Securities and Exchange Commission Historical Society
Oral History Project
Interview with Edmund Jenkins
Conducted on March 16, 2011, by James Stocker

JS: This is an oral history interview for the SEC Historical Society's online archive on the history of financial regulation. Today is March 16, 2011. I'm James Stocker. I'm talking today with Ed Jenkins who, after a long career at Arthur Andersen, spent five years at the helm of the Financial Accounting Standards Board. Welcome, Ed.

EJ: Thank you. It's nice to be here this morning.

JS: First of all, where were you born and where did you grow up?

EJ: Well, I grew up in East Lansing, Michigan, the home of Michigan State University, which I did not attend. I spent my time, until I went away to college, there in East Lansing.

JS: How did you come to study economics at Albion College?

EJ: I've always had an interest in business in one way or another. I worked in a hardware store as a high school student and did everything from stocking the shelves and sweeping the floor to keeping the books. I've had a strong interest in business and at a liberal arts college like Albion in Michigan, that was as close to business as you could get.

JS: While you were at Albion, did you have any particular influences that shaped your future career path?

EJ: Well, certainly at a small liberal arts college I think there were only 700 students there at the time, back in the early and mid-fifties. You got to know everybody on campus, including all the professors, whether you had them in class or not. There were many, many individuals that influenced me. The principal one, though, was Maynard Aris. Maynard was a professor of economics, but he taught all of the accounting classes, or almost all of the accounting classes. Over the years I got to know him very, very well and our relationship continued well beyond the time that I was at Albion.

Maynard came out of industry, which is a little unusual at a liberal arts college. He didn't have a PhD and that was a concern of the president of Albion. I learned about it and talked to Maynard and he finally did get his PhD at the University of Michigan in accounting. I helped him a great deal with his thesis, which was on deferred tax accounting, which happened to be a specialty of mine. In my early years at Arthur Andersen, in fact, I testified many times before the Michigan Public Service Commission for utility companies in the state on that subject. Maynard was, first of all, my teacher. Then he became my mentor and finally, my friend.

JS: I understand that Jim Leisenring also studied at Albion.

EJ: He did. Jim was about five years after me and so, we never knew one another at Albion.

But shortly after he graduated and started work in Michigan in public accounting, we became acquainted through mutual friends and we remain very close friends to this day. We worked together and played together for probably fifty years.

JS: Why do you think so many important people in the world of accounting standards setting came from Albion College?

EJ: Well, that's a very good question and it's not only accountants. There's a long list, and I won't enumerate them, of CEOs of Fortune 500 companies that come from Albion. I think it's basically getting a broad education that, as I like to express it, helps you learn how to learn. If you learn how to learn, you can pretty much tackle any subject.

Jim and I are each members of the Accounting Hall of Fame, which, while it's not Cooperstown, is still a pretty nice honor. To have two of about, at the time I entered it – Jim entered it before I did – two out of about eighty members of the Accounting Hall Of Fame over all the time it's been in existence come from Albion is probably pretty unique.

JS: That's an impressive number for such a small school. From Albion, how did you come to join Arthur Andersen?

EJ: I was ready to come to Arthur Andersen right after I graduated from Albion. But the managing partner of the Detroit office, where I was going to go to work, pulled me aside and said, "You know, Ed, if at all possible, it would be terrific if you could go out and get a master's degree. We'll hire you now or we'll hire you later. Please give some thought to doing that. You really should take advantage of an opportunity."

Maynard Aris, my professor at Albion, was really beating on me to go ahead and get a master's. He even arranged a scholarship for me. Actually, it was the William Paton Scholarship. Bill Paton is a well-known member, longtime member of the accounting profession. At the end of the day, I did go on to get my master's, which I was able to do in just one calendar year. Then I started with Arthur Andersen in 1958.

JS: Where did you do your training with Arthur Andersen?

EJ: Arthur Andersen is pretty well-known today, or before its demise, for its training center out at St. Charles, Illinois. That wasn't in existence then. We did our initial training, which was a three week course, at Northwestern University. We utilized their facilities in the summertime.

JS: You began working in the Detroit office after that?

EJ: Yes, I started in June of 1958 in our Detroit office and I was there for twelve years. I became a partner while I was there.

JS: What sorts of projects did you work on at the Detroit office?

EJ: I was an auditor and I handled all kinds of audits. My specialty was public utility accounting. Arthur Andersen really got its start during the thirties in public utility accounting, with the infamous Insull affair, and became the preeminent auditor in the United States for public utilities. We had a large utility practice in Detroit and I was a part of that.

JS: Now at this time, Leonard Spacek was still running Arthur Andersen?

EJ: Yes, Spacek, Leonard Spacek.

JS: Did you know him personally?

EJ: Oh, absolutely. Leonard made it a point to get around the firm's offices and to know not only his partners, but also certainly all of his managers. Leonard came up through the utility practice as well. I had numerous opportunities to meet and work with him while I was in Detroit and then later, when I went to the national office of Arthur Andersen, of course, I spent a lot of time with Leonard.

JS: Did you got to the national office immediately after making partner?

EJ: No, I was in Detroit for a couple of years. I made partner in 1968. In 1970, I transferred to Chicago and to what we called the home office to head up our practice before the Securities and Exchange Commission.

JS: How did you come to work on SEC issues?

