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THE SEC’S *ULTRA VIRES* RECOGNITION OF THE FASB AS A STANDARD SETTING BODY

*By Wm. Dennis Huber*
ABSTRACT

The Sarbanes-Oxley Act of 2002 conferred upon the Securities and Exchange Commission (“SEC”) the authority to recognize as ‘generally accepted’ for purposes of the securities laws, any accounting principles established by a standard setting body” provided that the standard setting body met certain conditions.1 Two weeks after the Sarbanes-Oxley Act was signed into law in July, 2002 the Financial Accounting Standards Board (“FASB”) and its parent organization, the Financial Accounting Foundation, submitted a letter to the SEC declaring that it met the conditions set forth in the Sarbanes-Oxley Act. Eight months later, in April, 2003 the SEC issued a policy statement that the FASB did in fact meet the Sarbanes-Oxley criteria.2

While the FASB met some of the criteria, this article argues that it did not meet all the criteria, and therefore the SEC exceeded its statutory authority in recognizing the FASB as a standard-setting body and accepting principles established by the FASB as a standard setting body.3 This article further argues that the SEC cannot recognize the International Accounting Standards Board as a standard setting body because it, too, fails to meet the criteria set out by Congress.4

I. INTRODUCTION

The Securities Act of 1933 bestowed on the Securities and Exchange Commission (“Commission” or “SEC”) the authority and obligation to make, amend, and rescind rules and regulations that prescribe the manner in which information must be presented in financial statements, and the methods to be followed in the preparation of accounts.5 The Securities Exchange

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3 Id.; Sarbanes-Oxley Act, supra note 1.
5 15 U.S.C. § 77s(a) (2012) (“The Commission shall have authority from time to time to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of this subchapter, including rules and regulations governing registration statements and prospectuses for various classes of securities and issuers, and defining accounting, technical, and trade terms used in this subchapter. Among other things, the Commission shall have authority, for the purposes of this subchapter, to prescribe the form or forms in which required information shall be set forth, the items or details to be shown in the balance sheet and earning statement, and the methods to be followed in the preparation of accounts, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of invest-
Act of 1934 likewise gave the SEC the power to prescribe the form in which the required information must be set forth in the financial statements. This is commonly referred to as “Generally Accepted Accounting Principles,” or “GAAP.”

For four decades, from 1934 to 1973, the SEC implicitly delegated that authority to the American Institute of Certified Public Accountants (“AICPA”) through its various committees. This delegation was heavily criticized as an abandonment of the SEC’s responsibility conferred upon it by Congress.

In 1972 the Financial Accounting Foundation (“FAF”) was incorporated in the State of Delaware which instituted the Financial Accounting Standards Board (“FASB”). In 1973 the FASB replaced the AICPA as the unofficial delegate of the SEC for developing GAAP.

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6 15 U.S.C. § 78m(b) (2012) (“[P]rescribe, in regard to reports made pursuant to this chapter, the form or forms in which the required information shall be set forth, the items or details to be shown in the balance sheet and the earnings statement, and the methods to be followed in the preparation of reports, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer. The rules and regulations of the Commission shall be effective upon publication in the manner which the Commission shall prescribe…”).

7 The term Generally Accepted Accounting Principles (GAAP) has been used for decades and is standard fare in every accounting textbook. The Need for Generally Accepted Accounting Principles, FLATWORLD, http://www.flatworldknowledge.com/pub/1.0/financial-accounting/what-should-decision-maker-know/objective-4. However, 15 U.S.C. § 77s(b) refers to “standards,” not “principles.”


10 FIN. ACCOUNTING FOUND., RELATED CERTIFICATE OF INCORPORATION OF THE FIN. ACCOUNTING
Beginning with the Sarbanes-Oxley Act of 2002 (“SOX”), however, Congress authorized the SEC to explicitly recognize accounting standards established by a private standard-setting body provided it met five criteria. These criteria include the organization of the entity, a requirement for a board of trustees serving in the public interest, a funding requirement under 15 U.S.C. § 7219, required procedures for prompt amendment of accounting principles, and finally, considering the adoption of accounting principles that are necessary or appropriate in the public interest and the protection of investors.

The fifth criterion requiring consideration, “in adopting accounting principles, the need to keep standards current in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors” is the subject of the analysis of this article. While the FASB and the IASB may meet the first four criteria, a deeper look into the Articles of Incorporation and Bylaws of these two entities shows that the fifth criteria is not satisfied. As discussed in detail infra, both entities have no mandate to consider the public interest or protection of investors when adopting accounting principles.

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12 15 U.S.C. § 77s(b) (2012). (“Recognition of accounting standards (1) In general In carrying out its authority under subsection (a) and under section 13(b) of the Securities Exchange Act of 1934 [15 U.S.C. § 78m(b)], the Commission may recognize, as ‘generally accepted’ for purposes of the securities laws, any accounting principles established by a standard setting body— (A) that— (i) is organized as a private entity; (ii) has, for administrative and operational purposes, a board of trustees (or equivalent body) serving in the public interest, the majority of whom are not, concurrent with their service on such board, and have not been during the 2-year period preceding such service, associated persons of any registered public accounting firm; (iii) is funded as provided in section 7219 of this title; (iv) has adopted procedures to ensure prompt consideration, by majority vote of its members, of changes to accounting principles necessary to reflect emerging accounting issues and changing business practices; and (v) considers, in adopting accounting principles, the need to keep standards current in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors; and (B) that the Commission determines has the capacity to assist the Commission in fulfilling the requirements of subsection (a) and section 13(b) of the Securities Exchange Act of 1934 [15 U.S.C. § 78m(b)], because, at a minimum, the standard setting body is capable of improving the accuracy and effectiveness of financial reporting and the protection of investors under the securities laws. (2) Annual report. A standard setting body described in paragraph (1) shall submit an annual report to the Commission and the public, containing audited financial statements of that standard setting body.”) (emphasis added). Note that 15 U.S.C. § 77s(b) does not specify the legal form of a standard setting body that can be recognized by the SEC.

13 Id.

Immediately following the enactment of SOX the FASB together with its parent entity, the FAF, submitted a letter to the SEC “in the interest of expediting implementation of the Sarbanes-Oxley Act of 2002 (the ‘Act’) as it relates to recognition of the standard-setting body.” SOX was signed into law on July 30, 2002. The FASB submitted the letter to the SEC on August 16, 2002, a mere two weeks later.

