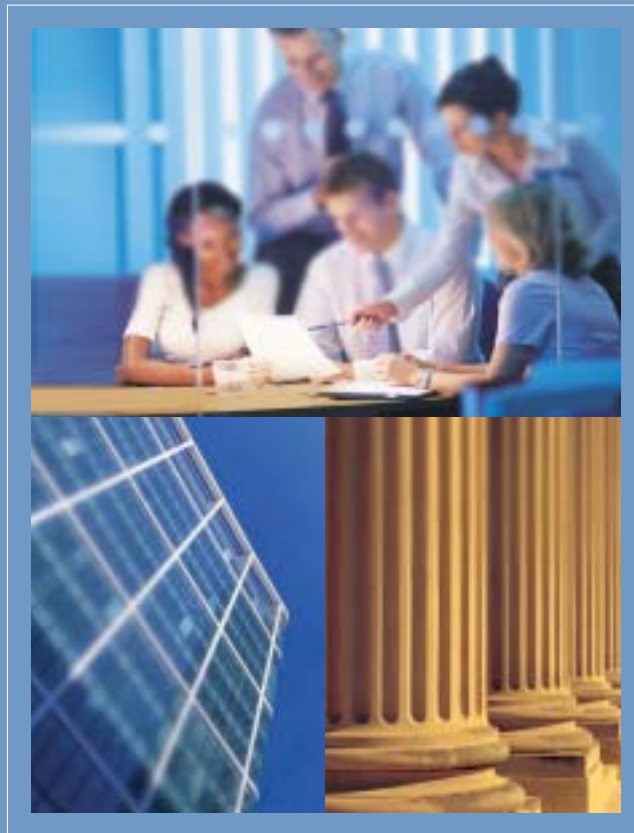


Financial Accounting Foundation



Reaching Out to Constituents

*Financial Accounting
Foundation*

The Financial Accounting Foundation, organized in 1972, is an independent, private-sector organization whose Trustees have oversight, appointment and funding responsibilities for the Financial Accounting Standards Board, the Governmental Accounting Standards Board and their Advisory Councils.

*Financial Accounting
Standards Board*

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

*Financial Accounting
Standards Advisory
Council*

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

*Governmental Accounting
Standards Board*

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

*Governmental Accounting
Standards Advisory
Council*

The Governmental Accounting Standards Advisory Council consults with the GASB about technical issues and other matters as may be requested by the GASB or its Chairman, including selection and organization of task forces.

Reaching Out to Constituents

Constituents play an integral role in the work of the Financial Accounting Standards Board and the Governmental Accounting Standards Board. Throughout the course of the standard-setting process, both organizations regularly seek participation from a broad base of financial statement users, ranging from corporations to governments and regulators to investment analysts.

Constituent input is critical to producing and strengthening U.S. accounting standards that are essential to the vitality of our capital markets, which depend on robust and rigorous accounting standards.

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FAF

Financial Accounting Foundation



Robert E. Denham, FAF Chairman



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

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

New Era, New Leadership:

Robert E. Denham Chairs Foundation

As the transition period marking major changes in the financial reporting field was unfolding during 2003, the Financial Accounting Foundation (FAF) was preparing for changes of its own at the top. In October, Robert E. Denham was elected Chairman and President of the organization, effective January 1, 2004.

Bob Denham, a Foundation Trustee since January 2003, succeeded Manuel H. (“Manley”) Johnson whose final term of office drew to a close at the end of last year. Manley Johnson, an FAF Trustee since 1996, was the longest serving Chairman of the organization, having held that position since 1997. More about Manley Johnson’s legacy of leadership will follow later in this report.

A partner in the Los Angeles-based law firm of Munger, Tolles & Olson and a native of Abilene, Texas, Bob Denham is a graduate of the University of Texas as well as Harvard Law School. He served as Chairman and Chief Executive Officer of Salomon Inc in New York City from 1992 to 1997. He is a member of the Board of Directors at several firms, chairing two audit committees.

In the accompanying text, Bob Denham looks back over the highlights of the past year, including the accomplishments achieved during Manley Johnson’s tenure, and looks ahead at what the FAF can expect in the near future.

Restoring Public Trust

Following a series of now infamous accounting scandals, the Sarbanes-Oxley Act helped usher in an era of change in the private sector. Sarbanes-Oxley also increased focus on the institutions that we rely on for integrity in corporate financial reporting. At the FAF, we are responsible for two of those institutions, the FASB and the GASB. We take that responsibility very seriously.

The FAF has two interrelated responsibilities with respect to the FASB and the GASB. We must maintain their independence, and we must be sure that they have resources, Board members and leadership that enable them to do their jobs.

Independence for accounting standard setters is critically important if you believe, as I do, that the single purpose of accounting principles is to assure clear and comparable reporting of the economic condition and economic performance of enterprises. This is a high purpose, because achieving it allows a market economy to allocate capital efficiently. If, on the other hand, you want accounting to be like the U.S. tax code, serving a multitude of social purposes (employee ownership, capital investment, provision of post-retirement benefits, to name a few), you worry less about independence and you accept less efficient capital markets. The choice of the FAF is clear: assuring the independence of the FASB and the GASB is job one for us.



Judith H. O'Dell

“Independence for accounting standard setters is critically important if you believe, as I do, that the single purpose of accounting principles is to assure clear and comparable reporting of the economic condition and economic performance of enterprises.”



Stephen C. Patrick

“The FASB and the GASB require resources to do their jobs, and it is the job of the FAF to provide these resources, principally talented people, without compromising independence. We made great progress on that front during 2003.”

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Oversight and Funding

Sarbanes-Oxley has permitted the FAF to insure adequate resources for the FASB while assuring independence. In August 2003, a new funding structure for the FASB, initiated under Sarbanes-Oxley, was implemented that involved mandated public company financial support.

I am pleased that the new source of funding has strengthened the FASB’s ability to do its job, and I would like to thank all of the more than 7,500 public companies that, through their mandatory contributions, are supporting the FASB’s standard-setting mission and the interests of investors. At the FAF, we take very seriously our responsibility to use the money we receive from you wisely and efficiently.

The FAF remains fully committed to securing a stable source of funding for the GASB and worked tirelessly throughout 2003 to identify alternatives to voluntary contributions, which have historically represented the majority of resources available to the GASB. The FAF, with the support of the GASB, is currently working with three of the GASB’s constituent groups, the National Association of State Auditors, Comptrollers and Treasurers; the Government Finance Officers Association; and the National Association of State Treasurers to help develop a fee assessment program for the GASB that, through small fees based on municipal bond offerings, would provide a significant part of the funds needed by the GASB. Plans for this funding structure are expected to be announced later this year. Even with the new funding mechanism for the GASB that we hope to achieve, however, we know that we still have more work to do to provide financial security for the GASB. We are committed to doing that work because we believe that independence is as important for government accounting standard setters as for private-sector standard setters.

Other Constituents Are Vital to Our Work

We cannot emphasize enough the ongoing importance of constituent involvement to the success of our Standards Boards’ work. Throughout the course of the year, our Boards receive invaluable input from a variety of forums, such as public board meetings, hearings and roundtable discussions and the comments and letters received in connection with numerous exposure drafts.

In addition, outreach is underscored through organized groups that tap the collective knowledge and experience of broad constituencies. Foremost among them is the valuable counsel afforded by the FASAC and the GASAC to the FASB and the GASB, respectively. Complementing its outreach efforts to the investment

community, the FASB established a new User Advisory Council during 2003 to gather the insights of investors, financial analysts, credit rating agencies and other consumers of financial information. Late in the year, the FASB also initiated planning for development of a Small Business Advisory Committee to provide another avenue of constituent outreach.

Convergence Supports Global Markets

Building and sustaining global capital markets require globally converging accounting standards. To that end, the FAF commends the efforts of the FASB and the International Accounting Standards Board (IASB) in 2003 to facilitate global convergence of accounting standards. During the year, the FASB and the IASB made important progress toward reducing the differences between U.S. accounting standards and those outside the United States. In 2004, the two Boards are building on those accomplishments and will develop a joint agenda in April of this year. In June, for the first time, the FAF and the International Accounting Standards Board Foundation (the oversight board for the IASB) will hold a joint meeting.

Regardless of geography, healthy and efficient capital markets depend on quality accounting standards, and it is in our interest to encourage the best standards to be adopted globally.

Accomplishments

The FASB and the GASB made significant progress in 2003 toward the goal of providing timely and important improvements to U.S. financial reporting. The FASB issued accounting guidance (FIN 46) to strengthen existing rules and to help curb financial reporting abuses involving off-balance sheet structures known as variable interest entities. The FASB also completed a project to improve disclosures relating to defined benefit pension plans and made significant progress on a number of major projects, including equity-based compensation, revenue recognition and fair value measurement.

The year 2003 marked the third and final year of implementation of the GASB's landmark financial reporting model, Statement 34, which continues to receive favorable feedback from a wide range of users of financial statements. Currently, the smallest governments, those under \$10 million in annual revenues, will complete implementation for fiscal years beginning after June 15, 2003. The Board also is nearing completion of its Other Postemployment Benefits project.

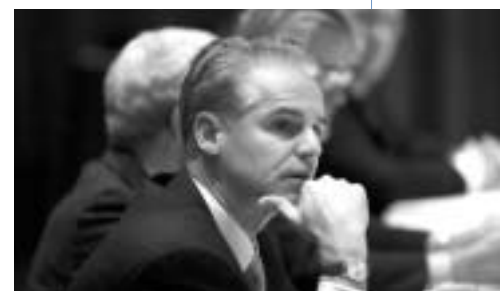
New Board Appointments

GASB Chairman Tom L. Allen's second term as Chairman of the Board ends on June 30 of this year and, his successor, Robert H. Attmore, was recently announced. Tom headed the GASB during a most critical period and led the

“We cannot emphasize enough the ongoing importance of constituent involvement to the success of our Standards Boards’ work. Throughout the course of the year, our Boards receive invaluable input from a variety of forums...”



Frank C. Minter and William H. Hansell



Eugene D. O'Kelly

“During the year, the FASB and the IASB made important progress toward reducing the differences between U.S. accounting standards and those outside the United States.”



Jerry J. Weygandt and Douglas R. Ellsworth

Board's work on Statement 34, which has made substantial improvements to state and local government financial reporting. He did an outstanding job during his tenure and will be missed.