EJ: Public utility companies have an insatiable need for capital. As public companies, of course, they had to register with the SEC every time they needed capital. So I spent a good portion of my time working on registration statements and filings and, of course, the subsequent reporting. I got to know not only the SEC rules and regulations, but also got to know people like the chief accountant of the SEC and the chief accountant of the Division of Corporation Finance and some of the other individuals at the SEC. When we, at Arthur Andersen, needed to make a change in who headed up that practice because the partner was transferring to London, I was selected.

JS: The chief accountant at that time was Andrew Barr?

EJ: Yes.

JS: So you knew him?

EJ: Oh, absolutely, yes. I knew him both as representing my clients, when we had accounting and financial reporting issues, as well as subsequently, when I was heading up the firm's practice before the SEC. We had a very good relationship.

JS: This was sort of a tumultuous era in accounting standards setting. There was a lot of conflict over, for instance, the issue of business combinations and pooling. Were you involved in these debates at all?

EJ: Yes, as head of the SEC practice, I was a part of the group which later became known as the Professional Standards Committee. At that time it was known as the Committee on Professional Standards. (Laughter.) Sometimes I think we changed names just to change. I got very involved with the firm and some other members of that small group were actively involved.

George Catlett was a member of the Accounting Principles Board at the time and he was my boss. It was that group that issued APB Opinions 16 and 17 on poolings of interest and good will. A very good friend of mine and another member of the Accounting Hall of Fame, Art Wyatt, was carrying George's bags at the time and he and another partner from another firm actually wrote those two opinions.

JS: At this point in time Andersen was opposed to getting rid of the pooling method for accounting for business combinations?

EJ: No, I don't think so. We've never supported pooling of interest accounting. But we were interested in seeing it improved, if we couldn't get rid of it. We were also very concerned about the accounting for good will. The initial attempt was to have one standard that would cover both accounting for business combinations and good will. They couldn't get enough support from the Accounting Principles Board to pass it. Some liked this part and some liked that part and so the decision was made to do two separate opinions, each of which could get majority support. That's how we happened to have two opinions at that time. You know, accounting is an art, not a science. That does lead to some political approaches to setting standards.

JS: At this time, were you active in the AICPA?

EJ: Yes, primarily at that time through the SEC committee of the AICPA. In fact, another member of that committee was Ray Groves, who later became the chairman of Ernst & Young, now Ernst & Young, back then Ernst & Ernst. The two of us, along with the chief accountant at the time, perceived a need to provide education to accounting firms that had an occasional public company as a client, but didn't have a large practice. How could we help those firms become proficient enough that they could feel comfortable in attesting in SEC filings, which carries some significant liability with it?

We set up what we called the SEC conference. It was the first time ever and members of the SEC staff, members of the large firms, made presentations and we invited representatives from these smaller firms around the country to attend. That first SEC conference, which was held in Washington at the Hilton Hotel, I can't remember the year, but it was like 1972, had about 250 participants. At the SEC conference that was held this past December, there were over 8,000 people in attendance. It was carried live to London, New York City and the West Coast. Ray Groves and I started that and that was certainly one of my large activities for the profession.

JS: It must be nice to see the fruits of your labor continue to grow. At this time, you must have also watched the growth of Arthur Andersen's consulting practice. How did this affect the company?

EJ: The consulting practice did grow out of the audit practice. In fact, when I was there, to become a partner in Arthur Andersen in the consulting area, you needed to be a CPA. That later changed, as we began to specialize in the consulting practice and in other areas that were of a more technical nature, maybe engineering or computer-oriented types of consulting engagements. It began to grow very fast, as the audit practice and the tax practices both were growing. It was a very good relationship at the start. I would say for twenty-five years it worked very well.

JS: Tell me how you came to work on the Emerging Issues Task Force.

EJ: Those of us on the SEC committee and others had noted that one of the concerns was how you account for unique transactions or transactions that had not yet been covered directly by accounting standards. You had to use accounting standards by inference to come to a decision as to how to account for a particular transaction.

There was a lot of pressure on the accounting firms by their clients to accept what became known as lowest common denominator accounting. In other words, "show me where in the books it says I can't do this. If you can't show me, I'm going to do it." The accounting firms had trouble stopping that. The thought was if we had a group of the profession that would include the top accountants in the country and representatives from business and we worked on these issues, which wouldn't be standards, but we would reach a consensus as to how they ought to be accounted for in the absence of specific standards.

The thought was, though, that in order to make that work, we needed a couple of things: One, we needed individuals that could speak authoritatively for the firm, that could commit the firm on the spot during an EITF meeting that, "Yes, worldwide, we will do this." We tried to get representatives from each of the major firms and from several of the smaller, intermediate firms, to participate on this committee that had that authority. I had that authority at Arthur Andersen, and my peers at the other firms had the same. That's how we started the EITF.

The second thing that was important was that we had the support of the SEC chief accountant. So the SEC chief accountant, who was Clarence Sampson at the time, Andy Barr's successor, agreed. We have an accounting series release that says that consensuses of the EITF will be required to be followed in SEC filings or words to that effect. We got off and running and still going.

JS: Would you say that the idea came from the accounting firms, the idea came from the SEC or was it just everyone putting their heads together?

EJ: I think it was everyone putting their heads together. The leadership was taken by Jim Leisenring at the FASB. At that time, he was the technical director of the FASB and he became the first chairman of the EITF.

JS: Who came up with the name?

