financial analysts provide another, more global

check. Regulators and media snoops, particularly media specializing in a particular industry, provide skeptical questioning that reporting entities must respond to. Sale of an item of wealth provides a final check on estimating accuracy.

--Fair values are always self-sharpening. The accretion of experiential knowledge from the comprehensive application of fair value measurement assures that estimating methodology will steadily improve and separate estimates will cluster closer to the bulls-eye.

--Fair values are always comparable. All value measurements under FAS 157 are market based and all estimators follow the same methodological guidance. Hence, both intra-entity and inter-entity comparison of items of wealth can be made with confidence within the limits of estimation errors, inter-entity classification differences, and reliability of recognition decisions.

## **FEDERAL ACCOUNTING STANDARDS**

A presentation by David Mosso  
For the American Accounting Association  
Financial Accounting and Reporting Section  
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Christine asked me to say something about federal government accounting. I will give you a few highlights and leave time for questions.

Point one is that budgetary accounting and accrual accounting are not affiliated for the most part in the federal government. Budgetary accounting is controlled by the Office of Management and Budget. It is predominantly cash based but with selected accruals mixed in. Business-type accrual accounting standards are set by the Federal Accounting Standards Advisory Board, FASAB for short. FASAB standards are consistent with traditional accrual accounting. FASAB is designated by the AICPA to set GAAP standards for the federal government.

FASAB follows the same operating procedures and due process as GASB and FASB. FASAB was created to straddle the line between the executive and legislative branches of government. The Comptroller General has statutory authority to set accounting standards for the executive branch.

But the Comptroller General is in the legislative branch and in the 1980's the Office of Management and Budget (OMB) challenged the CG's standard setting authority on constitutional grounds, that is, separation of powers. Neither party was confident enough of its position to take the issue to the Supreme Court, so FASAB was created by a Memorandum of Understanding. FASAB is not a statutory federal agency, but it is not a private entity either. It just is, by consensus.

The FASAB Board has six non-federal members and three federal employee members representing OMB, Treasury, and the General Accountability Office. That majority appears to tilt solidly toward non-federal power. However, OMB and GAO have veto power over FASAB decisions and non-federal members are often former federal employees potentially with biases carried forward. Those factors help keep the non-federal members from getting too rambunctious. Nonetheless, since FASAB started in 1990, most federal departments have progressed to the point of getting unqualified audit opinions on their business-type financial statements. The Defense Department is a glaring exception. It cannot even balance its checkbook.

The hottest issue throughout FASAB's life has been social insurance. The topic has been on FASAB's agenda from the very beginning and two or three pronouncements have been made dealing with disclosures. Near the end of my chairmanship of FASAB, the Board decided that unpaid social insurance benefits that had been earned by working in covered employment were liabilities that should be recognized on the federal balance sheet. That decision drew strong dissents from the federal employee members of FASAB and vigorous lobbying by the Social Security Administration. The federal members have been stonewalling that decision ever since, for about three years now, and most likely they will continue all the way to eternity even if it requires exercise of the veto power and therefore relinquishment of FASAB's designation as the GAAP standard setter.

**Slide 12** The eternal triangle

I will show you one slide that captures the drama of social security accounting. The Social Security program (the old age and disability program, not Medicare) was designed to be self financing in that all benefits were to be paid from taxes on covered workers and their

employers. In other words, the program was designed not to be a welfare program subsidized by general taxpayers. This policy is called pay-as-you-go. But the funding policy has always been to keep the fund in so-called “actuarial balance,” and that was defined as cash breakeven seventy-five years in the future.

The chart on this slide is not based on actual data, it just illustrates the pay-as-you-go funding policy. The difference between the green revenue line and the red payment line is the social security trust fund balance at any point on the time line. It is a relatively large dollar amount at year zero. It is a zero dollar amount at year seventy-five. The diverging lines beyond year seventy-five represent projected deficits.

Long before FASAB decided that a liability exists, private sector accountants have argued that a liability indeed does accrue and should be recognized on the federal balance sheet. The Social Security Administration vehemently argues that only cash basis accounting is appropriate for a pay-as-you-go policy, and that even at year seventy-five in this hypothetical example there is no liability. Of course, there is no cash either.