Bob Attmore is a former Deputy State Comptroller of New York State. He served New York State in key positions over a 23-year period. Previous to those posts, he was in public accounting. His experience in state accounting and fiscal matters should be a great asset to the GASB.

In 2003, the FAF appointed Leslie F. Seidman to a three-year term, completing the service of John K. Wulff, who left the FASB to return to private industry. Leslie, who had most recently founded her own consulting firm, previously worked for the FASB and is a former Vice President of Accounting Policy at J. P. Morgan & Company. Effective August 1, George J. Batavick, a former Texaco Inc. Comptroller, joined the FASB, succeeding John M. (“Neel”) Foster whose second term ended June 30. FASB member Gary S. Schieneman was reappointed to a new term that began on July 1, 2003.

In February 2004, the FAF announced that Edward W. Trott of the FASB and Paul R. Reilly of the GASB were reappointed for second terms that commence on July 1, 2004. Paul's term is for one year and will bring his total years of service to ten, which is the maximum for any Board member.

On behalf of the Trustees, we are delighted to welcome Bob Attmore as the next GASB Chairman and are very pleased with our new and reappointed FASB and GASB Board members. We greatly appreciate the service rendered to the FASB by both Neel Foster and John Wulff.

Trustees

Two new Trustees joined the Foundation in 2003. For one of them, Ned V. Regan, it marked a return to FAF Board service. Ned, who has been President of Baruch College in the City University of New York following his position as New York State Comptroller, is a former FAF Trustee. Our other distinguished new Trustee, Edward W. Kelley, Jr., is a former Governor of the Federal Reserve System. Mr. Kelley serves on a number of corporate boards. In February 2004, Barbara A. Yastine, Chief Financial Officer of Credit Suisse First Boston, was named a Trustee. David A. Viniar resigned from the Board in 2003.

On behalf of my fellow Trustees, I extend my sincere appreciation to all of our departing colleagues and thank them for their commitment to good financial reporting. We also welcome our newly appointed trustees.

Tribute to Manuel H. Johnson

I also would like to recognize the many contributions that my predecessor, Manley Johnson, made as the longest serving Chairman of the Foundation.

During his tenure, which ran from 1997 to 2003, Manley headed the organization during a challenging and turbulent period. He played a critical role in preserving the independence of the FASB and the GASB and led the Foundation in supporting mandatory public funding under the Sarbanes-Oxley legislation. Likewise, he also helped identify stable sources of funding for the GASB, which are now under review by interested parties.

Under Manley, the Board of Trustees provided support for convergence of global accounting standards. His other accomplishments include making important process improvements to the FASB, including a change in its voting structure from a super majority to a simple majority.

We owe Manley a deep debt of gratitude for his years of excellent leadership of the Foundation and its two Boards.

Conclusion

From my business and legal career, I have learned to appreciate the critical role that accounting plays in capital markets, as well as to appreciate the many people who work hard on a daily basis to “get the numbers right” in accordance with the robust and demanding accounting standards promulgated by the FASB and the GASB. From my experience with the FAF, I have developed a deeper appreciation of the members of the FASB and the GASB and their talented and hard-working staffs and Councils, who have contributed so much to U.S. accounting standard setting during a very challenging period.

With such dedication, I am confident that the FASB and the GASB will fulfill their missions of developing accounting standards responsive to the needs of a complex and dynamic economy.



Robert E. Denham
Chairman, FAF



Richard D. Johnson and Edward W. Kelley, Jr.

“...I have learned to appreciate the critical role that accounting plays in capital markets, as well as to appreciate the many people who work hard on a daily basis to ‘get the numbers right.’”

FASB

Financial Accounting Standards Board



Robert H. Herz, FASB Chairman



Established in 1973, the Financial Accounting Standards Board (FASB) is an independent, private-sector organization whose mission is to establish and improve standards of financial accounting and reporting for both public and private enterprises.

Those standards are essential to the efficient functioning of the economy because investors, creditors and other consumers of financial reports rely heavily on transparent, credible and comparable financial information. The FASB's standards are officially recognized as authoritative by the Securities and Exchange Commission and the American Institute of Certified Public Accountants.

Have the changes and reforms put in place under the Sarbanes-Oxley legislation been worthwhile, thus far?

It has clearly been a most challenging time for all concerned, not only as a result of new FASB standards that are tackling critical accounting concerns, but also because of the many new rules, regulations and process requirements emanating from various parties.

I believe that the changes and related reforms resulting from the Sarbanes-Oxley Act seem to have put in place the right kinds of structural and procedural mechanisms, incentives and penalties needed to keep us moving toward the promised land of a better reporting system. That includes a strengthened SEC, the establishment of the PCAOB, management certifications of financial information, reinvigorated audit committees and a new funding mechanism for the FASB, to name a few. We all hope the changes and reforms have been worthwhile, but they will only prove to have been so if the result is a better financial reporting system, one that earns and maintains the trust and confidence of all participants in the capital markets by providing the relevant, reliable, timely and understandable information they need.

Are these changes enough to accomplish the goal of a better financial reporting system?

As necessary as they have been, they are not, in and of themselves, sufficient to ensure we are truly moving in the right direction, in my view. With so many different players in the system—including investors, standard setters, preparers, employees, auditors, boards and audit committees, regulators and enforcers, legislators and analysts—it's necessary that we not only attend to our particular roles, but also that we all have a common understanding of the role of others as well as of our collective responsibilities to be able to move the system forward in an orderly and constructive way.

How can we move financial reporting forward?

While developing a common vision and staying the course won't be easy, it must of necessity involve all the key parties in the system and will take a collective determination and lots of communication and coordination to ensure we are on course. In short, it will take a sense of partnership and a shared commitment to the importance of quality financial reporting to the overall system. And, when we add on the desire for international convergence—not only of accounting standards, but other elements of the reporting system—we add another dimension of challenge.



David B. Rickard,
CVS Corporation

“... the changes and related reforms resulting from the Sarbanes-Oxley Act seem to have put in place the right kinds of structural and procedural mechanisms, incentives and penalties needed to keep us moving toward the promised land of a better reporting system.”



*L. Hal Rogero, Jr.,
MeadWestvaco Corporation*



*Robert E. Friedman, Standard & Poor's,
Thomas J. Ray, Public Company
Accounting Oversight Board (foreground),
and FASB's Leslie F. Seidman*

*“The FASB listens to
diverse viewpoints, con-
cerns, complaints and
sometimes, fears, almost
daily in our meetings
with constituents...”*

What have you learned about constituent groups and their diversity?

A successful partnership begins with a better understanding and appreciation of each partner's perspectives, ideas, fears, roles and responsibilities. Let's start with some of our constituents' concerns and perspectives by looking at preparers, auditors and users.

Preparers are concerned about what they view as disclosure overload and accounting standards that seem overly complex, often difficult to implement and that, in their view, may not always match up well with how they see the operating realities of their business and management objectives. They see a seemingly endless string of new standards, rules and requirements and question the cost-benefit and wisdom of what seems like constant change.

Auditors share many of the preparers' concerns, with particular emphasis in this current climate on the auditability of information underlying financial statements. They are sometimes uncomfortable with an increasing emphasis on critically evaluating key accounting estimates made by management and auditing fair value measurements in the absence of market quotes. They fear what they perceive as second-guessing by the SEC, PCAOB, the trial bar and others and are greatly concerned by what they feel is a continuing and potentially growing expectation gap between what the public thinks they should and can do by way of an audit and what they believe is genuinely possible. They are eager to restore their image and the overall vitality of, and public trust in, their profession.

Users are a particularly diverse group ranging from individual investors to professional analysts, and institutional investors, lenders, creditors and various other parties. Focusing mainly on the professional users of financial information, they are very interested in seeing and understanding not only management's operating performance, but also the effects on a particular company or industry of external forces, such as the impact of changing markets on enterprise assets, obligations and results. They're concerned about accounting methods that allow assets and liabilities to be kept off balance sheets and about accounting methods that delay recognition of certain events or about accounting that spreads such effects over multiple periods. More information is desired on cash impacts and current value. For some, the term “disclosure overload” doesn't exist.

While much of this is an oversimplification, my main point is to emphasize that there are many different, sincere and heartfelt perspectives on accounting and financial reporting.

How can the FASB perform its responsibilities while meeting and reconciling the diverse needs of a broad spectrum of constituencies?

The FASB listens to diverse viewpoints, concerns, complaints and sometimes, fears, almost daily in our meetings with constituents and via a variety of meetings with advisory councils, liaison groups, task forces and working groups. In addition, the FASB receives and reviews comments gathered from draft proposals and public roundtables. In short, the Board is always reaching out to constituent groups for feedback to ensure that our process is as thorough and objective as possible. Very importantly, we want to consistently demonstrate a thorough understanding of the nature of the business transactions and economic phenomena that are the subject of our accounting standards. We then must develop standards that are as faithful as possible to the guiding principles in our conceptual framework, trying our best to achieve the proper balance in many areas while meeting the interests and needs of our diverse partners in the process.

Does the FASB always get that balance right?

Undoubtedly, we do not always get the balance right. But one's view of how far off we are on a particular standard depends on where you sit. If you are a preparer, you may think we should have focused more on cost/benefit. If you are an auditor, you may think auditability should be the primary goal. And, if you are a user, you may desire additional disclosures. Striking the right balance, not only for the FASB in developing accounting standards but, more importantly, in guiding the overall reporting system to a bright future, requires the kind of partnership and cooperation that I'm describing in this process.

Describe the FASB's relationship with the SEC and PCAOB under the Sarbanes-Oxley legislation.

We have an excellent working relationship with the SEC and its staff. Under the Sarbanes-Oxley Act, we receive mandated public company funding just as the PCAOB does. In April 2003, the SEC issued a policy statement reaffirming the FASB as the official accounting standard setter. This was significant because, amongst other things, it explicitly recognized and reinforced the importance of our process being independent, objective and neutral.

I'm pleased to report that we're rapidly achieving effective formal and informal working relationships with the PCAOB. This includes being represented on each others' advisory councils as well as holding productive meetings between our respective Boards. While carrying out its auditing responsibilities with regard to the

“Very importantly, we want to consistently demonstrate a thorough understanding of the nature of the business transactions and economic phenomena that are the subject of our accounting standards.”



