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Interview with Donald J. Kirk

Donald J. Kirk

Raymond Perry

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CONCEPTS

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Shortly before he took over the chairmanship of the Financial Accounting Standards Board, Donald J. Kirk accepted an invitation to discuss for TEMPO readers the role of the FASB in the accounting profession and the major challenges that are now facing it.

What are the prospects of keeping accounting
rule making in the private sector? How is the FASB responding to issues raised by Congress, the SEC, the business world, and the general public? Who participates in the standard setting process? Is the FASB aware of the impact of its work on the business executive?

Carefully choosing his words, Kirk responded to the questions raised by Raymond Perry, a partner in the Touche Ross Executive Office in New York. Removing his glasses, dangling them, biting them, donning them, the new 45-year-old chairman needed no other prop to concentrate his mind on many of the substantive issues facing the profession.
An interview with Donald J. Kirk

How serious are the threats from Congress to shift accounting rule making from the private sector to the public sector? What would be the consequences of such a move?

KIRK: I should think the threats, if carried out, would be devastating to the Board. However, I find the tone of the recent report by the Metcalf subcommittee to be quite encouraging. Indeed, I am very optimistic from the current tone of Congress that the FASB will be able to go forward in its program for standard setting. As for the consequences of public rule setting, I should think it might be difficult for a government agency to get a commitment of the resources needed to do the kind of research and investigation that results in sound and consistent standards. And how insulated a government body can be from political pressures is another question. I don't mean to say we're immune to such pressures. We feel them. I've been feeling them through discussions with congressmen for the past month and a half, but I think we have a degree of independence that would be hard to match in a governmental agency.

Should the business executive be interested in whether or not the FASB continues to play the key role in standard setting?

KIRK: Well, I think he should be interested if he accepts the need for standards in financial reports. And if he believes that standards help to improve the credibility of his own business and its business reporting. For I believe that our structure offers him a greater assurance of being listened to. I think we bring to him more understanding of the business environment than would a government agency. Although businessmen who disagree with some FASB pronouncements might question that, I am sure it is so. Our problem is to convince businessmen that we should regulate them. Our standards are sort of imposed on them by auditors, and by the SEC if they are registered. It's not like being a member of or applying for a listing on the New York Stock Exchange, in which you agree to submit yourself to regulations. We have a much bigger job of convincing people that our form of standard setting is really in their best interest.

So, how will you convince them?

KIRK: Well, you can't keep pointing to past horror stories about business collapses and fraud. I think we have to convince them that credibility problems can also result from hiding behind "generally accepted accounting principles." Some of our best corporate citizens have given that at times as their sole reason for adopting an accounting method or making an accounting change—with no regard to the quality of the resulting information. And there has been valid criticism of that kind of flexibility. I think the Board can do something that will make the rules of the game more understandable, more consistent, and in some respects less flexible than they have been. I think the result would be beneficial to American corporations. The problem is making standards portray reasonably the activities of a business.

The new SEC chairman has strongly supported continuing accounting rule making in the private sector, but he also promised to report to the Metcalf subcommittee in 1978 on the progress that the FASB was making. How do you expect the SEC to impact the Board?

KIRK: I think clearly the SEC has some legislative responsibilities for the Board's activity. As a matter of fact, I can see some benefits coming out of SEC reports. They will, in effect, inform Congress what the FASB is doing; and this can do nothing but help the Board, provided we are doing our job. I think the relationship of the Board to the SEC is a key factor in the Board's success in the future. I am very encouraged, in fact, by my conversations with the commissioners, for all have indicated that not only would they like to see the private sector succeed, but that they believe it has promise of working. Needless to say, they have also reminded me of their legislative responsibility if the Board does not perform. So it's really up to us to do the job.