While this quick approval might cause a raised eyebrow or two, the major concern is that the FAF/FASB submitted no evidence to the SEC that it met the criteria as set forth by §77s(b). The letter merely asserted, rather self-servingly, that it met the criteria. “Please be advised that the FAF and/or the FASB meet the following criteria as set forth in section 108(a) of the Act.” With no evidence on record, on April 25, 2003 the SEC “reaffirmed the Status of the FASB as a Designated Private-Sector Standard Setter.”

This article examines the SEC’s recognition of the FASB as a standard-setting body and concludes that the SEC exceeded its statutory authority in recognizing the FASB as a standard-setting body. Contrary to its declaration of August 16, 2002, the FASB does not meet the criteria required by Congress to recognize a private standard setting body, and more specifically, the criterion concerning the public interest.

Furthermore, there has been much debate of the question of whether the SEC should, or can, recognize the International Accounting Standards Board (“IASB”) as a standard setting body and the International Financial Accounting Standards (“IFRS”) established by the IASB as “generally accepted” for purposes of the securities laws. After examining the IASB, this article further concludes that the SEC is not authorized by Congress to recognize the IASB as a standard setting body or the principles established by the IASB because, like the FASB, the IASB does not meet the necessary criteria.

The article is organized as follows. First, the SEC’s authority to recognize standard setting bodies is examined. In Section III, the FASB as a standard setting body is considered. Section IV analyzes the SEC’s recognition of the FASB. Section V discusses the question of whether the SEC can

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16 See Policy Statement, supra note 2.
17 Letter, supra note 15.
18 Letter, supra note 15.
19 Policy Statement, supra note 2.
recognize the IASB as a standard setting body. Section VI concludes the article.

II. THE SEC’S AUTHORITY TO RECOGNIZE STANDARD SETTING BODIES

When Congress created the SEC in 1934, Congress gave to the SEC the sole authority to make, amend, and rescind rules and regulations defining accounting terms and to prescribe the form in which required information must be set forth in a company’s financial statements.\(^\text{20}\) This includes the items or details shown in the balance sheet and earning statement as well as the methods to be followed in the preparation of accounts, valuing assets and liabilities, determining depreciation and depletion, differentiation of recurring and nonrecurring income, differentiation of investment and operating income, and in the preparation of consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.\(^\text{21}\)

For reasons beyond the scope of this article, the SEC delegated that authority, albeit implicitly (i.e., not authorized by Congress), to the American Institute of Certified Public Accountants (“AICPA”) through its various committees\(^\text{22}\) from its creation in 1934 to 1973.\(^\text{23}\) This delegation was heavily criticized as an abdication of the SEC’s responsibility conferred upon it by Congress.\(^\text{24}\)

Not only was the SEC’s delegation to the AICPA seen as an abandonment of its responsibility, the AICPA was the target of heavy criticism as the fox guarding the henhouse. Eventually capitulating to the critics, the Financial Accounting Foundation and Financial Accounting Standards Board, discussed in Section III, infra, were formed in 1972.\(^\text{25}\) The FASB was to be an independent, private-sector, not-for-profit, non-stock corporation with responsibility for establishing financial accounting and reporting standards and educating stakeholders about those standards and is responsible for the

\(^{22}\) Tucker, supra note 8.
\(^{23}\) Tucker, supra note 8.
\(^{24}\) Tucker, supra note 8.
\(^{25}\) Chatov, supra note 9; Barney, supra note 9.
oversight, administration, finances, and selection of the members of the FASB.\textsuperscript{26}

Without breaking stride, the FASB succeeded the AICPA as the standard setting body for establishing GAAP.\textsuperscript{27} While the FASB was not officially recognized by the SEC as a standard setting body (i.e., not authorized by Congress), its financial reporting standards were unofficially recognized by the SEC for 30 years.\textsuperscript{28}

III. THE FASB AS A STANDARD SETTING BODY

Prior to considering the FASB its parent organization, the FAF, must be examined. The FASB is not a legal entity in itself, but a board created by the FAF, which is a legal entity.\textsuperscript{29}

A. The Financial Accounting Foundation

1. Articles of Incorporation of 1972

The FAF was incorporated in Delaware in 1972.\textsuperscript{30} The Articles of Incorporation of the FAF have been amended several times since its initial incorporation.\textsuperscript{31} The 1972 Articles of Incorporation declared the purposes of the FAF as follows:

[T]o advance and to contribute to the education of the public, investors, creditors, preparers, and suppliers of financial information, reporting entities, and certified public accountants in regard to standards of financial accounting and reporting; to establish and improve the standards of financial accounting and reporting by defining, issuing, and promoting such standards; to conduct and commission research, statistical compilations, and other studies and surveys;

\textsuperscript{27} See Policy Statement, supra note 2.
\textsuperscript{28} See Policy Statement, supra note 2.
\textsuperscript{29} See Policy Statement, supra note 2. 2012 FAF CERTIFICATE OF INCORPORATION, supra note 10, at 1, 3
\textsuperscript{30} 2012 FAF CERTIFICATE OF INCORPORATION, supra note 10, at 1.
and to sponsor meetings, conferences, hearings, and seminars, in respect of fi-
nancial accounting and reporting.\textsuperscript{32}

It is important to note that there is nothing in the Articles of Incorpora-
tion that even suggests, let alone explicitly states, that any purpose of the 
FAF is to protect investors or the public interest as required by 15 U.S.C. 
\$77s(b).\textsuperscript{33}

The original Articles of Incorporation of the FAF created the FASB: 
“There shall be a Financial Accounting Standards Board in which the By-
laws shall rest sole and exclusive responsibility, power and authority in re-
spect of standards of financial reporting…”\textsuperscript{34} As with the FAF itself, no 
purpose of the FASB is to protect investors or the public interest.

2. Articles of Incorporation of 2002

The Articles of Incorporation of the FAF were amended on August 13, 
2002.\textsuperscript{35} These amendments occurred two weeks after the Sarbanes-Oxley 
Act was signed into law on July 30, 2002, and three days before FASB 
chairman Robert Herz and FAF chairman Manuel H. Johnson submitted a 
letter to Harvey Pitt, Chairman of the SEC on August 16, 2012, “in the in-
terest of expediting implementation of the Sarbanes-Oxley Act of 2002 (the 
“Act”) as it relates to recognition of the standard-setting body.”\textsuperscript{36} The letter 
argued that the FASB should “\textit{continue} to be \textit{the} designated organization in 
the private sector for establishing standards of financial accounting and re-
porting.”\textsuperscript{37} The amended Articles of Incorporation clearly re-affirm the pu-
roposes of the FAF to be:

[T]o advance and to contribute to the education of the public, investors, cred-
itors, preparers, and suppliers of financial information, reporting entities, and 
certified public accountants in regard to standards of financial accounting and 
reporting; to establish and improve the standards of financial accounting and 
reporting by defining, issuing, and promoting such standards; to conduct and 
commission research, statistical compilations, and other studies and surveys; 
and to sponsor meetings, conferences, hearings, and seminars, in respect of fi-
nancial accounting and reporting.\textsuperscript{38}

\textsuperscript{32} \textsc{Certificate of Incorporation of the Fin. Accounting Found.,} (Del.) (1972) [hereinafter 1972 
\textsc{FAF Articles of Incorporation}].