EJ: I don't remember. (Laughter.)

JS: It was a few years back. How were members chosen at this time? Did the firms choose the members or did the FASB choose the members and then get the approval of the firms?

EJ: Yes, mostly the latter. We had in mind, as a few of us were forming it, who we thought would be appropriate for the committee. We had representatives from industry, too. We worked with the FEI – Financial Executives Institute at that time, it's called a different name now – to come up with a good group of about fourteen members or something like that.

JS: How did you go about choosing issues to work on?

EJ: We would get issues in a variety of ways. One of the principal ways, though, was from the SEC accounting staff. They would see registrants come in with a unique issue and then they'd see another one with the same issues that became less and less unique and more emerging. So they would often suggest that we would take up issues. The accounting firms themselves would bring issues to the table and companies, also. Then those potential issues were discussed and voted on as to whether they should go on the agenda by the Emerging Issues Task Force itself.

JS: What do you think were some of the most important issues that you worked on?

EJ: Oh, boy, I can't remember. One of the keys initially was to try to get issues that were narrow enough that we could resolve them quickly, like in the same meeting. Later on, the issues got broader and more complex and we began to deal with things like special purpose entities and derivatives and leveraged buyouts. We actually ended up with issues that took several or many meetings and we even had subcommittees to deal with those issues.

That was a tough time for the EITF, because I think it ran the risk of not being able to deal with issues promptly and decisively and it began to look more and more like yet another standard setter. But we worked through almost all of those issues. I think it's been very, very successful. Of course, it continues to this day and internationally, almost every accounting standard setter around the world has a similar kind of arrangement now. Certainly the IASB, the International Accounting Standards Board, has one that mirrors the EITF almost directly.

JS: On that note, at this time did you consider the relevance of international standards while you were working on the EITF?

EJ: Not very much, no.

JS: In 1985, you became the managing partner of the Professional Standards Group at Andersen. Was that group already in existence at that time or had it just been created?

EJ: Yes, it already existed and was chaired by Art Wyatt, who I mentioned before. Art became a member of the FASB. He was a board member, so I took that job over at that time.

JS: Now this was the time of the Savings and Loan Crisis. How did Andersen make it through this period?

EJ: We never had a large S&L practice. However, we had a couple of very large and infamous ones, one right here in Arizona. So we had our issues in this area. But we quickly put a stop to accepting new clients in the S&L industry and began to focus and develop internal standards and auditing steps to control the matter. We only had one particularly significant issue in the S&L industry, much less than some of the other firms, just because they had a larger practice.

JS: How did you come to chair the AICPA Special Committee on Financial Reporting?

EJ: I was in the wrong place at the right time, I guess. (Laughter.)

JS: Tell me about it.

EJ: Andersen had a history of being fairly controversial and outspoken on the need to improve financial reporting. It goes back to Leonard Spacek's time, even before I started with the firm in 1958. We had done quite a lot of writing and speechmaking and so on the need to improve financial reporting. I had become fairly well-known through my work on the EITF and other things, so I was asked if I would undertake this project to see what we could do to develop a new model, perhaps, of financial reporting. I became the chair of it.

JS: Did they just call you up one day or did they approach you at a conference?

EJ: I think they called me up. It was Tom Rimmerman who was the Chairman of the AICPA at the time. We talked about it and I agreed to look into it. Of course, I had to talk to my other partners about it, because it would take a lot of time. I still kept my day job, so to speak, my other position at Arthur Andersen. But at the end of the day, I did. We pulled together again, a very good committee of individuals from the firms. The SEC had a representative on the committee.

JS: Who else was on there?

EJ: Representatives from all the major firms. There were about three representatives from smaller accounting firms, a representative from the SEC, a representative or maybe two from the Financial Executives Institute, an academic, Bill Holder, from the University of Southern California. It was staffed at first by AICPA staff people and later, I had one of my partners, who was on the Professional Standards Group, become my direct staff person on it. He did most of the writing of the report.

JS: How much time did it take to write this?

EJ: We were in existence for over three years.

JS: But on a daily basis, did you spent just a couple hours working on it?

EJ: We met almost every month for three years.

JS: You had to travel to these meetings usually?

EJ: Yes, almost always. They were mostly held in New York and I was in Chicago. They usually lasted a day or a day-and-a-half. But as we began pulling things together, the time commitment increased because we had to go out and try and sell this report to all the various constituencies of the AICPA and principally, business and Congress. We made, and I made many of them, speeches to groups, often groups that were opposed to what we were doing.

JS: Why did these groups oppose this?

EJ: Our idea of this new financial reporting model was that we should focus on the interests of investors. This was back at the time when the customer was king and companies were doing everything to develop products and so forth that really appealed to customers. They were advertising that way. We said the customers of financial reporting are investors and creditors. So our research, and we did a lot of research on this, this isn't just a dozen people talking about what they think. We tried to document and do significant research.

What that came out with was that the customers, investors, their approach was to look forward, have forward-looking information. That doesn't mean you have to have a forecast. That's not the job of financial reporting, to have a forecast. But providing historical information and trends that let investors and their representatives make forecasts more accurately than they could without that information is what we were trying to go after. We wanted information that could be audited. You can't really audit a forecast, but you can audit the elements that go into a forecast. That's what we wanted disclosed. Business was concerned that that would be giving away competitive information and they didn't want to be responsible for forecasts. There was a lot of misinformation that we had to try to clarify.