The structure committee headed by Russell Palmer seemed to observe a three-way split in the accounting profession.
First, industry accountants think the board has been issuing new standards at too rapid a rate and would prefer that it be more thoughtful. Second, accounting professors don't think the new standards fit together in a coherent pattern. And third, practitioners say that you have not been acting fast enough, you have not been providing the degree of guidance that they would like to see in their public practice. Are these divergencies accurate; and, if so, how would you go about getting the support of all three groups?

KIRK: With great difficulty. Yes, I think that analysis is accurate. Yesterday I had sessions with two Financial Executive Institute groups and one National Association of Accountants group, and I think the industry feeling characterized in your question is accurate. I think the analysis of the auditors’ viewpoint is also accurate. We get a great deal of pressure to deal with more problems. Now, the third group is academicians, and I would question their view. I think the Board has done a fairly good job at developing a consistent approach to some of the major problems it’s faced—such as: reflecting risks in financial statements, income normalization, and the matching concept in its pronouncements on R&D; self-insurance, catastrophe reserves, and other contingencies; foreign currency translation; and, most recently, accounting by oil and gas producing companies. The key will be how we proceed in the future. I believe the conceptual framework will really help to articulate a benchmark against which academicians and others can determine not only whether we’ve been consistent in solving problems in the past, but also whether we will be consistent in dealing with future problems.

Which of these outside views are you the most concerned about?

KIRK: Well, first, I am conscious of another audience, one not as easily defined as the preparers of financial statements or the auditors of financial statements. I mean the general public. What are its expectations? Some of its expectations you find articulated in the comments of the Metcalf subcommittee, as well as the questions at the hearing. There was a feeling that we haven’t proceeded fast enough, nor dealt with enough problems. So, let me state that, in my personal view, I think the Board has to increase its output. I think that is absolutely essential.

The profession has, in a sense, responded to public expectations through the actions of the structure committee and the Cohen Commission. Do you think it has made a satisfactory response?

KIRK: No, I don’t think we’ve satisfied the public’s feeling at all. Congressman Moss is holding hearings to find out where we stand. I think the SEC has expectations about what we are going to do. What we have done is indicated a willingness to be responsive to criticism and granted that some of the criticisms are valid. We’ve indicated to the Metcalf subcommittee that we are making certain structural changes—a commitment to staff increases in order to increase the productivity of the Board, and other changes to try to improve the efficiency of the Board. Above all, what we have done so far is to show our willingness to react positively to valid criticism.

What about the Cohen Commission report?

KIRK: Well, I’m not an expert on everything the Cohen Commission said, but I think the suggestion in its report that the auditors expand their areas of responsibility will have an impact on the Board. One of the most contentious points we face, primarily with businessmen, is the amount of soft data to be included in financial reports to shareholders, and how much the auditor should be involved with that data. There’s a fairly strong feeling that getting auditors involved puts the information in a straight-jacket and limits the company’s ability to present what it thinks is most meaningful. And involving the auditor also implies greater costs. So to include soft data within the auditor’s responsibility will definitely impact the Board, as we struggle to determine what our territory, our “turf,” consists of. And it seems to me that if we are going to be responsible to user needs, we can’t operate in a straight-jacket of rigid definitions of financial statements; the Board must consider financial reporting as a whole. We have to have flexibility, a
willingness to experiment with soft data. So I think there is a definite overlap between what the Cohen Commission suggests and the Board’s own responsibilities.

During the August hearings on conceptual framework, a number of companies were interested in making a distinction between financial statements and financial reporting. They advised the Standards Board to stay in the area of financial statements. On the other hand, when users of this information made their presentations, they, of course, wanted you to provide some of this other information.

KIRK: The most encouraging thing that I found in those hearings was a willingness on the part of many preparers to experiment with innovative financial disclosures on a supplementary basis. Now, there were differences of opinion on whether the Board should be involved in determining what should be included in that supplementary experimental data. But there definitely were preparers who said we should set the standards, not the SEC. On the other hand, there were some who said we should stick to the financial statements and leave the broader territory to others, meaning the SEC.