FASB member, Michael Crooch, with Susan L. Decker, Yahoo!, and Colleen A. Sayther, Financial Executives International



Janet L. Pegg, Bear Stearns & Co., Alan G. Levin, Pfizer Inc, and FASB Chair, Robert H. Herz

“We know that often the costs of compliance with our standards can fall disproportionately on smaller business. The FASB has, in numerous cases and various ways, tried to lighten that load...”



*Marc E. Lackritz,
Securities Industry Association*



*Donald D. Humphreys,
Exxon Mobil Corporation*

auditing arena, it is important for the PCAOB to understand accounting guidance. Conversely, we at the FASB need feedback from the PCAOB, as well as auditing firms, regarding the auditing considerations relating to our accounting standards.

Can you comment on the relationship of the FASB, private companies, small business and the users of the GAAP financial statements of those entities?

We know that often the costs of compliance with our standards can fall disproportionately on smaller business. The FASB has, in numerous cases and various ways, tried to lighten that load through reduced disclosures and extended effective dates for non-public companies. We’ve also actively encouraged participation of private companies and small business in various FASB activities, including representation on the FASAC and on the FASB’s User Advisory Council, with recent creation of a new Small Business Advisory Committee. An important issue that continues to be raised by some is whether, and/or to what extent, there should be a differential GAAP for small and private businesses. While the idea of differential GAAP has been examined a number of times in the past and rejected for a variety of sound reasons, I am not against re-examining it again. But I strongly believe that any differential accounting and reporting must be shown to meet the needs of users of financial statements of small businesses and private companies, not just designed for the convenience of those entities and accounting practitioners.

How does the financial reporting partnership factor into support of international convergence of accounting standards?

The IASB is the key player in international standard setting. Over the past couple of years, the FASB and the IASB have been working actively together in pursuit of international convergence. We’ve been working on joint projects such as purchase method procedures for business combinations, revenue recognition and the elimination of specific areas of difference in our existing standards through what we refer to as “short-term” convergence projects. We’re also working in parallel on other important projects such as equity-based compensation—frequently referred to as stock compensation accounting—and reporting on financial performance. Our goal in each of these areas is to end up with common or substantially converged standards to the maximum extent possible. Overall, I believe we have been working well on these efforts and continue to make steady progress toward convergence.

What have been the biggest challenges and potential obstacles to convergence?

Fear of and resistance to change and the potential political interference that this can engender, I believe, are the greatest obstacles not only for international convergence, but also in improving U.S. accounting standards. From time to time, various constituent groups have lobbied heavily against particular proposals from either the FASB or the IASB that would move our standards closer together. But the path to true convergence is a two-way street requiring statesmanship and an openness to change on both sides. Can we get there? Yes, I believe so, but it will take time, a lot of hard work and steadfast determination by all parties.

Can a true partnership be achieved alongside the many challenges and political interference you describe?

Despite my earlier comments about the negative aspects of political intervention, I truly believe that all of our constituents, including well-intentioned politicians, have a very legitimate and important interest and stake in our accounting standard setting. But that interest should be channeled into helping us to properly fulfill our mission of establishing sound, neutral accounting standards. The primary objective of standard setting must be the relevance, reliability and usefulness of reported financial information and not whether it advances the particular business, economic, social or political goals of special interest groups.

I believe that one aim of the Sarbanes-Oxley legislation was to ensure that our standard-setting process is carried out in an independent, objective and neutral way. Thanks to the efforts of many involved in that process, I believe we are achieving that goal.

All of us with roles in the financial reporting system must continually rededicate ourselves to the proposition that sound and unbiased financial reporting is a critical underpinning of our capital markets, our economic well-being and our way of life.

For those of us at the FASB who I am privileged to lead, I can pledge that we will continue to do our part in the process to reach out to constituents in a spirit of partnership to help make that proposition a reality.



*FASB Chair, Robert H. Herz, and
SEC Chair, William H. Donaldson*

“The primary objective of standard setting must be the relevance, reliability and usefulness of reported financial information and not whether it advances the particular business, economic, social or political goals of special interest groups.”

*Financial Accounting
Standards Advisory
Council*



Richard J. Swift, FASAC Chairman

FASAC

“In the wake of the widely reported corporate scandals of last year, the entire U.S. financial reporting system was put under the microscope of the nation’s leaders.”

The year 2003 proved to be a busy, eventful year for the FASB, FASAC and the accounting and auditing professions. Implementation of regulations from the Sarbanes-Oxley Act, together with several significant accounting standards, occupied the attention of professionals in the financial reporting process.

The FASB devoted much time to major projects, including revenue recognition, equity-based compensation, fair value measurement as well as convergence, FIN 46 issues and developing a working relationship with the PCAOB. Throughout the year, the FASB made special efforts to reach out to all of its constituents to ensure that all points of view have a chance to be heard. The establishment of the User Advisory Council was one part of this outreach program.

FASAC, in its role as the principal advisory body to the FASB, actively assisted the Board in achieving its goals. FASAC is the only constituent group with a diverse membership of preparers, auditors, users, academics and other financial experts. The Chief Accountant of the SEC is a permanent observer, as is the Comptroller General of the United States. This year, we invited the Chief Auditor of the PCAOB to become a permanent observer at FASAC meetings. To increase the diversity of viewpoints, FASAC also added a member from a private company.

During the year, FASAC held four open meetings with the FASB. We discussed a variety of technical issues, including principles-based standards (encompassing the SEC’s study of the issue), equity-based compensation, pension disclosures, international convergence, purchase-method procedures, financial performance reporting, fair value measurement, revenue recognition, liabilities and equity and liability extinguishments.

In addition to technical issues, FASAC provides support to the Board in other ways. The FASAC Steering Committee meets quarterly by teleconference with selected FASB members to assure that the quarterly FASAC meetings have an agenda that is timely. FASAC members’ companies have participated in field testing of proposed accounting standards, so that the FASB can evaluate the real-life issues that develop before new standards are enacted.

Part of FASAC’s charter is to advise the Board on policies and procedures. During 2003, FASAC and the Board discussed several topics related to this aspect of FASAC’s role, including the FASB’s agenda priorities, FASAC’s role as an advisor to the FASB, FASAC’s issue identification process and the current business environment. Several members of FASAC also met privately with the Board to support the FASB’s internal policy and procedure initiatives.

As we look to 2004, FASAC will continue to support the FASB in its efforts. Work is underway on the formation of a Small Business Advisory Committee for the FASB, and we will support the effort as required. We will miss the FASAC members whose terms expire this year, but we also look forward to the varied expertise of the new members joining us in 2004.

Richard J. Swift
Chairman, FASAC

GASB

Governmental Accounting Standards Board



Tom L. Allen, GASB Chairman



The Governmental Accounting Standards Board (GASB) was organized in 1984 by the Financial Accounting Foundation to establish standards of financial accounting and reporting for state and local governmental entities. Its standards guide the preparation of external financial reports of those entities.

The GASB's function is important because external financial reporting can demonstrate financial accountability to the public and is the basis for investment, credit and many legislative and regulatory decisions. The GASB's authority for its standards has been recognized under Rules of Conduct of the American Institute of Certified Public Accountants. Also, legislation in many states requires compliance with GASB standards.



Ryan P. Donovan, Bear Stearns & Co.,
GASB's Randall J. Finden and
Edward J. Mazur

“Constituent organizations and individuals representing financial statement preparers and attesters have been actively involved in providing feedback to the GASB since its creation.”

What constituent outreach efforts has the GASB made, and how has constituent feedback impacted the Board's work?

Constituent outreach has been an integral component of the GASB's success. Beginning with the guiding principles set forth in the Board's Mission Statement and interwoven throughout all we do, constituent feedback is sought at key phases in the development of each of the GASB's standards. For example, no project is added to the GASB's technical agenda without a thorough discussion with members of the Governmental Accounting Standards Advisory Council (GASAC), which is made up of representatives from approximately 30 different constituent organizations of the GASB.

Constituent organizations and individuals representing financial statement preparers and attesters have been actively involved in providing feedback to the GASB since its creation. However, the constituencies representing financial statement users initially were much less involved in the GASB's due process. Starting with the model research in the early 1990s that introduced the user focus groups, the integration of financial statement users into the GASB research and due process efforts has been a primary focus. GASB constituent outreach efforts this past year have focused, for the most part, on these user organizations.

The GASB's 2003 technical plan called for due process feedback on the important Other Post Employment Benefits (OPEB) project. What is its status?

The OPEB project is close to being finalized by the GASB. Constituent feedback played an important role in 2003 in reaching final conclusions on these very important standards for employers offering OPEB benefits and OPEB plans by requiring reporting resources and obligations, resulting from these promised benefits. Overall, feedback received during due process was supportive of the Board's fundamental decision to structure OPEB reporting so that it is similar to what is required for pensions.

The GASB received a number of responses from individuals working in government and organizations that represent government workers, requesting the GASB not to require the reporting of OPEB benefits. Their arguments generally took the position that these benefits could be withdrawn by employers and, therefore, did not represent future obligations. There also was concern that requiring the reporting of benefits could jeopardize a government's willingness to continue to offer them. Although these concerns are very real, it is the GASB's responsibility to provide the necessary financial information upon which knowledgeable decisions can be made. The GASB concluded that such information would not be complete without the benefit of these standards.

In addition, a number of respondents recommended modifications to specific details of the GASB's proposed approach. All of these recommendations were carefully considered and deliberated during the latter part of 2003. While the Board reconfirmed its basic approach to OPEB reporting—accruing obligations as they are earned by employees—a number of modifications were made based on issues raised by respondent comments.

What is the status of the pollution remediation project, and how will it improve government financial reporting?

Governmental entities are involved in pollution remediation more than one might expect, considering that governments generally are not involved in the manufacturing sector, which is normally associated with pollution. Although governments certainly create pollution problems that need to be cleared up through their operation of landfills, motor pools, hospitals and other governmental enterprises, they also are often left with the responsibility of remediating pollution originated by others. One of the most common circumstances in which governments face the task of pollution remediation occurs when a company has polluted property and then goes bankrupt. The “brownfield” sites are not the legal responsibility of a government, but often the government must clean up the site in order to get the property back on the tax rolls and to enable development to go forth. In other cases, the site causes health risks, and the government must eliminate those risks to its citizens.

Board deliberations will continue on this project until the Board issues a Preliminary Views document in the fourth quarter of 2004. Based on tentative Board decisions, the completion of this project will result in government financial statements that reflect liabilities for those sites a government is legally required to clean up as well as those sites for which a government has demonstrated a commitment to clean up—for health, economic or other reasons—even though not legally required to do so.