JS: Was there also concern about the costs of the audits?

EJ: Yes, cost was always an issue, the cost of gathering that information first and then auditing it. We were able to demonstrate, first of all, that almost all the information that we were talking about was, in fact, available and that companies who had investor relations departments, large public companies, were providing this information. It just wasn't done in a comprehensive, organized, audited package. Once we could get that idea across, a lot of the concern went away. We had to explain this to Congress, because business, the first thing they do is ask their lobbyists to have Congress jump on us. We were able to get it across. The SEC supported us.

JS: Did you testify before Congress on this issue?

EJ: I don't think so, I didn't testify on this particular issue, but I certainly talked to them a lot. With the SEC support, we were able to issue our report and it was unanimous by the committee. We did a very unique thing at the time: Our report was distributed to every subscriber of the *Journal of Accountancy*, in a little plastic envelope that you sometimes see more frequently now. We spent time afterwards trying to promote it.

Unfortunately, except in some minor areas, it's not been followed through on very well. The FASB undertook a project to see what it could do in that area, and came up with much the same conclusions. It still lingers on.

JS: Are you talking about the FASB's efforts at the time or later on?

EJ: Subsequently.

JS: At the beginning of this process of writing this report, did you expect that it would eventually be several hundred pages long and have an annex of, I believe, 1,600 pages?

EJ: (Laughter.) No. I didn't know what to expect. But as we began to work on it and do this research, we thought, "Well, it's important to preserve this work," and a lot of that 1,600 pages is research we did. Surveys, we employed professional opinion takers. We set up subcommittees of investment advisors, both debt analysts and equity analysts. We did a lot of work and we decided that we should memorialize it.

JS: How did the people at Andersen feel about the report?

EJ: Again, there were mixed feelings about it. I think that at the top we had strong support for it. Those auditors and partners who were working with clients and their clients were concerned, they relayed that concern. At the end, we had sufficient support. I never felt beat upon.

JS: You felt like you were independent of the firm and you didn't feel like you had to check back on every aspect of the report?

EJ: Absolutely not. (Laughter.) The only people I would've had to check with were the people who worked for me. (Laughter.)

JS: Were you also serving on the FASB's Advisory Panel at this time?

EJ: Yes, and part of that time I was, on FASAC.

JS: What did you do on that committee?

EJ: That committee is a longstanding committee and it's still in existence, of course. It's a cross-section of all the constituencies of the FASB, including academics, industry, accounting firms, investment advisors. I guess that covers it. It's designed to give the FASB advice, with respect to standard setting projects that it ought to undertake, and discussing with the FASB the direction that those standards are heading. I think it meets six times a year. It consists of individuals who are spending most of their lives doing this kind of thing, CFOs of major companies and so on.

JS: During these years, during the early-nineties, the FASB ran into a lot of opposition from business and from Congress on certain issues that they were working on; for instance, the issue of stock options. Did you observe that?

EJ: Well, I did, but I wasn't on the FASB at that time. I was in my role at Andersen at that time. It was very controversial, particularly with the high-tech companies, which were at the height of their growth and were merging every day and were paying for talent with stock options because they didn't have any cash. They were scared to death that requiring recognition of options as compensation, as an expense, rather than an equity transaction, would put their success at peril.

Remember that these startup high-tech companies were looking for an exit strategy. That exit strategy almost always involved an acquisition by a larger company. So being able to show a profit or show as small a loss as possible was, they believed, essential to them.

JS: So there was pressure on auditing companies to support these standards?

EJ: Right. The standard we had in place for what we called "qualified stock options" didn't require that they be recognized as an expense. Remember that most options do require, and always have required, expense recognition. It's only this very narrow qualified stock option to employees that didn't and there was really no logic to that. So the board felt it needed to address the issue. It did and again, Congress got heavily involved, to the point that there was a threat that they would put the FASB out of business if it proceeded. As a result of that, the FASB dropped the project.

Arthur Levitt was the chair of the SEC at the time. This was in 1994, I think. He was a new chair. He did not support the FASB on this issue. He has later told me privately and said publicly that that's the single biggest mistake he made during his term as chairman of the SEC, that he didn't support the FASB. So that's what happened.

Then later on, when we got dealing with other issues, like derivatives and business combinations and so on, those that opposed the FASB felt empowered by the success they'd had on stock options and tried it again. There are two reasons that I think it didn't work and we were able to go forward in a positive way with both derivatives and business combinations, and then after I left, with stock options again.

One was that the FASB got very proactive with Congress, spent a lot of time there. I testified seven or eight times. I was meeting with members of Congress and members of these particular committees that had an interest with them every other week. I spent at least two days every other week in Washington, sometimes seeing as many as ten or twelve senators and congressmen in a day. We were able to get them to understand what our role was and how we worked and that our due process was sufficient to let us do our business where they weren't experts. Arthur Levitt supported us. With that, we were able to overcome the ditch that we got into on the earlier stock option matter.

JS: Do you think the future of the FASB was ever in question in the early nineties, after the stock options incident?

EJ: Well, I think the FASB lost a lot of credibility that we had to get back. To the credit of board members and Jim Leisenring, who was still the technical director, they didn't just give up. They went to work and got it back. I think it was the second day that I was at the FASB in July of 1997, when I received a letter from Alan Greenspan on derivatives, suggesting that we should drop the project. So I, with the help of the staff, wrote him back and in effect, not in so many words, said, "Look, I won't set interest rates if you don't set accounting standards." So we took a pretty tough and direct stand on that issue.