Would you address yourself to this idea of flexibility? For example, a lot of the flexibility in accounting has been eliminated as the Board has issued standards; but on the other hand when you get into experimenting with supplementary information, let us say current value, then you start opening up new avenues of flexibility, so what happens is instead of reducing the choices you increase them.

KIRK: What I’m suggesting is that we offer some latitude on presenting data, that we not put it in a straight-jacket that says it is essential for the fair presentations of financial positions and results of operations. In other words, if we can move along with a set of financial statements that are essential for fair presentation, and then not be quite as ironclad about the supplementary data, we can have a different basis for judging that information. We’ll generate a lot more thinking about ways to communicate to shareholders. Your firm has done an excellent job of making people think about ways of portraying what you call the economic reality of a business. A lot of other people think your method isn’t the best way to portray that, and what the Board wants to do is try to keep this thought process going. Not immediately jump into a single method of presenting some supplementary data—because if we do that, I think we’re going to create a lot more dispute than positive thinking on how to present the information. I want to avoid the old saw that we are taking away the judgment of auditors, that by setting standards we are eliminating the professional judgment of the CPA. I do not agree with that point at all. I think what the Board has tried to do is put some definitional discipline into financial reporting. Then let professional judgment be put in the areas of measurement, not in arguing about whether you have an asset or liability on every problem that you deal with.

The public hearing in January will conclude the second part of the hearings on the objectives of financial statements and the conceptual framework. What are your major problems in moving ahead on a basic project such as this?

KIRK: Mostly time. For example, the Board and its staff had to spend substantial amounts of time last year on the oil and gas issue—and that forced us to divert some resources away from other projects, including conceptual framework. The time involved in the oil and gas issue is something that a lot of people just don’t appreciate. Then, there is the care with which the research must be done on the objectives question itself. And once the words are written, it becomes a matter of seven men discussing it, arguing about it, and coming to a meeting of the minds. So the slow pace is not so much because of a conceptual hang-up on these questions, it’s just a matter of being able to get to it and then to deal with it.

How do you think the supplementary disclosure approach will be used to enable some of the conceptual framework issues to be met?

KIRK: I think it’s clear the Board must take a position on the validity of replacement cost accounting. The timing is perfect. The SEC has said they’re going to restudy the question in ’78. And if the Board does act, the idea of supplementary disclosure will likely be the method that is followed.

Chairman Williams of the SEC recently said that some form of inflation accounting was a necessity, although not necessarily the type now required by the SEC.

KIRK: I would say that his assessment and mine are very close together. I sense a feeling on his part that historical cost financial statements will stay with us for a while. I think the experience in England has indicated this—that even with high inflation, and with a government commission recommending that they should get off historical cost and adopt another method—that even then there is a problem.
in making a wholesale change in the method of reporting. Touche Ross has recommended that we proceed in a more evolutionary fashion, and I think without question that’s the way we must go, although we also are not convinced that replacement cost is necessarily the way to reflect the current economics of a business. But I think we are coming together on this problem and hopefully we can reach a mutually acceptable solution in 1978. Of course, if we do, it will alleviate a lot of business concern about what the Board has in mind.

What kind of response do you usually get to a draft proposal? How unusual was the large response to the employee benefit plans proposal? Where do such responses come from?

KIRK: Whenever you deal with a broad-based industry you can expect to hear from a wide audience. As for employee benefit plans—I guess most every company in the country has one, and they have not received much attention from the viewpoint of public reporting. And whenever the Board suggests a significant change to such a group, it expects to get a large number of responses. The letters we received particularly expressed concern about the professional responsibilities of actuaries versus the professional responsibilities of auditors. And I think that gave rise to the vehemence of some of the letters. Now, the Board’s thinking was that in order to present the financial position of a plan, you must also present information about the obligations to past and present employees covered by that plan. The principal question was finding the best solution for measuring the plan obligations, and also whose responsibility it is. The Board has agreed to do whatever it can to resolve the potential conflict between actuaries and auditors, and has agreed to work with the Department of Labor and other professional groups to seek a solution to this problem. This is a very difficult situation, and it’s one we would like to demonstrate leadership on. It is also an essential ingredient in measuring pension costs of employers. I think there are many people who want us to deal with such pension costs, and we would like to resolve some of the measurement questions on the benefit plan project before moving into the pension cost measurement. Whether or not we will be able to do this in an orderly fashion, I don’t know.

