



## AMERICAN ACCOUNTING ASSOCIATION

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February 3, 2008

Mr. Robert C. Pozen, Chairman  
Advisory Committee on Improvements to Financial Reporting  
c/o Office of the Chief Accountant  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-6561

File No. 265-24

Dear Chairman Pozen and members of the Advisory Committee:

The Financial Reporting Policy Committee<sup>1</sup> (FRPC) of the Financial Accounting and Reporting Section of the American Accounting Association is charged with responding to financial-reporting-related rule-making and regulatory proposals. The FRPC is pleased to respond to the Draft Decision Memorandum issued by the Advisory Committee on Improvements to Financial Reporting (Advisory Committee) on January 11, 2008.

The FRPC supports the Advisory Committee's focus on improving the U.S. financial-reporting system by "focusing on ways to make information presented by U.S. companies more useful and understandable for investors." As a means of achieving this goal, Chapter 3 of the Draft Decision Memo proposes changes to the oversight and composition of the Financial Accounting Foundation (FAF) and the Financial Accounting Standards Board (FASB). A maintained assumption underlying a subset of the proposed changes is that investors' interests would be better represented by including a greater proportion of investors/users among the FAF's Trustees and the FASB's members. We do not take issue with greater representation by investors/users, *per se*. We, however, *strongly disagree* with the Draft Decision Memo's failure—whether intentional or not—to recommend that the FAF and FASB each include at least one academic representative.<sup>2</sup>

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<sup>1</sup>The comments in this letter reflect the views of the individuals on the Committee and not those of the American Accounting Association, the Financial Accounting and Reporting Section of the American Accounting Association, or the individuals' employers. Individuals serving on the FRPC include: Patrick E. Hopkins, Indiana University (Chair & principal co-author); Christine Botosan, University of Utah; Mark Bradshaw, Harvard University; Carolyn Callahan, University of Arkansas; Jack Ciesielski, Analysts' Accounting Observer; David Farber, University of Missouri; Mark Kohlbeck, Florida Atlantic University; Leslie Hodder, Indiana University; Robert Laux, Microsoft Corporation; Thomas Stober, University of Notre Dame; Phillip Stocken, Dartmouth College (principal co-author); and Teri Lombardi Yohn, Indiana University.

<sup>2</sup> Although the Draft Decision Memo does not prescribe experiential membership quotas for the Financial Accounting Standards Advisory Council (FASAC), the memo does propose formation of an Agenda Advisory Group (AAG) with "representation similar to that currently enjoyed by FASAC members" (p. 37). Currently, the FASAC includes two academic members; we strongly support continuation of this level of academic representation.

We highly recommend that the Draft Decision Memo be revised to state that the membership of the FAF and the FASB should both include at least one academic representative. We also propose that the academics serving in FASB oversight, advisory and decision-making roles should have research-publication records that provide evidence of expertise in performing and interpreting social-scientific research related to financial reporting. In the following paragraphs, we provide additional comments along with support for our recommendations.

*Precedence and International Best Practice:* The Draft Decision Memo's exclusion of academic participation in the oversight and decision-making authority of the FAF and FASB is contrary to academics' direct, past participation in U.S. private-sector standard setting and is contrary to the recently revised constitutional requirements governing the practices of the International Accounting Standards Board (IASB). For examples of the former, consider the roster of names that have participated in the decision making activities of the Committee on Accounting Procedure, the Accounting Principles Board, and the FASB.<sup>3</sup> With respect to current international practices, the International Financial Accounting Standards Committee Foundation (IASCF) Constitution (2005) requires that the IASCF Trustees include *at least* one academic representative (para. 7) and that the IASB include *at least* one academic representative (para. 21), with additional academic representatives permitted in each group.

There is much precedence in our society for including academic representatives in developing public policy. For example, the Council of Economic Advisers has three members drawn from academe. These members, who are appointed by the President of the United States, provide the President with authoritative information, economic analysis and advice on the development and implementation of a wide range of economic policy issues.

*Diversity and Expertise:* The research literature in organizational behavior robustly supports the finding that membership diversity is important when designing a decision-making team. Installing a more diverse team not only allows for team members to be recruited from an expanded talent pool, but a diverse or heterogeneous team is more likely to consider multiple viewpoints and be more effective at solving complex problems.<sup>4</sup> An academic experience, which differs from that of preparers, auditors, and analysts, is characterized by research and teaching; this experience provides opportunities to rigorously analyze the determinants and effects of

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Group (AAG) with "representation similar to that currently enjoyed by FASAC members" (p. 37). Currently, the FASAC includes two academic members; we strongly support continuation of this level of academic representation.

<sup>3</sup> During the terms of the AICPA's Committee on Accounting Procedure (1939-59) and Accounting Principles Board (1959-73), at least two academics were always members. At the FASB, from 1973 to the present, Bob Sprouse, Bob Swieringa, Gerry Mueller, Katherine Schipper and Tom Linsmeier have contributed to the Board's work.

<sup>4</sup> For further details, see Shaw, M.E. *Group Dynamics: The Psychology of Small Group Behavior*, (3<sup>rd</sup> Ed.). New York: McGraw-Hill.

financial-reporting policies and institutions. In addition, a common perspective taken in academic research is to explicitly consider the cognitive abilities of financial-statement users in comprehending and using financial-reporting information; this is completely congruent with the goal of the Advisory Committee as expressed in the Draft Decision Memo. A significant portion of academic accounting research provides evidence about how accounting information is associated with capital market decisions, which permits an academic to bring an important additional investor perspective to FAF and Board deliberations. Similarly, teaching and presenting complex information provides an academic with insight into the cognitive ability of financial statement users.

Academics with demonstrated expertise in performing and interpreting social-scientific research also are likely to have training in the scientific method. This expertise provides an academic member with the ability to develop and test rigorous models for analyzing phenomena and to evaluate cutting-edge research. Coupling these skills with knowledge of relevant research in accounting, finance, and economics allows an academic to bring insight, knowledge and analysis that will improve the quality of financial reporting standards.

We caution that that the loss of academic representation in the oversight and decision-making authority of the FASB would disenfranchise the academic community and the role of scientific discovery in improving financial reporting. It seems—given the scope and magnitude of the anticipated changes in financial reporting—that this is a particularly important time to explicitly incorporate the academic perspective in the oversight and decision process of FASB.

The members of the FRPC sincerely appreciate this opportunity to offer comments to the Advisory Committee on the Draft Decision Memo. Please do not hesitate to contact us if you wish to discuss further our recommendations or other issues to which we can lend our perspective.

Best regards,

/s/

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