\textsuperscript{33} 2012 \textsc{FAF Certificate of Incorporation} (2012), \textit{supra} note 10.

\textsuperscript{34} 1972 \textsc{FAF Certificate of Incorporation}, \textit{supra} note 32.

\textsuperscript{35} 2002A \textsc{FAF Certificate of Incorporation}, \textit{supra} note 31.

\textsuperscript{36} Sarbanes-Oxley Act, \textit{supra} note 1; \textit{Letter, supra} note 15.

\textsuperscript{37} \textit{Letter, supra} note 15 (emphasis added) (noting the letter urges the SEC that the FASB should con-
tinue to be \textit{the} designated organization, not \textit{a} designated organization.).

\textsuperscript{38} 2002A \textsc{FAF Certificate of Incorporation}, \textit{supra} note 31.
As can be seen, the purposes of the amended Articles of Incorporation are identical to the purposes identified in the original 1972 Articles of Incorporation. While the Article amendments were seemingly for the purpose of complying with the criteria and being designated as a standard-setting body, as with the 1972 Articles of Incorporation, one searches in vain for evidence that any purpose of the FAF is to protect investors or the public interest.

The 2002 Articles of Incorporation again created the FASB with expanded, but substantially similar, language.

There shall be a Financial Accounting Standards Board (the "FASB") to which there is hereby delegated all authority, functions, and powers of the Corporation and the Board of Trustees in respect of standards of financial accounting and reporting (other than in respect of activities and transactions of state and local governmental entities), including the conduct of all activities related thereto not reserved to the Board of Trustees or others in this Restated Certificate or in the By-Laws, which authority, functions, and powers shall be exercised by the FASB in conformity with the By-Laws.

3. Articles of Incorporation of 2012

The Articles of Incorporation were amended again on October 19, 2012 with, not surprisingly, the same purposes as the 1972 and 2002 Articles of Incorporation:

[T]o advance and to contribute to the education of the public, investors, creditors, preparers, and suppliers of financial information, reporting entities, and certified public accountants in regard to standards of financial accounting and reporting; to establish and improve the standards of financial accounting and reporting by defining, issuing, and promoting such standards; to conduct and commission research, statistical compilations, and other studies and surveys; and to sponsor meetings, conferences, hearings, and seminars, in respect of financial accounting and reporting.

Ten years later, the purposes of the FAF have not changed. There is still no purpose to protect investors or the public interest. Both the original and amended Articles of Incorporation fail to provide evidence that the FASB meets the fifth criterion for standard setting bodies under 15 U.S.C. §77s(b).

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39 1972 FAF CERTIFICATE OF INCORPORATION, supra note 32.
40 The Articles of Incorporation also created the Government Accounting Standards Board (GASB) which serves the same function as the FASB but for state and local government financial reporting. The GASB is beyond the scope of this paper. 2002A FAF CERTIFICATE OF INCORPORATION, supra note 31.
41 2002A FAF CERTIFICATE OF INCORPORATION, supra note 31.
42 2012 FAF CERTIFICATE OF INCORPORATION, supra note 10.
4. Bylaws

Since the focus of this paper is on the SEC’s recognition of the FASB pursuant to the Sarbanes-Oxley Act of 2002, only the Bylaws in effect subsequent to the enactment of SOX are relevant.

a. 2002 Bylaws

Among the qualifications for serving on the Board of Trustees of the FAF are the following: “subject to Section 8 of this Article, the remaining members of the full Board of Trustees shall be members at large...and shall be individuals with business, professional, government or other experience who, in the judgment of the Board of Trustees, can contribute to advancing the purposes of the Foundation.”

Recall, however, that none of the purposes of the Foundation include protecting investors or the public interest. Only individuals who can contribute to the education of the public, the education of investors, the education of creditors, the education of preparers, the education of suppliers of financial information, the education of reporting entities, and the education of certified public accountants in regard to standards of financial accounting and reporting; and who can contribute to establishment and improvement of the standards of financial accounting and reporting are permitted to serve on the Board of Trustees of the FAF.

Although the FASB is not a legal entity, it has a board appointed by the Trustees of the FAF. Pursuant to the Articles of Incorporation, the Bylaws provided that, “The FASB shall have and exercise all authority and power, and perform all functions, of the Foundation and the Board of Trustees in respect of standards of financial accounting and reporting,

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43 FIN. ACCOUNTING FOUND., BYLAWS, CHAPTER A, ARTICLE I-A (Dec. 1, 2002) (on file with author) [hereinafter 2002 FAF BYLAWS]. Sec. 4. Qualifications. Subject to Sec. 8 of this Article, of the sixteen Trustees on a full Board, three shall be certified public accountants in public practice at the time of their election; two shall be or, in the judgment of the Board of Trustees, have extensive experience as financial executives; one shall be or, in the judgment of the Board of Trustees, have extensive experience as an investment professional; one shall be or, in the judgment of the Board of Trustees, have extensive experience as an accounting educator; one shall be or, in the judgment of the Board of Trustees, have extensive experience as an investment banker; three shall be or, in the judgment of the Electors, have extensive experience as financial officers or as elected officials of state or local governmental entities; and, subject to Section 8 of this Article, the remaining members of the full Board of Trustees shall be members at large, shall be elected for three-year terms (subject further to Secs 3 and 6 of this Article) by the members of the Board of Trustees serving at the time, of such election, and shall be individuals with business, professional, government or other experience who, in the judgment of the Board of Trustees, can contribute to advancing the purposes of the Foundation. Id.

44 2002 FAF BYLAWS, supra note 43.
including the conduct of all activities related thereto.”

In respect of standards of financial accounting and reporting, “The FASB’s Statements of Financial Accounting Standards shall be designed to establish or improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, attesters, and users of financial information, investors, creditors, educators, and government.”