Do you receive many responses to draft proposals from people who may have a more objective view of the question, such as academicians, auditors, lawyers, and those from other groups?

KIRK: What is surprising is that we hear very little from academicians. Some have suggested to me that this is because they do not get any credit for responding to us, that they might find it more rewarding for their professional careers to write an article that can be published. Thus, responding to our issues may have no relationship to their own personal goals and may not be relevant to their own area of interest. As for other objective groups, it is hard to tell when someone is objective and not objective. There are groups or firms that consistently do an excellent job, of course, and I would hope those that have done so will continue to respond. It is very helpful to the Board. Very helpful indeed.

Do business firms respond whether or not the rules are concerned with them?

KIRK: A few companies have the capability to respond generally, but if it clearly has no relation to their business then most often they do not. Most of our standards probably affect the larger companies in one way or the other, so some of them respond regularly to the Board. Of course, we hear most often from the major accounting
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Do you anticipate a greater across-the-board response in the future?

KIRK: We will do whatever we can do to encourage it, such as summarizing projects in layman's terms. But more important will be the beneficial effect of the "sunshine" rules that we have adopted beginning in January, 1978, for this will help inform the public of the Board's attitudes and leanings throughout a project. In the minds of some, this may hinder our operations, but I think the benefits of letting people see where we stand will overcome some of the criticisms we've heard, such as that no one knows what we're going to say until we issue an exposure draft. Anyone who will follow the Board's meetings on a project is now going to know what the Board's leanings are, and we will see to it that those leanings will be made public, so every company won't need to have an observer at all of our meetings.

Most businessmen appear to agree that accounting rule making should be in the private sector, yet when it comes to a proposal they don't agree with, some seem ready to run to Congress for help. For example, the Haskell-Bartlett amendment. Will this kind of "end run" become a regular part of the process?

KIRK: In no way do we want to suggest that businessmen should not exercise their rights as citizens and maintain their relationships with their legislative representatives. But on the other hand, we do not think that Congress is the proper forum for resolving significant and technical financial reporting problems. They do not have sufficient time to do the research, for one thing. So our job is to convince businessmen that the forums that they do have—the FASB and the SEC—can do the job. Most of all, we must help them to understand our process at the Board. They must understand the reasoning we go through before reaching our conclusions. And if they then proceed to take whatever action they can to upset our solution, or that of the SEC, then I think the Board has an obligation to carry its message, its interpretation of the facts, to the Congress of the United States.

What do you see as the high priority items you will face during the coming year?

KIRK: I see both technical priorities and institutional priorities. The structure committee focused on institutional questions: how we could do a better job more efficiently and be more responsive to our constituents. Recently, we have devoted a lot of energy both to reorganizing ourselves and to recruiting additional staff, at which we've had great success. That is, we have hired 10 new professional staff members in the past three months. Yet, there are things that still need to be done, most of them mentioned in the structure committee report, and they are high on my priority list in 1978.

The quality of the Board's staff is obviously quite important. Has it been easy or difficult to attract good people to the FASB?

KIRK: It takes a special person to want to join our staff. You have to have an interest not only in the mission of the Board but also in the work of the Board, and to find people that have both of those is not easy. We are a specialized place. And so, more important than the ability to compensate people well is, I think, the ability to give them intellectual satisfactions that are hard to match. So, it's a very select group of people we want to attract, and trying to find them, convince them that we've got something to offer, takes time. But we've had a positive response in the last three months of active recruiting that indicates that, yes, we do have something to offer. In fact, I believe that as an institution we are more stable than perhaps we were a year and a half ago, when the Moss committee report came out, and the Metcalf staff subcommittee report was in process. For as the uncertainties of that time have lessened, we have found people who are not only interested in but receptive to joining the Board.
And your technical priorities?