How will completing its conceptual framework help the GASB and why work on it now?

The GASB's first Concepts Statement on the objectives of financial reporting was very helpful in guiding the Board's discussion of reporting objectives while completing its new reporting model project. However, many questions and debates arose during the several years the Board worked on the new reporting model because assets, liabilities and revenues needed to be more clearly defined and guidance was lacking on the placement of information within financial statements versus notes to financial statements or required supplemental information. The

“The OPEB project is close to being finalized by the GASB. Constituent feedback played an important role in 2003 in reaching final conclusions on these very important standards...”



*Michael J. Marz,
First Southwest Company, and
GASB's William W. Holder*



*Gerry G. Boaz, State of Tennessee,
and GASB's Cynthia B. Green*

“Another important issue covered in 2003 was the rapidly growing use of derivatives by governmental entities. Accounting guidance was issued in June that required disclosures for derivatives...”



*GASB's Richard C. Tracy
Gilbert W. Crain, Montana State
University*



*GASB's James M. Williams
and Paul R. Reilly*

same questions on definitions and placement of information also have arisen during the consideration of many, if not most, of the GASB's other projects.

Accordingly, with the new reporting model in the final phase of implementation and the GASB's OPEB standards about to be completed, staff and Board time for conceptual framework projects on communication methods and financial statement elements was scheduled in 2003, 2004 and 2005. An exposure draft on communication methods is scheduled to be issued in the second quarter of 2004.

What other projects did the GASB focus on during 2003?

In addition to the projects previously discussed, the Board addressed a full plate of technical issues in 2003. Early in the year, the GASB issued standards on deposit and investment risk disclosures and budgetary information presentation. Work also was completed on the asset impairment project in November.

Another important issue covered in 2003 was the rapidly growing use of derivatives by governmental entities. Accounting guidance was issued in June that required disclosures for derivatives not currently reported at fair value in the financial statements. A project dealing with the presentation of this fair value information and subsequent changes in fair value from period to period within the financial statements remains on the GASB's technical agenda during 2004. A due process document is expected in late 2004.

The GASB also issued an exposure draft on its economic condition project in 2003 that focused on the statistical section and started deliberations on the feedback received in early 2004. Finally, the Board addressed a narrowly scoped, yet significant, project on the issues related to the reporting by states and some local governments on their tobacco settlements. In late 2003, the Board issued an exposure draft on a proposal that would provide guidance on the reporting of these resources and resulting liabilities from the transfer of the benefits related to these resources by their tobacco settlement authorities.

What will the GASB focus on in 2004 and over the next few years?

In addition to the projects carried over from 2003, the Board is scheduled to start deliberations on several other projects in 2004. The most significant of these is the conceptual framework project, defining the elements of financial reporting. As I noted earlier, this should help deliberations on almost all future projects once it is completed in the next couple of years. A project has been added to help ensure clearer and more consistent reporting on the net assets and fund balances of governments. Another project on securitization and other transfers has been added and addresses the growing trend in governments of transferring future revenue

streams to other parties in an effort to provide immediate cash for governments under financial pressure.

The list of projects waiting in the wings to be added to the active technical agenda continues to grow as staffing limitations impact the number of projects that can be considered at any point in time. Future projects start with the next phase of the economic condition project and include intangible assets, fiduciary responsibilities, government combinations, conceptual framework—measurement attributes, exchange-like revenues, loans versus grant classification, in-kind contributions and, potentially, financial performance measurements and service efforts and accomplishments reporting.

What is the status of the GASB's service efforts and accomplishments research?

The GASB's research on service efforts and accomplishments, commonly referred to as performance measures, continues thanks, largely, to the Alfred P. Sloan Foundation's financial support. In 2003, a Special Report, *Reporting Performance Information: Suggested Criteria for Effective Communication*, was published and disseminated to governmental entities and other interested parties. This report resulted from five years of research on the preparation, reporting and use of performance information previously carried out by the GASB in accordance with the provisions of the Sloan Foundation grant.

The plan now calls for the GASB, over the next several years, to encourage and assist governments in experimentation with reporting of performance information consistent with the suggested criteria. The staff then will evaluate the effectiveness and usefulness of this experimental performance-based external reporting and will present its findings to the Board for future agenda consideration.

As you complete your term as Chairman, of what accomplishment are you most proud?

The first issue that comes to mind is obviously the completion of a new reporting model for governments—Statement 34. The efforts to improve the short-term-focused model historically used by governments began as soon as the GASB was created in 1984. Although much good research and deliberations had taken place prior to my joining the Board in 1994, the Board was divided on how to improve government financial reporting. In an historic special meeting that took place in January 1995, the Board, under then-Chairman Jim Antonio, reached a compromise that would retain the fund-based short-term current financial resources focus but would add a government-wide full accrual economic focus to required government financial statements. This meant capitalizing and depreciating all government-



Stephen Gauthier, Government Finance Officers Association, Michael Genito, City of Rye, New York, and GASB's David R. Bean

“In addition to the projects carried over from 2003, the Board is scheduled to start deliberations on several other projects in 2004. The most significant of these is the conceptual framework project...”



Matthew B. Roggenburg,
J.P. Morgan Securities

“My biggest challenge – and I guess you could say accomplishment – was to hold all Board members together so that Statement 34 would be supported unanimously.”

tal assets including infrastructure and accruing revenues and expenses as they were incurred. Because this was such a dramatic change for governments, a Preliminary Views document was issued in 1995, just as Jim left the Board.

In the years that followed, the GASB faced strong opposition from many of its important constituent organizations, either because of new proposed financial reporting requirements or because the GASB had retained much of its old reporting model. Reporting model task force meetings took place, user focus groups continued to be held throughout the country, meetings were held with important constituent organizations that threatened to end their support of the GASB, and two additional GASB seats were added to increase representation of financial statement users and preparers of state government financial statements.

How did those events impact you on the Board?

Board members held contrasting views of what the new reporting model should look like. My biggest challenge—and I guess you could say accomplishment—was to hold all Board members together so that Statement 34 would be supported unanimously. Subsequently, the standard was issued in June 1999. The three phased implementation of this important standard will be completed with small governments finishing this process for fiscal years ending after June 15, 2004. The most satisfying part of this reporting model saga is that, despite the strong protest by many financial statement preparers, most comments received from those who have actually implemented the new model have been positive.

I also am pleased with many other statements and accounting guidance issued during my tenure. And, I am proud of our small, but very dedicated, staff and the hard work of the Board members who produced significant improvements to governmental financial reporting during my tenure. I also am appreciative of the many dedicated GASAC members and other professionals in the governmental financial area with whom I have had the privilege to work. Support of the FAF Trustees and staff also has been critical to the success of the GASB and is much appreciated.

As I end my tenure as a Board member and Chairman of the GASB, I would like to express my sincere appreciation to the many constituent organizations and thousands of individuals who have supported and significantly enhanced the work of the GASB.

Throughout 2003, the GASAC played a vital role in the GASB's process by providing important constituent feedback to the GASB at critical junctures in the Board's process. Exemplifying this commitment, the Council provided key commentary on the need for and prioritization of potential projects. It also gave timely advice on its tentative conclusions, leading to the issuance of exposure drafts or final standards. And, when changes or modifications to an exposure draft or existing accounting guidance were necessary, the GASAC also provided input.

In 2003, the GASAC held three meetings. To assist the Board in project prioritization, the GASAC reviewed the importance of projects aimed at improving the accounting for intangible assets; termination offers and benefits; fund balances and net assets; securitizations including tobacco settlement issues and revolving loan projects.

In preparation for issuance of the due process documents, the GASAC provided feedback on the accounting for pollution remediation by state and local governments and tobacco settlement accounting issues.

The GASAC also advised the GASB on modifications being considered by the Board as a result of due process feedback from its Other Postemployment Retirement Benefit (OPEB) project that addressed the accounting for implicit rate subsidies state and local governments pay on behalf of retirees.

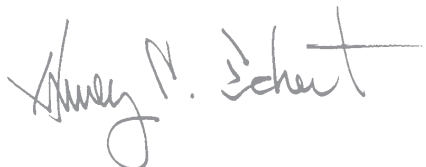
In March, the GASAC provided input for the GASB on decisions reached on the pollution remediation obligation project and on potential projects. The Council also expressed interest in the GASB exploring a tentative agenda project on tobacco settlement issues.

Next up for the GASAC was a meeting in Harrisburg, Pennsylvania that was held in conjunction with the annual conference of the National Association of State Auditors, Comptrollers and Treasurers. Reports were received on the activities of both the FAF and GASB, as well as a report on current agenda projects. The Council was updated on the progress of the Board's OPEB project and provided feedback on the tobacco settlement project.

At its third meeting of 2003, the Council shared its perspectives on the FAF development campaign efforts aimed at solicitation of funding for GASB from among the largest cities and counties served by the organization. In addition, your Chairman participated in initial discussions regarding the potential of assessing a voluntary fee on the issuance of municipal bonds to help fund the GASB. The GASAC also provided commentary on the additional issues that were raised on pollution remediation.

Looking ahead, the GASAC has planned its 2004 joint meeting in conjunction with the National Association of College and University Business Officers' (NACUBO) national conference in Milwaukee, Wisconsin.

I extend my gratitude to all the GASAC members for their contributions and commitment on behalf of the Council and am confident that we will continue to build on the Council's accomplishments in 2004.



Harvey C. Eckert
Chairman, GASAC

Governmental Accounting Standards Advisory Council



Harvey C. Eckert, GASAC Chairman

GASAC

*“Throughout 2003,
the GASAC played a
vital role in the GASB’s
process by providing
important constituent
feedback to the GASB
at critical junctures
in the Board’s process.”*

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About FASB Members

Members of the Financial Accounting Standards Board serve full time and are required to sever all ties with the institutions they previously served.

Mr. Herz was Senior Partner with PricewaterhouseCoopers and its North America Theater Leader of Professional, Technical, Risk & Quality.

Mr. Batavick was most recently Comptroller of Texaco Inc.

Mr. Crooch was Partner and Director of the International Professional Standards Group at Arthur Andersen, LLP.

Mr. Schieneman was Director, Comparative Global Equity Analysis of Merrill Lynch & Co.

Ms. Schipper was L. Palmer Fox Professor of Business Administration at Duke University's School of Business.