Obviously, members of the FASB must have “knowledge of accounting, finance, and business.” However, they must also have “a concern for the public interest in matters of financial accounting and reporting.” Criteria for how a “concern for the public interest” is measured or evaluated is not specified other than it is “in the judgment of the FAF Trustees.” However, a “concern for the public interest” clearly does not rise to the level of protecting either investors interest or the public interest. As with the Articles of Incorporation of the FAF, and the Bylaws of the FAF, the Bylaws of the FASB make no mention of protecting investors or the public interest; only to guide and to educate.

b. 2012 Bylaws

The Bylaws in effect in 2012 expand, albeit marginally, both nominations and qualifications for the Board of Trustees. Nominations for at-large Trustees are now sought from “domestic and international investor, accounting, and business organizations; financial and capital markets participants; accounting and business academicians; consumer groups; regulatory organizations; and other interested entities and persons...” Nominations from the public are not explicitly included except to the extent that “consumer groups” might be considered as a subset of the public.

Qualifications for election to the Board of Trustees include evidence of a candidate’s commitment to the mission of the FAF; his or her ability and commitment to exercise independence and objectivity as a Trustee; understanding of financial and capital markets; appreciation of the interests of

45 2002 FAF BYLAWS, supra note 43.
46 2002 FAF BYLAWS, supra note 43.
47 2002 FAF BYLAWS, supra note 43.
48 2002 FAF BYLAWS, supra note 43.
49 2002 FAF BYLAWS, supra note 43.
50 FIN. ACCOUNTING FOUND., BYLAWS, CHAPTER A, ARTICLE I-A (Feb., 2010) (in effect in 2012) (on file with author) [hereinafter 2012 FAF BYLAWS].
investors and other users of financial information, a *concern* for the public interest; and unquestionable professional ethics and integrity.\(^{51}\)

What constitutes an “appreciation of the interests of investors” or a “concern for the public interest” is not addressed. Also unanswered is how an “appreciation of the interests of investors” translates into the mandate of “protecting investors” given to the SEC by Congress.\(^{52}\)

Suitability for election to the Board of Trustees are “evidence of the candidate’s commitment to the mission of the Foundation…appreciation of the interests of investors and other users of financial information in standards of financial accounting and reporting and … concern for the public interest…”\(^{53}\) “Concern,” however, is not defined.

Neither the 2002 nor the 2012 Articles of Incorporation or the Bylaws of the FAF require the Board of Trustees of the FAF or of the FASB to “serve” in the public interest, a requirement of §77s(b).\(^{54}\) Indeed, one may wonder what it means to “serve in the public interest.” Yet, the letter from the FAF/FASB to the SEC boldly declares that “the FAF and/or the FASB [h]ave, for administrative and operational purposes, a board of trustees serving in the public interest.”\(^{55}\)

Like the Board of Trustees of the FAF, the members of the FASB “shall, in the judgment of the Trustees, each have a *concern* for the investor and public interest.”\(^{56}\) Thus, the problems presented by the inconsistency between the mission the FAF and the requirements of 15 U.S.C. § 77(s)(b) apply equally to the FASB.

The 2012 Bylaws require the FASB to “at all times be mindful of the importance of clarity and persuasiveness in its standards and other communications, and of their impact on users of financial information, investors, creditors, issuers, auditors, educators, and the public at large.”\(^{57}\) Thus, the

\(^{51}\) 2012 FAF BYLAWS, *supra* note 50.


\(^{53}\) 2012 FAF BYLAWS, *supra* note 50.

\(^{54}\) 15 U.S.C § 77s (2012). *See generally* 2002A FAF CERTIFICATE OF INCORPORATION, *supra* note 31; 2002B FAF CERTIFICATE OF INCORPORATION, *supra* note 31. (leaving out a decision on whether receiving compensation is consistent with serving the public interest, as it is a debate left for others).


\(^{56}\) 2012 FAF BYLAWS, *supra* note 50 (emphasis added). It seems that here “a concern for the investor” is equivalent to an “appreciation of the interests of investors” but neither is for the protection of investors.

\(^{57}\) 2012 FAF BYLAWS, *supra* note 50.
FASB has an obligation to be mindful of the importance not just of the clarity of the standards, but the ability of the standards to be persuasive to the public at large.

Questions naturally arise. One question is, persuasive to the public at large of what? That the standards are in the best interest of the public? That is not the purpose for which the FASB was created. Attempting to persuade the public of something that is contrary to the purpose of the standards, i.e., to guide and educate of the public, would be antithetical to the FASB’s purposes and mission. It is doubtful the public at large cares about the clarity of the standards and highly questionable whether the public at large believes the standards are in their best interest.

Is the FASB to be mindful of the importance to persuade the public at large that the standards are to protect the public? If this is the intent of the FASB, it would be an egregious misrepresentation of the missions and mandates of both the FASB and the SEC since it has been shown that the Securities Laws were not enacted to protect the interest of the public at large.\textsuperscript{58} For the FASB to be mindful of the persuasiveness of its standards and their impact on the "public at large" runs contra to both the mission and mandate of the SEC and the FASB.

5. FAF Annual Report 2014

Section 77s(b) requires a standard-setting body recognized by the SEC “to submit an annual report to the Commission and the public, containing audited financial statements of that standard setting body.”\textsuperscript{59} With this in mind, it is important to review the FAF’s annual report to determine if the annual report reveals any information pertaining to its purpose. 15 U.S.C. 77s(b) does not specify the legal form of a standard setting body in order to be recognized by the SEC; i.e., it is not required by 15 U.S.C. 77s(b) that the standard-setting body be a corporation.

The recognized body standard-setting body is the FASB, which is not a corporation. As the recognized standard setting body under 15 U.S.C. § 77s(b), it is also important to review the annual report of the FASB.

The 2014 Annual Report of the FAF does not explicitly state the purposes of the FAF other than it was incorporated under Delaware General Corporation Law “to operate exclusively for charitable, educational, scien-

\textsuperscript{58} Huber, Public Accounting and the Myth of the Public Interest, 16 J. ACCNT., ETHICS, AND PUB. POL’Y 2, 251–72 (2015).
tific, and literary purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code, as amended (Code).”

According to the 2014 Annual Report, the FAF is an independent, private-sector, not-for-profit, non-stock corporation with responsibility for establishing financial accounting and reporting standards and educating stakeholders about those standards and is responsible for the oversight, administration, finances, and selection of the members of the FASB. Although no purpose is explicitly stated, the purpose of the FAF is implied in the following paragraph: “The FAF [is] committed to the development of high-quality financial accounting and reporting standards through an independent and open process that results in useful financial information, considers all stakeholder views, and ensures public accountability.”

A review of the 2014 Annual Report of the FAF thus confirms that, consistent with its Articles of Incorporation and the Bylaws, the purpose of the FAF omits consideration of adopting accounting principles and standards necessary or appropriate in the public interest and for the protection of investors as required by 15 U.S.C. § 77s(b).