Then Chairman Greenspan and I met privately and the outcome of that was that we established a liaison relationship with the Federal Reserve. One of the members of the Federal Reserve undertook that responsibility and we agreed that if either of us had any issues that we felt needed to be discussed with the FASB or the Federal Reserve that we would call each other and that we would talk about it and we'd do that. We had each other's home phones. We began to meet with the Federal Reserve on an annual or semi-annual basis. It defused the situation.

JS: We may come back and talk a little bit more about that in just a minute. First I'd like to ask you about your final years at Andersen and then we'll come back to the FASB. In the early 1990s, you started to see a few problems at Andersen publicly, for instance on the Sunbeam case. Did you notice any changes in the firm at all?

EJ: No. I think that was simply a case and I don't remember the details of that any longer. That was simply a case of where we probably didn't do as good a job of auditing as we should have. In a very large firm with 1,000 partners, sometimes those things are going to happen. We try to put in all the controls in that we can and internal processes and procedures to see that that doesn't happen, but once in a while, it does.

JS: Was it difficult to leave the firm?

EJ: Well, I didn't have any choice. (Laughter.) We had mandatory retirement at sixty-two and in 1997, I was sixty-two. Actually, I left in 1996 and then I went to the FASB nine months later, in 1997. In that interim nine months when I was trying to retire, it was very hard. I flunked retirement. I was out here in Tucson when I got the call to see if I'd go to the FASB.

JS: Was that unexpected?

EJ: Yes and no. I had been asked earlier if I would do this. This was the end of Denny Beresford's ten year term and he couldn't stay at the FASB, because of term limits. I had been asked if I was interested by the chairman of the Financial Accounting Foundation, which has the responsibility for appointment. I had said that I didn't have any interest. But as time went on and the Foundation was having difficulty finding the right person, I began to get inquiries as to whether or not I would reconsider. At that point, as I said, I wasn't very comfortable with my retirement. Sixty-two was way too early for me. So I began to think more seriously about it.

JS: You were already here in Tucson?

EJ: We were, but we were just here for the winter. We still maintained our home in the Chicago area. That went on during that spring and finally, in early June – and Denny's term ended at the end of June 1997 – I agreed. That was just about eighteen days before

July 1. On July 1, I was at the FASB working.

JS: Before agreeing to serve as chairman of the FASB, did you have any concerns about the political nature of the job at all?

EJ: Well, I was certainly aware of it. Through my work on FASAC, the advisory committee, and the EITF and my responsibilities at Andersen, I was well-acquainted with the FASB and its operations and actually knew personally all the board members and many, many of the people on the staff. I felt very comfortable from that aspect in taking on the responsibilities. I had a high regard for most everyone at the FASB and, as I said, knew them all, knew most of the Financial Accounting Foundation members. I was able to hit the road running. I was up-to-date on most of the issues, because of my responsibilities and so I felt very good about that.

I knew about the political issues as well and the fact that the FASB has always been controversial to some. As I mentioned earlier, that letter on the second day from Alan Greenspan certainly convinced me that that was going to be the case, if nothing else. I was willing to do it.

JS: I know that corporate donations to the FAF had been declining in the years before you started serving. Did you have any concerns about funding for the FASB?

EJ: Funding has always been an issue at the FASB. Fortunately, the major accounting firms had an implicit agreement or understanding with the Foundation that they would keep the FASB going, so I didn't overly worry about that. That wasn't my responsibility. It was the FAF's. I was willing to believe that they could handle it.

JS: Did you have any discussions with the SEC before joining, with Arthur Levitt or the chief accountant?

EJ: I did. I wanted to get their assurance that they would continue to work with us and would support me. I don't remember the specific discussions, but yes.

JS: After taking over as chair, what was the first big issue that you dealt with?

EJ: Well, derivatives was the hot button right at that time. The board was most of the way through their deliberations and were trying to fine-tune this monster with all the implications of derivatives and all the pressure and so forth. Their goal at that time, I think, was to issue a standard in about nine months. I think it took another couple of years before we actually got the standard issued. And then, as it is with many standards, and always has been, the implementation of the standard brings its own set of challenges.

JS: The Jenkins Committee Report had already talked about dealing with what it called innovative financial instruments. So you had worked on this issue before.

EJ: Well, yes. In our practice at Andersen, we ran across it all the time. The Emerging

Issues Task Force dealt with it in-depth. One of the experts in the whole profession, John Stewart, was one of the partners who worked with me, and attended all the Emerging Issues Task Force meetings with me. He really was the guy, not only in Andersen, but one of the few in the country that really understood or worked on these areas.

JS: At that time, you weren't able to come up with a consensus within the auditing industry?

EJ: No, and that's why we spent so much time at it at the EITF and why it was so difficult to get the standard out.

JS: So at the FASB, how did you propose to deal with this issue?

EJ: We continued to discuss it. We issued interim reports – exposure drafts, we called them. We continued to seek and search out contacts. We continued to do research. We did field tests. We went out to companies that had derivatives and tried to apply the new standards, the proposed standard. That's a very common practice in any of our complex standards with the FASB, to see if you could implement the standard and if the results would make sense. We continued to work on the issue and eventually came up with a standard that we did issue.