Ms. Seidman was Vice President at J.P. Morgan and Co. and most recently managed her own consulting firm.

Mr. Trott was head of the Accounting Group of KPMG's Department of Professional Practice.

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Edward J. Mazur, 2007

Paul R. Reilly, 2005

Richard C. Tracy, 2006

James M. Williams, 2007

**Robert H. Attmore* succeeds Mr. Allen on July 1, 2004. Mr. Attmore is a former Deputy State Comptroller of New York State.

About GASB Members

Mr. Allen serves the GASB full time. All other members serve part time.

Mr. Allen was the State Auditor of Utah.

Ms. Green was the Vice President for State Studies of New York's Citizens Budget Commission.

Mr. Holder is the Ernst & Young Professor of Accounting at the University of Southern California.

Mr. Mazur is the Vice President for Administration and Finance of Virginia State University.

Mr. Reilly is the retired Finance Director and Comptroller of the City of Madison, Wisconsin.

Mr. Tracy is the Director of Audits for the City of Portland, Oregon.

Mr. Williams is a retired Partner and the former National Director of Public Sector Accounting and Assurance Services with Ernst & Young, LLP.

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Steven Weinberger
Director
Connecticut State Employees
Retirement System

Corrine G. Wilson
*Tribal Government Financial
Consultant*

2003 Documents

Financial Accounting Standards Board

Statement No. 149,
*Amendment of Statement 133
on Derivative Instruments and
Hedging Activities*

Statement No. 150, *Accounting
for Certain Financial
Instruments with Characteristics
of both Liabilities and Equity*

Statement No. 132 (revised
2003), *Employers' Disclosures
about Pensions and Other
Postretirement Benefits*

Interpretation No. 46 and 46
(revised), *Consolidation of
Variable Interest Entities*

Exposure Draft, *Accounting for
Real Estate Time-Sharing
Transactions*

Exposure Draft, *Qualifying
Special-Purpose Entities and
Isolation of Transferred Assets*

Exposure Draft, *Inventory Costs*

Exposure Draft, *Earnings per
Share*

Exposure Draft, *Exchanges of
Productive Assets*

Exposure Draft, *Accounting
Changes and Error Corrections*

*The FASB issued nine Staff
Positions in 2003.*

Governmental Accounting Standards Board

Statement No. 40, *Deposit and
Investment Risk Disclosures*

Statement No. 41, *Budgetary
Comparison Schedules —
Perspective Differences*

Statement No. 42, *Accounting
and Financial Reporting for
Impairment of Capital Assets
and for Insurance Recoveries*

Technical Bulletin No. 2003-1,
*Disclosure Requirements for
Derivatives Not Reported at Fair
Value on the Statement of Net
Assets*

Exposure Draft, *Accounting
and Financial Reporting by
Employers for Postemployment
Benefits Other Than Pensions*

Exposure Draft, *Financial
Reporting for Postemployment
Benefit Plans Other Than
Pension Plans*

Exposure Draft, *Economic
Condition Reporting: The
Statistical Section*

Proposed Technical Bulletin
No. 2003-b, *Tobacco Settlement
Recognition and Financial
Reporting Entity Issues*

Special Report, *Reporting
Performance Information:
Suggested Criteria for Effective
Communication*

Implementation Guide, *Guide
to Implementation of GASB
Statement 40 on Deposit and
Investment Risk Disclosures*

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Management's Discussion and Analysis

Financial Statements of the Financial Accounting Foundation

Presentation

The Foundation's financial statements are presented in accordance with FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*. The accompanying statements of activities segregate program expenses of the Standards Boards from support expenses of the Foundation. Program expenses include salaries, benefits and other operating expenses for the members and research staffs of the Boards, as well as expenses for the production, marketing, publication distribution and library activities of the Foundation. Support expenses include costs for the finance, human resources, facilities management, information systems, public relations, development and general administration assistance provided by the Foundation. Support expenses also include amounts related to the Foundation's Board of Trustees' oversight role. The financial statement presentation which follows is consistent with the single program concept of the Foundation, which is to establish and improve standards of financial accounting and reporting for both private sector and state and local governmental entities.

Overall Financial Results

The year 2003 produced an operating surplus for the Foundation for the first time in seven years, and net investment income for the first time in four years. Mandatory funding for FASB as a result of the implementation of provisions in the Sarbanes-Oxley Act of 2002, as well as a recovery in the health of the financial markets, contributed toward these positive results.

For 2003, the Foundation reported an increase in unrestricted net assets of \$12,579,000, which includes a \$1,177,000 non-cash credit toward otherwise unrestricted net assets to reflect the required adjustment to the minimum pension liability under its Employees' Pension plan. Although the accumulated benefit obligation under this plan increased 10% for 2003, the fair value of the plan's assets grew by a much larger amount (27%) over the same period, resulting in the required minimum pension liability reduction. The total net asset increase also reflects the operating surplus for the year of \$8,029,000, and net investment income of \$3,373,000. The operating surplus largely resulted from \$19,697,000 of accounting support fee revenues for FASB pursuant to the system of mandatory assessments against public companies provided by Sarbanes-Oxley. A portion of the funds generated from the operating surplus was then re-invested in the Foundation's reserve fund, to replace reserve amounts used to finance operations prior to the receipt of the first support fees in September 2003. Impacted by a sharp improvement in financial market results, and despite significant investment losses generated from liquidations necessary to meet working capital requirements during a portion of the year, reserve fund investment income totaled \$3,283,000 in 2003, compared with losses of \$2,787,000 in 2002. Investment income from

cash equivalents and short-term investments totaled \$90,000 in 2003, substantially higher than 2002's income of \$36,000 due to the availability of mandated funding for FASB during the last third of the year.

The dramatic shift in financing sources for FASB caused total net operating revenues for the organization to increase 74% for the year to \$34.2 million. This overshadowed a \$971,000 decline in combined net subscription and publication sales for both Boards for 2003. Total operating expenses for the organization grew by 9.2% in 2003 to \$26.2 million.

Salaries and employee benefits continue to comprise the vast majority of total expenses, over 75% for each of the last four years. Total salaries increased by \$1,186,000, or 7.8%, in 2003 to \$16,425,000, reflecting merit increases and higher technical headcount during the year for the FASB research staff, including practice fellow positions. Employee benefit costs increased by \$870,000, or 28.1% during 2003 to \$3,967,000, due primarily to actuarially determined pension expense under the Foundation's Employees' Pension Plan being \$745,000 higher for the year.

Total occupancy and equipment expenses in 2003 were \$1,880,000, virtually identical to the 2002 total. Depreciation and amortization expenses decreased \$89,000, or 19.6%, in 2003 to \$366,000, as certain improvements relating to original construction of office space became fully amortized in 2002 upon reaching the termination date of the original lease, which was subsequently amended.

All other operating expenses increased \$238,000, or 7.2%, in 2003 to \$3,564,000, due primarily to higher costs paid by the FASB to an agent to invoice and collect the accounting support fees. In addition, higher expenses were incurred in 2003 for FASB research consultants, liability insurance, provisions for doubtful accounts and fees and other expenses to search for a new Chair for the GASB.

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

Accounting Support Fees

The Sarbanes-Oxley Act provides for funding for the FASB through a system of mandatory fees assessed against issuers of securities, as those issuers are defined in the Act. 2003 represented the initial calendar year of invoicing and collecting fees from issuers, which amounted to \$19,161,000 of revenues from the domestic sector. FASB's revenues also include \$536,000 of fees for foreign issuers of securities that trade in the U. S. marketplace. Although the invoices to the foreign issuers were not mailed until 2004, they represent assessments for calendar 2003.

Contributions

Contributions for 2003 and 2002 are shown in the table below.

(Dollars in thousands)	FASB		GASB		Total	
	2003	2002	2003	2002	2003	2002
Gross contributions	\$ 263	\$5,305	\$1,640	\$2,176	\$1,903	\$7,481
Sales value of subscriptions provided to contributors	—	(1,410)	—	—	—	(1,410)
Net contributions	\$ 263	\$3,895	\$1,640	\$2,176	\$1,903	\$6,071

With the exception of contributed services, all contribution types were discontinued for the FASB in 2003 and replaced by the abovementioned mandatory fees system.

Gross contributions to FASB in 2002 were \$5,305,000. Industry and bank contributions represented \$2,087,000 of the total amount. Support from the public accounting profession was \$2,463,000 in 2002. Contributions from investment firms, certain constituent organizations and all other supporters aggregated \$474,000 in 2002. The value of contributed services was \$281,000 for FASB in 2002, and in each of the last two years has included the services of a practice fellow donated to the Board by a Big Four firm.

Total contributions to GASB decreased \$536,000 during 2003 to \$1,640,000. This is due primarily to the fact that the Foundation chose not to accept public accounting contributions for GASB in 2003, reinforcing that Board's independence. The public accounting profession contributed \$435,000 during 2002. The Alfred P. Sloan Foundation gave \$254,000 in 2003 as their final installment under a three-year commitment providing a total of \$682,000 in support of the GASB's research on reporting performance measures. Having met the criteria for this grant, a total of \$207,000 of Sloan funds were recognized as contribution revenues during 2003, including certain amounts received in prior years. Corresponding revenues for the performance measures work in 2002 were \$239,000. State government support increased \$6,000 in 2003 to \$969,000. The Government Finance Officers Association contribution increased \$4,000 in 2003 to \$186,000. Insurance industry organizations and all other supporters, including contributed services, generated \$278,000 of support for GASB in 2003, an increase of \$89,000 from the 2002 level. This growth resulted from a campaign targeted toward municipal governments in 2003, which raised \$96,000. Finally, the FAF fund-raising program in effect from 2000 through 2002 resulted in \$168,000 of Foundation contributions being allocated to GASB for 2002. The 2003 fundraising programs were realigned to solicit support specifically for the GASB.

Subscription and Publication Sales

Total net subscription and publication sales were \$12,631,000 in 2003, \$971,000, or 7.1%, lower than 2002's amount of \$13,602,000. Total subscription and publication sales decreased \$1,119,000 or 7.3% in 2003 to \$14,175,000, while direct costs of publications also dropped \$148,000, or 8.7%, to \$1,544,000. A portion of the subscription and publication sales for both the FASB and GASB is always dependent upon the results of activities of the Boards' respective technical agendas.