In the real world of documented history, as the vertical axis at year zero on the chart has marched inexorably to the right from year to year, the initial breakeven point at year seventy-five has marched back to meet it, often more than one year at a time, mostly because the benefit payment line has grown faster than the revenue line. Each time the two points get close together, the Congress gets in a dither and does something to push the breakeven point out once again to seventy-five years or more. You can picture the pay-as-you-go policy by visualizing the triangle on the chart gradually compressing from a seventy-five year span to, say, a five year span and then suddenly snapping back to a new seventy-five year span as new revenues are legislated. That pulsating triangle symbolizes the government's social security policy. If history is prologue, this is an eternal triangle.

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# TROUBLES IN THE GAAP MODEL

- Totals that are not what they say they are
- Owners who are not owners
- Dollars that are not addable
- Bad news that is not reported

# ACCOUNTING FOR WEALTH & HEALTH

- Principle 1: The objective of accounting is to measure an entity's income and wealth for the purpose of diagnosing the entity's financial health.
- --Income is change in wealth

# FIVE MORE BASIC PRINCIPLES

- P2 Recognize ALL assets & liabilities
- P3 Measure ALL assets & liabilities at fair value
- P4 Measure equity share transactions at fair value
- P5 Disclose commitments & contingencies
- P6 Report total wealth on balance sheet. Report total change in wealth on income statement. Design statements to diagnose financial health.

# IMPLEMENTATION IMPERATIVES

- Standards, not concepts
- Universal, no choice, no exceptions

# IMPLICATIONS

- FASB Conceptual Framework obsolete
- GAAP standards either extinct (cost allocation methods) or adapted as implementation guides for Six Basic Principles
- COMPARABILITY at last!!
- And more...

# CRISIS PREVENTION

- Net worth, the epicenter of crises
- Early warning, and late
- GAAP net equity a trailing indicator
- Transparency
- Capital market as regulator

# TROUBLES IN STANDARD SETTING

- Outrageously slow
- Conflicts of interest
- Narrow focus
- CPA advocacy

# THE EXISTING PROCESS

- Fuzzy GAAP objectives which lead to -
- Choices of method which lead to -
- Endless debate which leads to -
- Lobbying government which leads to -
- Compromised standards which lead to -
- Recycling issues, and thus we have -
- Process without end, and -
- Insatiable appetite for consuming time.

# THE PROPOSED PROCESS

- Wealth measurement objective which compels -
- Recognition of all assets and liabilities (guided by six basic principles & pre-adopted implementation standards) and -
- Measurement at fair value guided by FAS 157-
- Resolution of appeals & freezing practice in the interim.

**Present Standard Setting Process**

Elapsed time measured in years.

**1 CONCEPT**

Non-authoritative concepts are in place.

**2 PROBLEM**

An accounting problem arises in the field.

**3 AGENDA DECISION**

The standard setter makes an agenda decision through a triage process. To be put on the agenda, a problem must ascend to a high enough priority level (become rancid enough) to crowd out other problem candidates for Board deliberation. The problem festers and spreads during this process and all other non-agenda problems go unattended, or get narrow interim guidance in the emerging issues process, and also fester and spread.

**4 DELIBERATION**

Standard setters deliberate the issues. The problem continues to fester and spread during these deliberations along with all other problems shunted aside in the triage process.

**5 INITIAL RESOLUTION**

A standard is adopted, applicable only to the industry or transaction directly considered. Continuing Implementation guidance begins immediately after issuance of the standard.

**Proposed Standard Setting Process**

Elapsed time measured in months or days.

**1 PRINCIPLE**

Authoritative basic principles are in place as standards.

**2 PROBLEM**

An accounting problem arises in the field.

**3 INITIAL RESOLUTION**

The entity and its auditor apply the six basic principles, guided by pre-adopted implementation standards, in consultation with the standard setter if necessary. The initial application decision stands unless appealed.

**4 REVIEW APPEALS**

If appealed, the standard setter decides whether to endorse the initial resolution in step 3 or to further deliberate the issues *after* freezing practice by issuing universally applicable interim guidance.

**5 FINAL RESOLUTION**

A standard is adopted as implementation guidance for the six basic principles, universally applicable, no choice, no exceptions.

# THE ETERNAL TRIANGLE

## Open Group: In Balance at 75 Years