6. FASB Annual Report 2014

Although not a legal entity, as a recognized standard-setting body the FASB submits an annual report pursuant to 15 U.S.C. § 77s(b). The 2014 Annual Report of the FASB states, in relevant part, that the FASB was organized in 1973 as an independent standard-setting body created by the FAF. Furthermore, the FASB is the designated body in the private sector responsible for establishing standards of financial accounting and reporting in the United States for non-governmental entities. Those standards govern the preparation of financial reports and are provided for the guidance and education of the public, including issuers, auditors and users of financial information.

Once more, the standards of the designated standard setting body are provided only for the guidance and education of the public, including issu-

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60 FIN. ACCOUNTING FOUND., supra note 26, at 35.
61 FIN. ACCOUNTING FOUND., supra note 26, at 35.
62 FIN. ACCOUNTING FOUND., supra note 26, at 27.
65 Id. (emphasis added).
ers, auditors and users of financial information. They are not designed to protect investors or the public, but merely to guide and educate them. Note again that the FASB proclaims that it is the designated body in the private sector responsible for establishing standards of financial accounting and reporting in the United States, not a designated body in the private sector responsible for establishing standards of financial accounting and reporting in the United States.

7. FAF IRS Form 990

Not-for-profit corporations exempt under 501(c)(3) must file on an annual basis IRS Form 990. FAF Form 990 contains a disclosure of the purpose of the corporation, although referred to as “mission,” of the FAF. Not surprisingly, that mission does not include the protection of investors.

Quite simply, “The mission of the FASB is to establish and improve standards of financial accounting and reporting that foster financial reporting by nongovernmental entities that provides decision-useful information to investors and other users of financial reports.”

The FAF does not believe, however, that establishing and improving standards of financial accounting and reporting protects investors or the public. Instead, “The FASB believes that by faithfully implementing US GAAP, entities will produce financial reports that provide useful information to investors, creditors, and other providers of capital.” Through examination of the stated mission of the FASB we find no evidence that the FASB conforms to the fifth criterion of 15 U.S.C. § 77s(b).

IV. THE IASB AS A STANDARD SETTING BODY

The only private standard-setting body that the SEC presently recognizes is the FASB. However, there has been much debate within the SEC and throughout the field, regarding the adoption of the IFRS by the SEC.
As a condition of being recognized as a standard setting body, the entity is required “to keep standards current in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors.”

This language of the statute is both revealing and disturbing. The criterion does not require that an entity to be recognized by the SEC as a standard setting body actually adopt high quality accounting standards necessary or appropriate in the public interest and for the protection of investors, international or otherwise. The body need only consider whether international convergence on (undefined) high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors.

It is obvious that “international convergence on high quality accounting standards” is necessarily targeted to the IASB since there is no other body whose mission and purpose is to develop high quality international accounting standards. The language reflects the purpose and mission of the IASB, as discussed in the following section.

A. IFRS Foundation

1. Articles of Incorporation of the IFRS Foundation

Undisclosed by either the IFRS Foundation (IFRSF) or the IASB is the fact that IFRSF was first incorporated in Delaware on January 25, 2001 as the International Accounting Standards Foundation (IASF). The affairs of the IASF were to be managed by the Trustees whose “qualifications, election, number, tenure, powers and duties of the Trustees shall be as provided in the Bylaws.” The IASF was dissolved one month later on February 6, 2001 only to be immediately re-incorporated on the same date as the International Accounting Standards Committee Foundation (IASCF).
The affairs of IASCF also were to be managed by the Trustees whose “qualifications, election, number, tenure, powers, and duties of the Trustees shall be as provided in the Bylaws.” 77

Since its previous incorporation, dissolution and reincorporation with a different name has not been disclosed, no reason is found in any of its documents for the previous incorporation and subsequent dissolution.

The purposes for which the IASF was formed on January 25, 2001 were

(1) to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world’s capital markers and other users make economic decisions: (2) to promote the use and rigorous application of those standards; and (3) to bring about convergence of national accounting standards and International Accounting Standards to high quality solutions. 78

On April 21, 2010, the IASCF changed its name to the International Financial Reporting Standards Foundation (IFRSF), the name by which it is known today. 79

After its incorporation in the U.S., on May 31, 2001 IASCF was registered in the UK as an Oversea Company “under Section 691 of the Companies Act 1985 as having established a place of business in England and Wales.” 80 On April 21, 2010 the UK registered IASCF changed its name to the International Financial Reporting Standards Foundation (IFRSF), 81 to match the name of the U.S. corporation. 82

2. Bylaws of the IFRSF

First, the Bylaws establish the Trustees as members of IFRSF. The Trustees manage the affairs of the corporation and appoint the members of the

77 Id.
78 Id.
81 INT’L. ACCOUNTING STANDARDS COMM. FOUND., RETURN BY AN OVERSEAS COMPANY OF AN ALTERATION OF CONSTITUTIONAL DOCUMENTS, Form OS CC01 (England & Wales) (Apr. 21, 2010) (on file with author).
IASB. The vacant positions on the board are filled by an election of the current Trustees.83

While the meetings of the Trustees are generally open to the public, meetings concerning selection, appointment and other personnel issues, and funding may be held in private.84 The Trustees approve the annual budget of the Corporation and determine the basis for funding.85 The Trustees are also charged to ensure that each Trustee makes a commitment to act in the public interest.86 Each Trustee shall be required to show a firm commitment to the Corporation as a high quality global standard setter, to be financially knowledgeable, and to have an ability to meet the time commitment. Each Trustee shall have an understanding of, and be sensitive to the challenges associated with the adoption and application of high quality global financial reporting standards for use in the world’s capital markets and by other users. The mix of Trustees shall broadly reflect the world’s capital markets and a diversity of geographic and professional backgrounds. The Trustees shall be required to commit themselves formally to acting in the public interest in all matters.87

3. Mission Statement of the IFRSF

The Mission Statement reiterates the objectives of the IFRS Foundation and IFRS Standards. According to its Mission Statement the primary mission of the IFRSF is to develop International Financial Reporting Standards (IFRS) that bring (1) transparency, (2) accountability and (3) efficiency to financial markets around the world.”88 The work of IFRSF “serves the public interest by fostering trust, growth and long-term financial stability in the global economy.”89

Elsewhere, the IFRSF states its objectives are:

87 Id. What constitutes “acting in the public interest” is not explained or defined.
89 Id.
• to develop, in the public interest, a single set of high quality, understand-
  able, enforceable and globally accepted financial reporting standards based
  upon clearly articulated principles. These standards should require high
  quality, transparent and comparable information in financial statements and
  other financial reporting to help investors, other participants in the world’s
  capital markets and other users of financial information make economic de-
  cisions;
• to promote the use and rigorous application of those standards;
• in fulfilling the above objectives, to take account of, as appropriate, the
  needs of a range of sizes and types of entities in diverse economic settings;
and
• to promote and facilitate adoption of International Financial Reporting
  Standards (IFRS), being the standards and interpretations issued by the
  IASB, through the convergence of national accounting standards and
  IFRS.90

Transparency “enhance[s] the international comparability and quality of
financial information, enabling investors and other market participants to
make informed economic decisions.”91 Note, however, that transparency is
not intended to protect investor or the public interest.