FASB subscription and publication sales decreased \$746,000 in 2003 to \$12,602,000. Sales derived from FASB's basic, comprehensive and loose-leaf subscription services declined by \$1,234,000, or 20.8%, in 2003 to \$4,690,000, as complimentary subscriptions are no longer provided due to the shift in funding sources for FASB from voluntary contributions to mandatory assessments. Prior to 2003 the sales value of FASB complimentary subscriptions was reclassified from contributions to subscription and publication revenues. In addition, sales of *Original Pronouncements*, *Current Text* and other annual bound publications decreased by \$225,000, or 11.4%, in 2003 to \$1,754,000 as amounts committed to under year-to-year purchase agreements continued their recent period of decline. Sales of Statements, Interpretations and Technical Bulletins decreased by \$60,000, or 12.5%, in 2003 to \$421,000. Revenues earned from electronic licensing and royalty arrangements increased significantly (\$1,426,000, or 34.6%) in 2003 to \$5,548,000, as sales volume grew in both the Big Four public accounting firm and commercial publisher marketplaces. Finally, sales of Research and Special Reports, along with revenues obtained from seminars, public records

Management's Discussion and Analysis *continued*

and all other sources, were approximately \$653,000 lower in 2003 due mainly to the elimination of certain payments received under publications agreements with major public accounting firms. In 2003 FASB made its statements available for downloading without charge from the Board's website.

The direct costs of \$1,255,000 to produce and distribute FASB publications were \$173,000, or 12.1%, lower in 2003 due primarily to lower expenses associated with subscription plan products, including the loose-leaf versions.

GASB subscription and publication sales decreased \$373,000, or 19.2%, in 2003 to \$1,573,000. Sales of Statements, Special Reports and other final documents decreased by \$175,000, or 50.8%, to \$170,000. This reflects a decline in document sales related to implementation guides and other publications associated with the standards on the new reporting model for governmental entities introduced in 1999. Revenues yielded from GASB's subscription based products decreased by \$66,000, or 8.5%, in 2003 to \$703,000, due to a decline in receipts from subscriptions sold through the public accounting marketplace. Revenues from electronic licensing and royalty agreements declined \$30,000, or 8.7%, against 2002 levels and totaled \$313,000 for 2003. Revenues from the *Codification* and *Original Pronouncements* annual editions were \$10,000, or 3.5%, lower in 2003 and aggregated \$288,000. Lastly, revenues earned from all other sources were \$92,000, or 48.3%, lower for GASB in 2003 and stood at \$99,000. This decrease was attributable primarily to a lower level of fees earned for speaking engagements and smaller payments received under publications agreements with major public accounting firms.

Direct costs of \$289,000 to produce and distribute GASB publications increased \$25,000, or 9.5%, from 2002, due primarily to higher 2003 printing and distribution costs associated with subscription plan products.

Investments and Investment Income and Losses

Cash Equivalents and Short-Term Investments

The emergence in 2003 of the funding system for FASB provided by Sarbanes-Oxley yielded \$18.7 million of receipts for the Board in accounting support fees for the year. This had a profound effect on the Foundation's liquidity, and resulted in \$13,590,000 of cash and short-term investments on hand at December 31, 2003, over five and a half times more than the amount present a year earlier. In turn, investment income from cash equivalents and short-term investments increased to \$90,000 in 2003, due to the significantly higher cash balances available for investment. Investment income results in this area continued to be held down in 2003 by a decrease in the interest rate yields applicable to these funds, and the fact that the first receipts of accounting support fees did not take place until September.

Reserve Fund Investments

The reserve fund was established at the end of 1981 to provide for the continuation of operations in the event of unforeseen circumstances or a prolonged business downturn. The Foundation's Trustees have adopted a policy establishing a targeted reserve fund investment level equal to one year of total operating expenses for the entire organization. The fund is also intended to finance major capital expenditures that cannot be met from operating resources, and to provide funding as needed to supplement the operating deficits of the GASB. Reserve fund assets are unrestricted, but require Board of Trustee approval for use in continuing operations. In order to meet various working capital requirements, a total of \$5,250,000 was transferred from the reserve fund to operating cash at several points during 2003 prior to the initial receipt of accounting support fees. In addition, \$2,000,000 was transferred out of the reserve fund in 2003 to finance current and future operating deficits of the GASB. Over the last two months of 2003 a total of \$6,000,000 was then re-invested in the reserve fund once the FASB support fees could meet operating needs for the foreseeable future. An additional \$1,000,000 was invested in the reserve fund from operations in February 2004. Additional transfers into the reserve fund are likely in 2004 and will be made as appropriate so long as the cash receipts from the mandated fee assessments are sufficient to meet the FASB's operating expense needs. Accordingly, the Foundation will strive to attain the targeted investment level in the reserve fund, with a view toward appropriately reducing future requests for FASB accounting support fees.

Reserve fund investments are maintained within the guidelines of the investment policy established by the Foundation's Finance Committee. At December 31, 2003, approximately 60% of the fund's market value was invested in an equity index fund, 35% in a fixed income index fund and the balance represented by cash and money market investments. The net transfers to operating cash of \$1,250,000 in 2003 were offset by investment income of \$3,283,000 (net of investment management fees of \$40,000), thereby increasing the reserve fund balance to \$20,583,000 at December 31, 2003. Unrealized gains on the fund's equity index investments were responsible for the positive investment results in 2003.

Statements of Activities

<i>Years Ended December 31 (dollars in thousands)</i>	2003	2002
<i>Operating revenues:</i>		
Accounting support fees - FASB (Note 2)	\$ 19,697	\$ —
Net contributions :		
FASB	263	3,895
GASB	1,640	2,176
	1,903	6,071
Subscription and publication sales :		
FASB	12,602	13,348
GASB	1,573	1,946
	14,175	15,294
Less - Direct costs of sales :		
FASB	1,255	1,428
GASB	289	264
	1,544	1,692
Net subscription and publication sales	12,631	13,602
<i>Net operating revenues</i>	34,231	19,673
<i>Program expenses:</i>		
Salaries and wages :		
FASB	10,284	9,327
GASB	2,484	2,457
Administrative	1,588	1,523
Total salaries and wages	14,356	13,307
Employee benefits (Note 4)	3,258	2,597
Occupancy and equipment expenses (Note 6)	1,077	1,072
Other operating expenses	1,658	1,780
<i>Total program expenses</i>	20,349	18,756
<i>Support expenses:</i>		
Salaries and wages	2,069	1,932
Employee benefits (Note 4)	709	500
Occupancy and equipment expenses (Note 6)	803	806
Depreciation and amortization	366	455
Other operating expenses	1,906	1,546
<i>Total support expenses</i>	5,853	5,239
Total expenses	26,202	23,995
<i>Operating revenues greater than (less than) expenses</i>	8,029	(4,322)
Short-term investment income (Note 3)	90	36
Reserve fund investment income (losses) (Note 3)	3,283	(2,787)
Adjustment for additional minimum pension liability (Note 4)	1,177	(3,026)
<i>Increase (Decrease) in unrestricted net assets</i>	12,579	(10,099)
Net assets at beginning of year	16,371	26,470
Net assets at end of year	\$ 28,950	\$ 16,371

See notes to financial statements.

Statements of Financial Position

<i>As of December 31 (dollars in thousands)</i>	2003	2002
Current Assets:		
Cash and cash equivalents	\$ 2,393	\$ 229
Short-term investments (Note 3)	11,197	2,158
Accounting support fees receivable (Note 2)	1,027	—
Contributions receivable	249	1,698
Subscription, publication and other receivables	1,172	2,519
Less : Allowance for doubtful accounts	(140)	(82)
Inventories	202	207
Prepaid expenses and other current assets	156	178
Total current assets	16,256	6,907
Noncurrent Assets:		
Furniture, equipment and leasehold improvements, at cost, net of accumulated depreciation and amortization (Note 5)	898	842
Intangible asset - pension accrual (Note 4)	281	293
Reserve fund investments (Note 3)	20,583	18,551
Total noncurrent assets	21,762	19,686
Total assets	\$38,018	\$26,593
Current Liabilities:		
Accounts payable, accrued expenses and other current liabilities	\$ 555	\$ 679
Accrued payroll and related benefits	530	636
Current portion of accrued pension costs (Note 4)	463	500
Current portion of accrued rent expense (Note 6)	312	308
Unearned publication and other deferred revenues	4,262	4,061
Total current liabilities	6,122	6,184
Noncurrent Liabilities:		
Accrued pension costs (Note 4)	432	1,211
Accrued postretirement health care costs (Note 4)	1,857	1,734
Accrued rent expense (Note 6)	544	856
Unearned publication and other deferred revenues - long - term	113	237
Total noncurrent liabilities	2,946	4,038
Total liabilities	9,068	10,222
Net Assets – Unrestricted	\$28,950	\$16,371

See notes to financial statements.

Statements of Cash Flows

<i>Years Ended December 31 (dollars in thousands)</i>	2003	2002
<i>Cash flows from operating activities:</i>		
Cash received from contributors	\$ 3,069	\$ 6,862
Cash received from publication sales	15,657	14,187
Cash received from accounting support fees	18,670	—
Interest and dividend income received	476	616
Cash paid to suppliers and employees	(27,152)	(25,433)
Net cash provided by (used in) operating activities	10,720	(3,768)
<i>Cash flows from investing activities:</i>		
Proceeds from sales or maturities of reserve fund investments	\$ 12,438	\$ 8,061
Purchases of reserve fund investments	(11,533)	(4,839)
Proceeds from maturities of short-term investments	3,000	125
Purchases of short-term investments	(12,039)	(280)
Purchases of furniture, equipment and leasehold improvements	(422)	(433)
Net cash (used in) provided by investing activities	(8,556)	2,634
Net increase (decrease) in cash and cash equivalents	2,164	(1,134)
Cash and cash equivalents at beginning of period	229	1,363
Cash and cash equivalents at end of period	\$ 2,393	\$ 229
<i>Reconciliation of change in net assets to net cash provided by (used in) operating activities:</i>		
Increase (decrease) in unrestricted net assets	\$12,579	\$(10,099)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
(Credit) provision for additional minimum pension liability	(1,177)	3,026
Depreciation and amortization	366	455
Unrealized (gains) losses on reserve fund investments retained	(5,070)	2,533
Losses on sales of reserve fund investments	2,133	784
Provision for losses on accounts receivable	58	9
Decrease (increase) in contribution, subscription, publication, support fee and other receivables	1,769	(183)
Decrease (increase) in inventories	5	(26)
Decrease (increase) in prepaid expenses and pension intangibles	34	(470)
Increase in accounts payable, accrued expenses and employee benefit accruals	254	365
Increase in unearned publication and other deferred revenues	77	150
Decrease in accrued rent expense	(308)	(312)
Total adjustments	(1,859)	6,331
Net cash provided by (used in) operating activities	\$10,720	\$ (3,768)

See notes to financial statements.