For all its complexity and for all its problems and for all of the subsequent EITF issues and amendments and so on, I think the standard was headed very much in the right direction and we've had very few debacles in the derivatives area since then.

JS: The rule that you proposed would've required companies to report derivatives at their fair market value on the quarterly income statements, right? The banks complained that the accounting rule would distort their earnings. Was that a valid criticism?

EJ: Well, it didn't distort the earnings. It kept them from being smooth. It reflected reality. In reality, in economics, income streams are not smooth. This is an issue we've had not only for derivatives, but for almost everything else. So to reflect the fact that based on specific transactions or interest rates or whatever, the reality is that income is going up and down.

The banks have a problem because they're regulated and they have capital requirements. They don't want to have to have any more capital than they absolutely are required to have. If you have this fluctuating income level, your capital is going to go up and down. To guard against that, you have to carry more capital than you otherwise would need.

JS: The SEC backed your proposal?

EJ: Yes.

JS: But the Federal Reserve opposed it?

EJ: Yes, because of the banks.

JS: So you think it was just because of pressure from the banks?

EJ: Yes.

JS: Were you in touch with the Federal Reserve during this period about this issue?

EJ: Yes, as I said earlier, we had this liaison relationship and so we did discuss it with the Federal Reserve and with their staff.

JS: Did they ever say to you, we agree with you on the merits, but we need the support of the banks; was it ever that explicit?

EJ: No, no.

JS: What about the Treasury Department? I believe it asked for exemption for certain of its bonds.

EJ: I don't remember that. We had a very similar kind of relationship with the Treasury Department. I met with the Secretary of Treasury several times on all kinds of issues and with his staff. I don't remember the specific discussions with Treasury.

JS: You took over in the summer of 1997 and I believe in October of 1997 you were called to testify before the Congress on this issue twice. How was that experience?

EJ: Well, you have to be patient. You have to recognize that members of Congress, particularly when they're at a committee hearing, are talking to you, but they're speaking to their constituents. There are some people who can't handle that and some people who can. Fortunately, I think I'm able to handle that. Even though you're tempted to say, "This is just silly," you don't do that.

JS: I have a quote here from Senator Phil Gramm. "Your job is not making rulings. Your job is making a consensus. You have failed to do this."

EJ: (Laughter.)

JS: I'm not sure if you remember that or not.

EJ: I don't remember that particularly, but I can tell an anecdote about Phil Gramm. I think it was on business combinations. He called me up and said, "I want to hold a session. It's not a hearing, but I want to get a group together and talk about this issue of business combinations. Would you participate?" I said, "Yes, certainly, Senator. Of course, I would."

So I get there and there are seven people on this panel that are going to speak to his committee. It was billed as an informal thing. He had me sit in the middle of these seven people. The other six were opposed to what we were doing and I was the only one. I had gotten to know him fairly well by then and I said to him, "Well, Senator, I see I'm the thorn among six roses." (Laughter.)

JS: On this issue of derivatives, did you have to make any concessions to the banks in crafting the standards?

EJ: Well, in every standard there are compromises that you make. That's the primary reason why standards are so complex, because once you move away from a conceptually pure approach to standards; you have to set arbitrary rules for how you're going to do something differently. Yes, there are many cases in there. I don't know that I can remember any specific at this point, but yes, that's one reason why it's so long and so complex.

JS: Do you think that undermines the idea of principle-based standards?

EJ: Absolutely. But there are several reasons why we don't have what's called principle-based standards in the U.S. I think they are principle-based. We have a conceptual framework. We have the best conceptual framework in the world. One of the best things about the newest International Accounting Standards Board is that it did develop a conceptual framework. It's where we all start. Why do we have standards that then become, I prefer to say complex, rather than not principle-based, because they are. They do start out with this conceptual framework of principle-based standards.

I think there's several reasons. One is that companies have to stop saying, "Show me where it says I can't do this," and accept the broad principles and the interpretation that they make in good faith of compliance to the standard and their auditors and accept their auditors' view on that.

Secondly, the SEC staff has to recognize that under those circumstances, different companies and different auditors are going to reach slightly different conclusions on particular standards and the SEC staff has to accept that. They cannot impose their views, because then they're setting the standards and not the private sector. They have to recognize that that's going to happen. Then companies and their auditors will feel better about that and not fear that they're going to be sued by the SEC or by others.

The third issue is, again, that auditors themselves need to develop their own interpretations of the principles and follow them and be consistent and insist that their clients follow them. We don't have those things now. I've been saying those same things in speeches since 2000. I think everybody nods their head, "Yes," but in practice they don't.

JS: Just to finish up on derivatives, I know that the FASB created a derivatives implementation group to supervise the implementation of that standard. How did that group work?

EJ: It was a group of experts in derivatives from all the firms and from the SEC and others. It was designed to deal with these difficult implementation issues. It facilitated getting the standard out. It's not unique. When the standards came out way back on business combinations, APB Opinion 16 and 17, there immediately was set up an implementation group and they published thirty or forty official interpretations. There are now books on interpretations of business combination accounting, or there were before the new standard.

It wasn't unique, but it was designed to help everyone –reporting companies, their auditors, the SEC staff – in understanding how this standard worked and understanding better derivatives. I think it's done a great job and I think it may still be in existence. I'm not sure about that.