Accountability is strengthened by IFRS “by reducing the information gap
between the providers of capital and the people to whom they have en-
trusted their money.”92 It is not claimed that reducing the information gap
protects investors or the public interest.

Furthermore, IFRS provides information “that is needed to hold man-
agement to account. As a source of globally comparable information, IFRS
is also of vital importance to regulators around the world.”93 Again, no
mention is made of how holding management to account, or how, assuming
globally comparable information IFRS is of vital importance to regulators
around the world, protects investors or the public interest.

Finally, the IFRSF claims that “IFRS contributes to economic efficiency
by helping investors to identify opportunities and risks across the world,
thus improving capital allocation. For businesses, the use of a single, trusted
accounting language lowers the cost of capital and reduces international re-
porting costs.”94

Protecting either investors’ interests or the public interest is omitted from
its mission statement.

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90 IASCF REVISED CONSTITUTION, supra note 87, at 5.
91 Mission Statement, supra note 89.
92 Mission Statement, supra note 89.
93 Mission Statement, supra note 89.
94 Mission Statement, supra note 89.
4. IFRSF Constitution

The IFRS Foundation has developed a Constitution. The Constitution sets forth the objectives of the IFRSF. In addition, the Constitution states that the governance of the IFRSF rests with the Board of Trustees. The Trustees are required to show a firm commitment to the IFRS Foundation and the IASB. In addition, the Trustees must be financially knowledgeable, and “have an understanding of, and be sensitive to, the challenges associated with the adoption and application of high quality global accounting standards developed for use in the world’s capital markets and by other users.” The Trustees must also “commit themselves formally to acting in the public interest in all matters.” As a group, the Trustees comprise individuals who provide “an appropriate balance of professional backgrounds, including auditors, preparers, users, academics, and officials serving the public interest.” The Trustees appoint the members of the IASB who “exercise all powers of the IFRS Foundation.”

Qualifications for membership of the IASB include professional competence and practical experience. However, although the members of the IASB are required to “commit themselves formally to acting in the public interest,” there is no public representation on the IASB. Rather, as a group IASB members consist of “an appropriate mix of recent practical ex-

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96 IFRS Constitution, supra note 96. The objectives of the IFRS Foundation are: (a) to develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles. These standards should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world’s capital markets and other users of financial information make economic decisions; (b) to promote the use and rigorous application of those standards. (c) in fulfilling the objectives associated with (a) and (b), to take account of, as appropriate, the needs of a range of sizes and types of entities in diverse economic settings. (d) to promote and facilitate adoption of International Financial Reporting Standards (IFRSs), being the standards and interpretations issued by the IASB, through the convergence of national accounting standards and IFRSs. IFRS Constitution, supra note 96 at 5.
97 IFRS Constitution, supra note 96, at 5.
98 IFRS Constitution, supra note 96, at 6.
99 IFRS Constitution, supra note 96, at 6.
100 IFRS Constitution, supra note 96, at 6.
101 IFRS Constitution, supra note 96, at 6.
102 See IFRS Constitution, supra note 96, at 7–8.
103 IFRS Constitution, supra note 96, at 10.
104 IFRS Constitution, supra note 96, at 10.
perience among auditors, preparers, users and academics.” Furthermore, members of the IASB must agree contractually to “act in the public interest.” It should be noted that members of the FASB, the only standard-setting body recognized by the SEC, are not committed to, and have no obligation to, act in the public interest or to protect investors.

The IFRS/IASB created a document entitled “Working in the Public Interest: The IFRS Foundation and the IASB” which argues that its standard-setting “is motivated by a strong sense of Public Interest as embodied in our Constitution and, more recently, our Mission Statement” and that the IFRSF “has emphasized that IFRS Standards are created to serve the Public Interest by “fostering trust, growth and long-term financial stability in the global economy.” Noticeably absent from its “Working in the Public Interest” document is any reference to protecting either investors’ interest or the public interest.

5. IFRSF 2014 Annual Report

The 2014 Annual Report identifies the mission of the IFRSF, namely, “to develop International Financial Reporting Standards (IFRS) that bring transparency, accountability and efficiency to financial markets around the world.” The Annual Report explains that the work of the IFRSF “serves the public interest by fostering trust, growth and long-term financial stability in the global economy” and repeats its objectives to bring transparency, strengthen accountability, and contribute to economic efficiency.

Not found in any other IFRSF document is its claim that “Securities regulators and accounting standard-setters are natural allies, because we both have investor protection at heart.” But, besides revealing that protecting the public is not at the heart of either securities regulators or accounting standard-setters, its claim is inaccurate for two reasons. First, se-

\footnotesize

105 IFRS FOUND., supra note 96, at 11.
106 Id. at 1.
108 Id. at 1.
109 Id. at 3.
110 Id.
112 Id.
113 Id. at 8.
securities regulators, at least the SEC, have more than investor protection “at heart.” The SEC has a mandate from Congress not “to have investor protection at heart,” but to actually protect investors.114

Second, there is nothing to support the statement in the IFRSF Annual Report that it has “investor protection at heart.” None of the purposes, missions, or objectives identified in the Articles of Incorporation, the Bylaws, Constitution, Mission Statement, Working with the Public Interest, or IRS Form 990 (discussed in the following section) include any reference to investor protection.