Notes to Financial Statements

1. Nature of Activities and Summary of Significant Accounting Policies

Nature of Activities

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

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

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

Accounting Policies

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

Presentation

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and are presented pursuant to FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*. The statements of activities are based on the concept that standard setting is the sole program of the Foundation. These statements set forth separately, where appropriate, revenues, costs of sales and certain program expenses of the Standards Boards, giving recognition to their distinct responsibilities as described in the Foundation's Certificate of Incorporation and By-Laws. Program expenses include salaries, benefits and other direct operating expenses for the members and research staffs of the Standards Boards, as well as expenses for the production, marketing, publication distribution and library activities of the Foundation. Foundation services for public relations, finance, human resources, facilities management, information

systems, development and general administration are reflected as support expenses in the accompanying statements of activities. Fund-raising expenses aggregated approximately \$231,000 in 2003 and \$186,000 in 2002.

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

Accounting Support Fees

The Foundation recognizes as accounting support fee revenue all amounts invoiced pursuant to the aggregate amount of fees established for each calendar year. In 2003 support fee revenues also include \$536,000 for certain foreign security issuers which, although not invoiced until 2004, represent assessments against those issuers for calendar 2003. See Note 2 for further information regarding accounting support fees.

Contributions

The Foundation has reported all contributions as an increase in unrestricted net assets, as donor-imposed restrictions on certain contributions received in 2003 and 2002 were met by the end of each period. Contributions reported for the FASB in 2003 consist entirely of contributed services, as all cash contribution sources were replaced by the system of mandatory fees assessed against issuers of securities, as provided by Sarbanes-Oxley. In 2002, gross contributions to the FASB were reduced by the sales value of complimentary subscriptions provided to qualified contributors, with these values being reclassified as subscription and publication revenues.

Many individuals have contributed significant amounts of time to the activities of the Foundation, the Standards Boards and the Advisory Councils without compensation. These individuals include certain members of the Foundation's Board of Trustees and participants of the following groups: FASAC and GASAC, the FASB's Emerging Issues Task Force and various other FASB and GASB working groups on technical projects. Many others contribute to the Standards Boards' processes by sending comment letters, appearing at public hearings and roundtable meetings, and participating in field tests. Members of the Board of Trustees are eligible for compensation, with the option of waiving their right to be compensated. The financial statements reflect the value of all contributed services, including waived Trustee compensation, that meet the recognition criteria of FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*. The value of contributed services recognized in the statements of activities was \$283,000 and \$292,000 in 2003 and 2002, respectively.

In the fourth quarter of 2000, the GASB received a conditional commitment which provided for a total contribution of approximately \$682,000 over a three-year period, beginning in January 2001, to fund research activities leading to the consideration of a technical project on performance measures of state and local governments. Conditional commitments to contribute are recognized as revenues when the conditions on which they depend are substantially met. Accordingly, GASB contributions for 2003 and 2002 include \$207,000 and \$239,000, respectively, relating to this conditional commitment.

Subscription Plans, Loose-Leaf Services and License Agreements
Revenues from these publication sources are recognized over the life of the applicable subscription, loose-leaf service or license period. Costs for the production of updates and for fulfillment are charged to expense as incurred.

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

Investments
The Foundation's investments are reported at fair value, with carrying amounts determined using net asset figures reported by the custodian. See Note 3 for further information regarding investments.

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

Furniture, Equipment and Leasehold Improvements
Furniture, equipment and leasehold improvements are reported at cost, less accumulated depreciation and amortization computed using the straight-line method. Furniture and equipment are depreciated over their estimated useful lives. Leasehold improvements are amortized over a period representing the shorter of their estimated useful lives or the remaining term of the current office lease, which extends until September 30, 2006.

Reclassifications
Certain reclassifications have been made to prior year amounts to conform to the current year's presentation.

2. Accounting Support Fees

The Sarbanes-Oxley Act now provides for federally mandated funding for the FASB through annual accounting support fees assessed against and collected from issuers, as those issuers are defined in the Act. The accounting support fees are calculated to provide for the cash flow needs of the FASB as identified in the Board's operating and capital budget for the applicable calendar year. 2003 represents the initial year of collecting fees from the issuer community to support the work of the FASB. The support fees and related expenses incurred for FASB for 2003 are as follows :

Accounting Support Fees invoiced to issuers for 2003:

For domestic-based entities	\$ 19,161,000
For foreign-based entities	536,000
	19,697,000

Program expenses:

Salaries and wages :	
FASB	\$10,284,000
Administrative	1,276,000
Total salaries and wages	11,560,000
Employee benefits	2,547,000
Occupancy and equipment expenses	815,000
Other operating expenses	1,181,000
Total program expenses	16,103,000

Support expenses:

Salaries and wages	1,602,000
Employee benefits	560,000
Occupancy and equipment expenses	642,000
Depreciation and amortization	322,000
Other operating expenses	1,299,000
Total support expenses	4,425,000
Total expenses	\$20,528,000
Excess FASB expenses for 2003	\$ 831,000

The foreign invoices were forwarded to those issuers in 2004 and relate to that community's share of FASB accounting support fees for calendar 2003. Over the last third of 2003 \$18,670,000 of accounting support fees were collected, leaving \$1,027,000 of fees receivable at December 31, 2003. In 2003 FASB paid \$209,000 to an agent under an agreement to invoice and collect the Board's accounting support fees.

Notes to Financial Statements *continued*

The excess of FASB's expenses for 2003 over the amount of accounting support fees recognized as revenues will be incorporated into the calculation of support fees for future periods, subject to adjustments for non-cash expenses and certain other cash requirements not reflected in the statements of activities. Because the aggregate amount of support fees invoiced is calculated and set based upon the FASB's budgeted requirements for the upcoming calendar year, any differences between actual and expected costs for the Board are reflected in subsequent year accounting support fee calculations. The accounting support fees are subject to review by the Securities and Exchange Commission.

3. Investments and Investment Income (Losses)

Investments are as follows:

<i>At December 31</i>	2003	2002
Short-term:		
Investment company mutual funds	\$11,197,000	\$ 2,158,000
Reserve fund:		
Common trust funds:		
Equity index fund	\$12,369,000	\$13,075,000
Fixed income index fund	7,214,000	5,476,000
Cash and money market securities	1,000,000	—
	<u>\$20,583,000</u>	<u>\$18,551,000</u>

Investment income (losses) consist of the following:

<i>Year ended December 31</i>		
Short-term:		
Interest, including return on cash equivalents	\$ 87,000	\$ 43,000
Net unrealized gains (losses)	3,000	(7,000)
Total short-term	<u>\$ 90,000</u>	<u>\$ 36,000</u>
Reserve fund:		
Interest and dividends	\$ 386,000	\$ 580,000
Net realized and unrealized gains (losses)	2,937,000	(3,317,000)
	3,323,000	(2,737,000)
Less: advisory fees	(40,000)	(50,000)
Total reserve fund	<u>\$3,283,000</u>	<u>\$(2,787,000)</u>

Reserve fund assets are maintained within the guidelines of the investment policy established by the Foundation's Finance Committee and are unrestricted, but require Board of Trustee approval for use in operations.

4. Employee Benefits

Employee benefits expense consists principally of payroll taxes, health care benefits for active and retired employees, and pension costs. The Foundation uses a December 31 measurement date for its pension and other postretirement benefit plans.

The following amounts were charged to operations pursuant to the Foundation's pension plans and postretirement health care plan for the periods presented:

<i>Year ended December 31</i>	2003	2002
Defined contribution pension expense	\$1,039,000	\$1,051,000
Defined benefit pension expense	872,000	90,000
Postretirement health care expense	274,000	222,000
	<u>\$2,185,000</u>	<u>\$1,363,000</u>

The principal actuarial assumptions utilized for 2003 and 2002 to determine costs and benefit obligations for the defined benefit pension plans and the postretirement health care plan are as follows (not all assumptions are applicable to all plans):

<i>At December 31</i>		
Discount rate	6.0%	6.5%
Rate of increase in compensation levels	4.5%	5.0%
Long-term rate of return on pension assets	8.0%	8.0%
Health care cost trend rate for next year	10.0%	7.5%

The health care cost trend rate assumption was increased in 2003 to reflect current market conditions, future expectations of healthcare inflation and the Foundation's recent cost experience. The assumed rate declines gradually to an ultimate level of 5.0 % after 2008.

All of the actuarial assumptions are reviewed by the Finance Committee of the Board of Trustees annually. The expected long-term return on pension assets of 8.0% was adopted by the Committee based upon the assessment of several factors. These included a review of historical returns of the plan's assets over the past ten years, expectations and capabilities of future market returns, discussions and meetings with the Foundation's actuarial consultants and reviews of survey data prepared by those consultants.

Pension Plans

The Foundation sponsors defined contribution and defined benefit pension plans for its employees. Employer payments into the defined contribution plan are based on employee earnings levels. The defined benefit plans are designed to supplement the pension benefit otherwise provided by the defined contribution plan only if the employee's targeted pension benefit, as defined, is deemed not to have been met. The targeted pension benefit is an amount equal to 2% of an employee's

highest average annual salary over any five-year period, multiplied by the years of credited service, up to 20 years. Employees do not contribute to the plans and pension benefits under the plans vest after five years of service. The plans do not contain partial vesting provisions.