JS: You brought up business combinations. This was your next big issue to work on, after derivatives, correct? Was this something that you knew you'd work on from the beginning or did it come up later?

EJ: No, business combination accounting has been broken for many years. It's an area that I spent a lot of time on at Arthur Andersen and actually became an expert on in the accounting profession, on business combination accounting. From the time I went and started at the FASB, it was one of my goals to deal with it. It came before readdressing stock options, primarily because stock options was still too recent. It was too politically hot. But I wanted to do business combinations and we did. We killed pooling of interest accounting and we amended accounting for good will.

JS: But the business community wasn't much more enthusiastic about business combinations than they were about stock options, were they?

EJ: No, exactly right, although the pressure wasn't quite as intense as it was on stock options. We had already established the groundwork with Congress and had gained some of their respect for standing up on derivatives and for all of the efforts that the FASB made to help Congress understand what we were. We had the support of the SEC.

JS: Did you deal directly with the business organizations on this, either the FEI or the American Business Conference or the Chamber of Commerce?

EJ: Yes, with all of those, mostly FEI.

JS: How did those interactions usually go? Was it usually just sending letters back and forth or did you talk to them a lot personally?

EJ: There was a lot of personal contact. We put members of the business community on every group. We had a special committee to work on that standard that was composed of people who were experts in it. I remember I was having lunch in San Francisco with John Doerr of Kleiner Perkins, which is the big equity investor in high tech companies – John is the principal in that – and with John Chambers, the chairman of Cisco.

We were talking about business combinations. They wanted to talk to me. I happened to be out there for different reasons and we met for lunch, just the three of us. They remembered the stock option debacle and how when the FASB went out there to hold a public hearing on stock options, the high tech companies let all their people have the day off. They had a marching band and they marched by the hotel where the board was meeting and all of that.

They wanted to know if we could hold a public hearing on Silicon Valley again. I said, "We will if you guarantee me we won't have any of that hoopla out there." I said, "This is serious business and I'm not interested in putting up with that." They agreed that they would see that that didn't happen. We had a public hearing out there and it didn't happen, and we got through it. As part of that discussion, they wanted to know how they could participate in the process.

I said to John Chambers, "We'd be happy to have your chief financial officer serve on our panel that's helping the board in their decisions on this." He said, "You'd want my guy on that thing?" I said, "Yes, we'd be happy to have him if he participates himself, comes to the meetings." He did and he was very constructive. You know, this is just part of the art of standard setting.

JS: The art of compromise, to a certain extent. Was this connected at all to the issue of accounting for research and development expenses, which you started to deal with at the time?

EJ: I don't think there was a direct connection there. It's an area that there's a very diverse practice in around the world and in some cases, by industry standards, which aren't very good. I don't think we've ever really come to grips with it. I can't remember where it is on the convergence projects the FASB and the IASB have going right now, sorry.

JS: So already at this time, the accounting industry was beginning to make strides toward convergence in the accounting standards. Can you tell me a little bit about how you saw this issue when you came into office?

EJ: The second big issue that I felt we needed to deal with when I became chair of the FASB was international accounting standards. I felt at that time that we had pretty much a global financial market and investors and creditors needed to have a single set of high quality standards in order to evaluate investment and credit opportunities worldwide, and they didn't.

So an American investor wanting to invest in a German company had to deal with German accounting standards, which were different from the standards that person knew in the United States. That created an impediment to the efficient functioning of global financial markets. The answer was to have an international set of accounting standards that everyone followed, even at the cost of having the FASB ultimately go out of business, if that's where it ran.

But the International accounting standards setter, which at that time was called the International Accounting Standards Committee, was not equipped to do the job. It was too large. It had about thirty-five members. It was too political. The members were appointed by the governments of the various countries. It didn't have the quality of people or the due process that was necessary to have standards that were high quality and would be commonly accepted.

So what to do about this? Well, working with the Financial Accounting Foundation, we decided to work toward changing that. At the same time, we had this small group of Anglo-Saxon standard setters. We called it the G4+1. It consisted of the chairman of the accounting standards groups in the U.K., Ireland, Canada, United States, Australia and New Zealand and the IASC had a representative. So we started talking about it there at that level and we reached agreement – very difficult – that we would try to restructure the IASC.

So we set about doing that. The FASB and the FAF jointly wrote a paper to outline what we thought was necessary. We got the SEC, both Arthur Levitt and Lynn Turner, the chief accountant, involved and they supported it. We began to go to work to try to change it. At one meeting, we were able to do that and get a new framework for this new committee.

JS: How did the rest of the world feel about this Anglo-Saxon effort?

EJ: Well, it wasn't billed as an Anglo-Saxon effort, first of all. We had good participation with people from Germany and France and some other countries, too, and Japan. This didn't take place over night, but it took place over time. The next issue was who's going to chair this new committee? There was a person who was in charge at the time of the U.K. committee, Sir David Tweedie, who is an excellent person, very outstanding in his interpersonal relationships and a very good accountant. They don't always go together. We wanted him as chair, but he had another semi-commitment to go back to teaching. We also needed someone to head up this foundation. This whole model was modeled after the FASB, as you can see.

Through Arthur Levitt's efforts, we were able to get Paul Volcker, who was the former chairman of the Federal Reserve and obviously very highly respected. He agreed to chair that. When I knew that was going to happen, I called up Mr. Volcker. I had not met him before. I said, "I think it would be good if we got together. I might be able to tell you what you've gotten yourself into here." He said, "I think that would be a good idea." The next day I went to New York and met with him.