6. IFRSF IRS Form 990

The IFRSF IRS Form 990 states “the IFRS Foundation is an independent, not-for profit private sector organization working in the public interest.”115 Its objective it to “develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted international financial reporting standards based upon clearly articulated principles.”116

While serving voluntarily on the board of a standard setting body is not required by 15 U.S.C. § 77(a), in order to judge the degree of commitment to “serving in the public interest” of the IASB it is useful to know the salaries of the Trustees. The top ten highest paid officers received more than $6 million in reportable compensation in 2014, over 14% of its annual budget. (One officer was part-time. If the part-time officer had been on a full-time basis, the total would be slightly less than 15% of the annual budget).117 Some would argue that is not “serving in the public interest.” Even more

114 Huber, The Myth of Protecting the Public Interest: The Case of the Missing Mandate in Federal Securities Law, supra note 58 (stating that the SEC was not created primarily to protect investors’ interest, but to protect the market, and protecting the public interest is not within the mandate given by Congress).
117 Compare INT’L FIN. REPORTING STANDARDS FOUND., ANN. REP., supra note 112, at 43, with INT’L FIN. REPORTING STANDARDS FOUND., Schedule J, Part II, in FORM 990 (2014), available at https://www.guidestar.org/FinDocuments/2014/134/164/2014-134164140-0b9782f3-9.pdf (stating the salaries of: Hans Hoogervorst, Chairman $813,149; Yael Almog Secretary/Executive Director $336,346; Michel Prada Chair of Trustees (1600 hours) $189,472; Ian Mackintosh Vice-Chairman $754,421; Miranda Corti Treasurer/Director of Operations $279,636; Patrick Finnegan Board Member $750,330; Patricia McConnell Board Member $750,330; Prabhakar Kalavacherla Board Member $756,659; Takatsugu Ochi Board Member $771,373; and Darrel Scott Board Member $676,164).
importantly, nothing in the entire IRS Form 990 makes any reference to protecting investors.118

B. IASB

The International Accounting Standards Board is the independent standard-setting body of the IFRS Foundation. The IASB is not a legal entity. Rather, the IASB is to the IFRS Foundation what the FASB is to the Financial Accounting Foundation, and IFRS is to the IASB what GAAP is to the FASB.119

The Trustees of the IFRS Foundation appoint the members of the IASB.120 Among the criteria for IASB membership are the following: members must have a demonstrated technical competency and knowledge of financial accounting and reporting; members of the IASB must have an awareness of the financial reporting environment; and IASB members should have an understanding of the global economic environment in which the IASB operates including an awareness of financial reporting issues “that are relevant to, and effect [sic] the quality of, transparent financial reporting and disclosure in the various capital markets worldwide.”121

Trustees must also have a “commitment to the corporation’s mission and public interests.”122 Each member of the IASB must “agree contractually to act in the public interest.”123 But acting in the public interest is not equivalent to protecting the public interest or protecting investors. Noteworthy is the requirement that, “The Trustees shall select members of the IASB so that the IASB as a group provides an appropriate mix of recent practical experience among auditors, preparers, users and academics.”124 Absent is any reference to members representing the public.125

Another criterion is that “While a working knowledge of English is necessary, there should not be discrimination in selection against those for whom English is not their first language” which suggests a greater emphasis

119 Ironically, although it is called Generally Accepted Accounting Principles, GAAP is rule based, while IFRS is principles (based on judgment) based. William W. Bratton & Lawrence A. Cunningham, Treatment Differences and Political Realities in the GAAP-IFRS Debate, 95 VA. L. REV. 989, 994, 1009 (2009). The difference is beyond the scope of this paper.
120 IFRS Constitution, supra note 96, at 8.
121 IFRS Constitution, supra note 96, at 16.
122 IFRS Constitution, supra note 96, at 17.
123 IFRS Constitution, supra note 96, at 11.
124 IFRS Constitution, supra note 96, at 11.
on issues of concern to the U.S. and UK. Still another indication of a greater emphasis on issues of concern to the U.S. and UK is the requirement that, “The authoritative text of any exposure draft, draft Interpretation or IFRS shall be that published by the IASB in the English language. The IASB may publish authorized translations or give authority to others to publish translations of the authoritative text of exposure drafts, draft Interpretations or IFRSs.”

Similar to the IFRS Foundation, the IASB claims that it is “committed to developing, in the public interest, a single set of high quality, global accounting standards that provide high quality, transparent and comparable information in general purpose financial statements.” But assuming the IASB actually achieves that goal, the IASB makes no claim that the global accounting standards it develops would protect investors.

Unlike the FASB, the IASB does not file an annual report separate from its parent organization.

V. DISCUSSION AND CONCLUSION

The purpose of this article was to inquire first, whether the SEC was authorized to recognize the FASB as a designated standard setting body and second, whether the SEC can recognize the IASB as a designated standard setting body. The answer to both questions is no.

Recognition is a two-step process. First, the SEC was authorized by Congress to recognize private standard-setting bodies if they meet a set of five criteria. To be recognized as a standard-setting body it must (1) be organized as a private entity; (2) have a board of trustees serving in the public interest; (3) be funded as provided in section 7219; (4) have

126 IFRS Constitution, supra note 96, at 16.
127 IFRS Constitution, supra note 96, at 13.
128 IFRS Constitution, supra note 96, at 10.
130 Sarbanes-Oxley Act, supra note 1, at § 108(b)(1)(A)(i). The criterion does not state it must be a corporation. A for-profit close corporation would be a private entity.
131 Sarbanes-Oxley Act, supra note 1, at § 108(b)(1)(A)(ii). How members of the board “serve in the public interest” is not explained. Whether receiving compensation can be considered as serving in the public interest is not considered here.
adopted procedures to ensure prompt consideration of changes to accounting principles necessary to reflect emerging accounting issues and changing business practices; and (5) consider, in adopting accounting principles, the need to keep standards current in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors.

But the inquiry does not stop there. Once the set of five criteria is met the Commission must then determine that the private standard-setting body has the capacity to assist the Commission in fulfilling the requirements of prescribing the form or forms in which the required information shall be set forth, and the methods to be followed in the preparation of reports, because the standard setting body is capable of improving both the accuracy and effectiveness of financial reporting and the protection of investors under the securities laws.

A. The SEC was not authorized to recognize the FASB as a designated standard setting body

For purposes of the article, it is accepted that the FASB is organized as a private entity. It has a board of trustees serving in the public interest. It is funded as provided in 15 U.S.C. § 7219. It has procedures to ensure prompt consideration of changes to accounting principles necessary.

A serious problem, however, is encountered when considering whether the FASB meets the fifth criterion. None of the purposes, missions, or objectives of the FAF or the FASB as found in the Articles of Incorporation, Bylaws, Annual Reports, or IRS Form 990s is to protect investors’ interest (and certainly not the public interest). Therefore, the FASB cannot consider, in adopting accounting principles, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors.