The components of net periodic pension expense for the defined benefit plans in 2003 and 2002 are as follows:

<i>Year ended December 31</i>	2003	2002
Service cost	\$ 101,000	\$ 32,000
Interest cost	663,000	541,000
Expected return on plan assets	(469,000)	(662,000)
Amortization of prior period net losses	578,000	180,000
Amortization of prior service credit	(1,000)	(1,000)
Defined benefit pension expense	\$ 872,000	\$ 90,000

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

Change in plan assets

Fair value of plan assets, beginning of year	\$ 6,080,000	\$ 7,509,000
Employer contributions	500,000	—
Actual investment income (losses) on plan assets	1,440,000	(1,110,000)
Benefits paid	(313,000)	(319,000)
Fair value of plan assets, end of year	\$ 7,707,000	\$ 6,080,000

Change in benefit obligation

Projected benefit obligation, beginning of year	\$10,429,000	\$ 7,919,000
Service cost	101,000	32,000
Interest cost	663,000	541,000
Actuarial losses	419,000	2,365,000
Benefits paid	(313,000)	(428,000)
Projected benefit obligation, end of year	\$11,299,000	\$10,429,000

At December 31

Funded status of plans	\$ (3,592,000)	\$ (4,349,000)
Unrecognized net actuarial losses	4,629,000	5,761,000
Unrecognized prior service cost	198,000	196,000
Net amounts recognized	\$ 1,235,000	\$ 1,608,000

Amounts recognized in the financial statements

Intangible asset	\$ 281,000	\$ 293,000
Accrued pension costs	(895,000)	(1,711,000)
Provision for pension liability – cumulative	1,849,000	3,026,000
Net amounts recognized	\$ 1,235,000	\$ 1,608,000

The actuarial losses for the year ended December 31, 2003 result from, among other factors, changes in actuarial assumptions, including lowering the discount rate to 6.0%. The amounts recorded in the financial statements are as a result of measuring the additional minimum pension liability at December 31, 2003 and 2002 for the Foundation's Employees' Pension Plan, in accordance with FASB Statements No. 87, *Employers' Accounting for Pensions*, and No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits (revised 2003)*. The credit recorded in the statement of activities for 2003 for the minimum pension liability includes the effect of the reduction in the minimum liability during the year of \$871,000.

The accumulated benefit obligation for the Employees' Pension Plan amounted to \$8,171,000 and \$7,415,000 at December 31, 2003 and 2002, respectively. The projected benefit obligation and accumulated benefit obligation for the Supplemental Executive Retirement Plan, which is unfunded, was \$489,000 and \$354,000, respectively, as of December 31, 2003, and \$347,000 and \$191,000, respectively, as of December 31, 2002. There were no benefits paid under the unfunded plan in 2003 and benefits of \$109,000 were paid for the year ended December 31, 2002. The Foundation expects to contribute at least \$463,000 to its Employees' Pension Plan during 2004.

Gains and losses subsequent to the adoption of FASB Statement No. 87 that result from changes in actuarial assumptions and from actual experience which differs from that assumed are amortized over a ten-year period. Prior service costs from plan amendments are recognized over the employees' remaining service periods.

The asset allocations for investments under the Employees' Pension Plan are as follows :

<i>At December 31</i>	2003	2002
Equity securities	76%	78%
Debt securities	24%	22%

The Finance Committee of the Foundation's Board of Trustees has adopted an investment policy covering investments under the Employees' Pension Plan. The policy includes objectives emphasizing such items as optimization of longer-term returns, high standards of portfolio quality, diversification, preservation of capital, minimization of risks, capital appreciation and achievement of an annually stated long-term return.

The Committee has the responsibility to allocate assets under the Plan and to retain, as necessary, investment managers and advisors. The Foundation retains a professional investment manager who maintains complete discretion over investment decisions. The investment manager's performance is monitored by the Committee quarterly, and these two parties meet in person at least once annually.

Notes to Financial Statements *continued*

In order to achieve a competitive return and minimize the risk of large losses, the Committee has recommended asset allocation ranges to the investment manager. These recommended ranges are 65 to 80 percent of the portfolio's market value in equity investments and 20 to 35 percent in fixed income investments. All securities invested in the Pension Plan must be marketable. Several types of investments are prohibited without the express consent of the Committee, including real estate, oil and gas, venture capital, commodities, private securities and derivative instruments. The policy provides for a minimum investment quality rating for fixed income securities and certain other restrictions on investment concentrations.

The investment manager is prohibited from purchasing securities on margin, selling positions short or otherwise leveraging the portfolio. Mutual and commingled fund investments are permitted provided that certain requirements are met. The assets under the Foundation's Employees' Pension Plan have been invested in indexed commingled funds. The investment policy includes performance standards to measure the program as a whole, and the investment manager individually, against appropriate benchmarks.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid under the Foundation's pension plans:

<i>Year ended December 31</i>	
2004	\$ 442,000
2005	507,000
2006	559,000
2007	603,000
2008	654,000
2009 - 2013	3,919,000

Health Care Plan

The Foundation sponsors a postretirement health care plan for all eligible employees. Employees retiring after reaching age 55, and completing at least 10 years of service, receive a one-time opportunity to elect continued coverage under the health care plan then in effect for active employees. The cost of coverage beyond the date of retirement is then shared between the Foundation and the retiree, with the Foundation responsible for the amount equal to its cost for the employee's coverage immediately prior to retirement. Premium increases for any reason beyond the retirement date are the responsibility of the retiree. Decreases in premiums for any reason beyond the retirement date, including Medicare integration at age 65, would reduce the retiree's cost first, then the Foundation's cost.

The components of net periodic postretirement health care expense for 2003 and 2002 are as follows:

<i>Year ended December 31</i>	2003	2002
Service cost	\$ 83,000	\$ 67,000
Interest cost	153,000	141,000
Amortization of net losses	72,000	48,000
Amortization of prior service credit	(34,000)	(34,000)
Net periodic postretirement health care expense	<u>\$274,000</u>	<u>\$222,000</u>

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

Change in benefit obligation

Accumulated benefit obligation, beginning of year	\$ 2,432,000	\$ 2,086,000
Service cost	83,000	67,000
Interest cost	153,000	141,000
Actuarial losses	601,000	281,000
Benefits paid	(151,000)	(143,000)
Accumulated benefit obligation, end of year	<u>\$ 3,118,000</u>	<u>\$ 2,432,000</u>
<i>At December 31</i>		
Funded status of plan	<u>\$(3,118,000)</u>	<u>\$(2,432,000)</u>
Unrecognized net actuarial losses	1,247,000	718,000
Unrecognized prior service cost (credit)	14,000	(20,000)
Accrued postretirement health care costs	<u>\$(1,857,000)</u>	<u>\$(1,734,000)</u>

The Foundation funds retiree health care benefits on a cash basis. Gains and losses that occur because actual experience differs from that assumed, and from changes in actuarial assumptions, are amortized over 10 years. The actuarial losses for the year ended December 31, 2003 result from changes in actuarial assumptions, including lowering the discount rate to 6.0% and increasing the health care cost trend rate to 10.0%. In addition, the actual increase in healthcare cost premiums for 2003 was much larger than the increase anticipated a year ago. The amortization of the prior service credit includes the impact of plan amendments and revisions in the measurement of benefit obligations for certain retirees.

A one-percentage-point change in the assumed health care cost trend rate would have the following effects on costs and benefit obligations at December 31, 2003:

	<i>1-Percentage- Point Increase</i>	<i>1-Percentage- Point Decrease</i>
Increase (decrease) in total amount of service and interest costs	\$20,000	\$(18,000)
Increase (decrease) in accumulated postretirement benefit obligation	203,000	(179,000)

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid under the Foundation's postretirement health care plan:

Year ended December 31

2004	\$ 184,000
2005	207,000
2006	225,000
2007	237,000
2008	250,000
2009 - 2013	1,380,000

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 was signed into law. As permitted by FASB Staff Position No. FAS 106-1, the Foundation has not recognized in its accounting for the postretirement health care plan any effects of the Act in its financial statements for the year ended December 31, 2003. As such, measurements of the accumulated postretirement benefit obligation and net periodic postretirement health care expense included in the accompanying financial statements and related notes do not reflect the potential effects of the Act on the Foundation's accounting for the plan. Specific authoritative guidance on the accounting for the federal subsidy provided by the Act is expected to be issued during spring 2004 by the FASB. Accordingly, issuance of that guidance could result in changes to information reported about the plan.

5. Furniture, Equipment and Leasehold Improvements

These assets consist of the following :

<i>At December 31</i>	<u>2003</u>	<u>2002</u>
Furniture and equipment	\$ 5,261,000	\$ 4,903,000
Leasehold improvements	2,446,000	2,382,000
	<u>7,707,000</u>	<u>7,285,000</u>
Accumulated depreciation and amortization	(6,809,000)	(6,443,000)
	<u>\$ 898,000</u>	<u>\$ 842,000</u>

6. Lease Commitments

The Foundation occupies office space in a single building pursuant to an operating lease. Total rental expense for office space and equipment amounted to \$1,673,000 and \$1,660,000 in 2003 and 2002, respectively. The operating lease for the Foundation's office space commenced April 15, 1988 and the current extension expires on September 30, 2006. Accrued rent expense for escalating minimum lease payments and initial rent abatement amounted to \$856,000 and \$1,164,000 at December 31, 2003 and 2002, respectively, and is reflected in liabilities in the accompanying statements of financial position. The accrued rent expense balance is being amortized over the remaining term of the operating lease.

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

Year ended December 31

2004	\$1,981,000
2005	2,025,000
2006	1,518,000
Total minimum lease payments	<u>\$5,524,000</u>

Report of Management

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

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

In response to recommendations and regulations stated in the past by the Blue Ribbon Committee of the New York Stock Exchange and the National Association of Securities Dealers, as well as the Securities and Exchange Commission, the Audit Committee of the Foundation has developed a formal charter governing its operations. Although the Foundation is not a publicly owned entity, the Committee has concluded that the organization should voluntarily comply with recommendations and regulations of this type where appropriate. The charter identifies the key functions, objectives, operating practices, membership requirements and duties and responsibilities of the Committee. Part of the Committee's responsibility is to regularly review the charter to identify areas requiring enhancement and/or clarification. This effort is continuing in light of the audit committee provisions included within the Sarbanes-Oxley Act of 2002, and the related Securities and Exchange Commission's rules. The Committee's current charter is available through the office of the Executive Vice President.

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



Robert E. Denham, Chairman and President
Financial Accounting Foundation



Joseph S. LaGambina, Executive Vice President
Financial Accounting Foundation

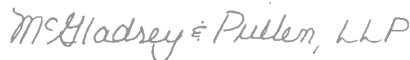
Independent Auditor's Report

Board of Trustees
Financial Accounting Foundation

We have audited the accompanying statements of financial position of the Financial Accounting Foundation as of December 31, 2003 and 2002, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Financial Accounting Foundation as of December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



New Haven, Connecticut
February 20, 2004

*Financial Accounting
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