KIRK: I think clearly the Board must move ahead on its conceptual framework project. It must resolve as best it can the question about objectives, the question about asset, liability, and earnings definition; and it must consider the validity, the appropriateness of measurement schemes other than historical cost. Hopefully, the oil and gas project is now behind us, although the Board, or at least the staff, may still be spending a fair amount of time on that question. I also have on my priority list the reconsidering of our existing statements, thereby demonstrating our willingness to question and analyze our own work. Another major question you mentioned before: financial statements versus financial reporting. Should the Board get involved in areas other than the traditional balance sheet and income statements? Finally, should accounting standards differ for small companies and large companies? There is not a clear-cut solution to this problem. It is alluded to in the Metcalf report, and I think that the Board, the AICPA, and others who are involved must address the question soon.

How important...what priority do you give to maintaining communications with the Washington scene?

KIRK: I have two external responsibilities that are very high on my list. One is on the Washington scene. It’s very important that the Board convey what we are to key people in Congress. We must convince them that we are operating in the public interest and that we are following a reasonable due process. The other responsibility relates to chief executive officers. They are the most difficult audience to speak to. They are the ones who often say that, yes, there is a need for standards, but more often they will say there are needs for standards for somebody else, not themselves. But we must remember that they are the ones who carry the burden of any change in reporting. They are the ones who are obligated to explain it. They are the ones who feel the most accountable. They are the ones who feel they are being graded by the earnings they report. And, therefore, when we ultimately issue a statement and it does affect a company, the chief executive will often take it as a personal matter. I certainly will do my best to communicate to that audience. For, unfortunately, only when financial reporting becomes a crisis do they become involved. I can cite a perfect example. A well-known company, responding to the discussion memorandum on oil and gas, said that it was very important for comparability purposes to adopt a single method of accounting. They favored the full cost method. Now, this correspondence was written by the vice president and controller. Only when we came down on the side of the successful efforts method did the chairman of the board become involved. So, as much as we try, we often don’t get to the audience that has the most at stake. And I’d like to communicate better with that audience, as well as with the Washington audience.

To close on a personal note, have these problems ever caused you to have second thoughts about your decision to leave Price Waterhouse five years ago and join the FASB?

KIRK: Well, at that time, I felt I had an understanding of what the pluses would be, what the minuses would be, what the pressures would be, and I have to say I didn’t misjudge what was involved.

What were some of the pluses and minuses?

KIRK: The major plus is the feeling that you are participating in a worthwhile, an essential mission, and that it has wider importance than the work you were doing before. On the other side is the recognition that you are giving up the comforts, the companionship, the challenges that exist in a partnership. Instead, you are charged with a responsibility to make up your mind, defend your position, and then hear all who do not like what you did. I think I recognized that all those things would be here. So I was prepared. No only do I enjoy the job, I am a better person as a result. I’m better at living with frustration for example.

You must enjoy the job to have accepted the chairmanship of the FASB.

KIRK: Well, when you enjoy what you are doing and you’re given the opportunity to be the head of the organization, it seems to me to be the only logical thing to do—and to accept the additional challenge that goes along with it.

And the frustrations?

KIRK: Yes, and the frustrations. In fact, I can testify they are already much greater than they were. However, I must say that I am personally pleased that the Board has changed the voting requirement from five votes out of seven to four out of seven. I think that it gives me as chairman much more intellectual freedom than existed before. For in addition to handling the administrative and technical work, my personal goal is to retain my ability to do my own thinking and to express my own views on a particular subject.

You have certainly done that this morning. Thank you.