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133 Sarbanes-Oxley Act, supra note 1, at § 108(b)(1)(A)(iv).
134 Sarbanes-Oxley Act, supra note 1, at § 108(b)(1)(A)(v). (“In the public interest” has no meaning since the mandate of the SEC is to protect first the market and second investors’ interest.) See Huber, The Myth of Protecting the Public Interest: The Case of the Missing Mandate in Federal Securities Laws, supra note 58.
135 Sarbanes-Oxley Act, supra note 1 (emphasis added).
The letter from FASB chairman Robert Herz and FAF chairman Manuel H. Johnson to the SEC cited the five criteria and declared that the FAF and FASB met all five criteria. However, the letter contained no evidence to support the declaration that the FAF and FASB met the criteria.

The SEC Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter (“Policy Statement”) states that:

The Securities and Exchange Commission has determined that the Financial Accounting Standards Board (FASB or Board) and its parent organization, the Financial Accounting Foundation (FAF), satisfy the criteria in section 108 of the Sarbanes-Oxley Act of 2002 and, accordingly, FASB’s financial accounting and reporting standards are recognized as "generally accepted" for purposes of the federal securities laws. As a result, registrants are required to continue to comply with those standards in preparing financial statements filed with the Commission, unless the Commission directs otherwise. Our determination is premised on an expectation that the FASB, and any organization affiliated with it, will address the issues set forth in this statement and any future amendments to this statement, and will continue to serve investors and protect the public interest.

This clearly exceeds the parameters set by Congress. First, Congress requires that the board “serve in the public interest,” not that the standard-setting body “serve investors” or “protect the public interest.” Even if the members of the board serve the public interest, the FASB cannot “serve investors” because serving investors is not within the scope of the FASB’s Mission. Second, the FASB cannot determine if “international convergence on high quality accounting standards is necessary or appropriate...for the protection of investors” because protection of the investors is not within the scope of the FASB’s Mission.

For the SEC to determine that the FASB and FAF will “continue to protect the public interest” is an outrageous overstatement since neither the FASB nor FAF ever acted to protect the public interest. Neither have even claimed its purpose is to protect the public interest. Thus, it is impossible that the FASB and FAF can “continue to protect the public interest.” The SEC has created a criterion that is not only not authorized by Congress, but one that does not even exist within the documents of the FAF or the FASB.

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139 Letter, supra note 15.
140 Policy Statement, supra note 2.
142 Policy Statement, supra note 2.
Furthermore, Congress did not give a mandate to the SEC to protect the public interest. 143 It gave a mandate to the SEC primarily to protect the market and secondarily to protect investors’ interest. 144 But while the FASB may contribute to the efficiency of the market and capital formation, neither the FASB nor FAF claim to protect the market, the public, or investors.

The Policy Statement continues:

The Commission has determined that the FASB has the capacity to assist the Commission in fulfilling the requirements of subsection 19(a) of the Securities Act of 1933 145 and section 13(b) of the Securities Exchange Act of 1934 146 and is capable of improving both the accuracy and effectiveness of financial reporting and the protection of investors under the securities laws. 147

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145 15 U.S.C. § 77s(a) (2012). The section states that “[t]he Commission shall have authority from time to time to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of this subchapter, including rules and regulations governing registration statements and prospectuses for various classes of securities and issuers, and defining accounting, technical, and trade terms used in this subchapter. Among other things, the Commission shall have authority, for the purposes of this subchapter, to prescribe the form or forms in which required information shall be set forth, the items or details to be shown in the balance sheet and earning statement, and the methods to be followed in the preparation of accounts, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer. The rules and regulations of the Commission shall be effective upon publication in the manner which the Commission shall prescribe. No provision of this subchapter imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.”
146 15 U.S.C. § 78m(b) (2012). The section describes the form of report, books, records, internal accounting, and directives, and states that “(1) The Commission may prescribe, in regard to reports made pursuant to this chapter, the form or forms in which the required information shall be set forth, the items or details to be shown in the balance sheet and the earnings statement, and the methods to be followed in the preparation of reports, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of separate and/or consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer; but in the case of the reports of any person whose methods of accounting are prescribed under the provisions of any law of the United States, or any rule or regulation thereunder, the rules and regulations of the Commission with respect to reports shall not be inconsistent with the requirements imposed by such law or rule or regulation in respect of the same subject matter (except that such rules and regulations of the Commission may be inconsistent with such requirements to the extent that the Commission determines that the public interest or the protection of investors so requires).”
147 Policy Statement, supra note 2.
While FASB standards may improve the accuracy and effectiveness of financial reporting, it is not intended for the protection of investors. The intent is clear: “The mission of the FASB is to establish and improve standards of financial accounting and reporting that foster financial reporting by nongovernmental entities that provides decision-useful information to investors and other users of financial reports.”\footnote{Facts about FASB, supra note 142.} Thus, the determination by the SEC that “the Commission has determined that the FASB…is capable of improving…the protection of investors under the securities laws” is unsupported.

The ultra vires recognition of the FASB as a standard-setting body raises a prosecutorial problem. Although the SEC has directed that “As a result [of recognizing the FASB as a standard-setting body], registrants are required to continue to comply with those standards in preparing financial statements filed with the Commission…”\footnote{Policy Statement, supra note 2.} However, if the SEC could not have recognized the FASB as a standard setting body, it may be difficult to prosecute companies and individuals can not complying with standards promulgated by the FASB.

B. The SEC is not authorized to recognize the IASB as a designated standard setting body.

Although the SEC has not recognized the IASB as a standard setting body, the same reasoning that the SEC cannot recognize the FASB as a standard-setting body applies to the (potential) recognition of the IASB as a standard-setting body. The IASB does not meet the criteria set forth by Congress.

C. Where do we go from here?

This article has searched for evidence that the FASB, (or the IASB) fulfilled the criteria set forth by Congress to recognize the FASB (or IASB) as a standard setting body. No evidence was found to support the SEC’s recognition of the FASB as a designated standard setting body or its determination that the FASB is capable of improving the protection of investors. On the contrary all evidence points to the SEC’s recognition of the FASB as a designated standard setting body as ultra vires.
The FASB must prove to the SEC that it meets the criteria, not just declare it. Not only has the FASB failed to prove it meets the criteria, given its Articles of Incorporation and Bylaws it cannot do so at the present time.

The SEC has an obligation to explain and justify to Congress and the public how the FASB meets the criteria. Not only has the SEC failed to explain and justify to Congress and the public how the FASB meets the criteria, it cannot do so since the FASB does not meet the criteria.

Therefore, Congress must take immediate action to amend the criteria in a manner that will allow the SEC to recognize the FASB as a standard setting body, which would then require the FASB to apply for recognition under the new criteria. Alternatively, the FASB must amend its Articles of Incorporation and Bylaws which would also require the FASB to apply to the SEC for recognition as a standard setting body. Either way, changes should be implemented quickly in order to uphold the original intent of the law and avert destabilization of the market.