The first issue was dealing with who's going to chair this group. We knew that David Tweedie was the obvious person, but timing was critical. Through the efforts of Paul and Arthur and myself, we were able to convince David to take the job and he did. Now he's completing ten years and he'll go off. We got off to a very good start with David Tweedie and Paul Volcker and with the support of the SEC and the IASB. That gets back to your question on convergence. That really set the stage for us to go full blast on convergence.

JS: Were there any specific issues that you worked on during this period? I know for instance on financial instruments there was some discussion at the time.

EJ: There was a whole laundry list of issues that needed to be addressed with convergence. We already had been working on convergence on selected areas and maybe financial instruments was one of them. I'm pretty sure it was. We would use joint staff from the IASB and the FASB and we would have one staff person take the lead on a project. We had lots of joint meetings. Convergence, after the restructuring of the IASB, just took off from that.

There were meetings to prioritize projects, to decide who was going to take the lead, what were going to be the criteria. One of the issues was, as I mentioned earlier, getting a common conceptual framework in place so that we could all talk off the same page. There's been tremendous progress made. This all was happening right at the end of my term. It all happened from the middle or end of 2001 through June and July of 2002. I said at the time that I thought it would take ten years for us to achieve convergence. We won't have it all done in a year, but they have set deadlines for substantial convergence.

JS: How did people react to that assessment, because ten years, that seems pretty optimistic?

EJ: Well, no, people thought that's way too long. We can't wait that long. I said, "Well, you know, this is going to take time." I think I'm about right on that. Now the SEC is getting a lot of pressure to accept international accounting standards, even though they're not fully in conformance. And I saw in the paper the other day that the European Union has threatened something dire if the SEC doesn't accept international accounting standards; I don't know what they can do. In any event, it's still a very live and interesting hot issue.

JS: Do you remember when you first learned about the problems at Enron?

EJ: I was at the FASB at the time. That probably was in 2001.

JS: How did that affect the FASB's agenda?

EJ: Well, the basic issue there was special purpose entities and consolidation issues. We already had projects going in both areas. I don't think it immediately affected that, but it obviously confirmed the need for those projects.

JS: What was the rule in place at the time? I think there was something called the 3 percent rule?

EJ: Yeah, the 3 percent rule was something that the SEC staff had come up with many years before on a similar kind of issue. This is a good example of lowest common denominator accounting or extrapolating from a very specific and unique circumstance to a broader discussion. But the SEC staff didn't stop it and it was actually the basis for several EITF consensuses. It was something that was, I believe, generally followed by Enron, but not strictly enough.

JS: You testified to Congress in May 2002 that you thought that even the, quote, "most efficient and effective accounting standards setter imaginable and the highest quality accounting standards conceivable could not have prevented the Enron bankruptcy," unquote. Do you think that that still stands?

EJ: Well, yes. You can have all of that in place, but if you have individuals, whether they're with the company or the auditing firm, who won't follow those standards in good faith and try to cut corners, particularly if there's any collusion involved, it's going to happen.

JS: Did the SEC or the Congress put any pressure on you to do something about the accounting rules?

EJ: Well, not beyond what we were already working on.

JS: Did you offer any input into the process that led to Sarbanes-Oxley or were you asked to?

EJ: I worked pretty closely with Senator Paul Sarbanes. Oxley came in at the last minute on that project to give support for the proposal from the House as well as the Senate. I did know Mike Oxley very well and met with him many times during this process. But I worked mostly with Paul Sarbanes. The area that I was most interested in, and fortunately he was too, was making sure there was nothing said in there that would significantly impede the ability for the FASB to remain an independent private sector standards setter.

JS: Was there any danger to the FASB?

EJ: Yes, there was pressure from other members of Congress to use this "opportunity," in quotes, to bring the FASB under the control of the SEC or Congress, like they did in Sarbanes-Oxley with respect to the auditing profession.

JS: How did the SEC feel about that?

EJ: The SEC supported us as being independent. Of course, the funding was changed and that's where the greatest risk was to the FASB, if the funding for the FASB had to be a direct part of the annual federal government's budget. Senator Sarbanes was very supportive of all that and he would call me up personally, and sometimes his staff, but personally and read me sections out of what they were drafting and ask was I comfortable with that and so on.

JS: Do you think they ended up with a good bill?

EJ: I think on balance, overall, the bill was necessary and good. There was a lot of complaining about it, particularly in terms of cost and time to implement it. I think it was necessary. As at least one CEO said, "I feel I know more and feel more comfortable about my internal controls than I ever did before. I never felt I needed to pay attention to it in the past."

JS: At this time, the FASB also had a project that looked into alternative measures of earnings and performance. Did that go anywhere?

EJ: We do have some different measures and definitions of unusual items, extraordinary items, where you draw subtotals, where you compute earnings per share and so on. I'm not a student of that. I don't know if it's been helpful or not. My basic view has always been that earnings per share should not be a part of accounting standards. I think that's a part of the analysis of financial statements.

Again, providing the information in the financial statements that enables others, investors, creditors, analysts and their advisors to compute our needs per share, but to compute them and to try to decide as accountants of where to draw the lines, I don't think it's any of our business. But we are in it.

JS: Let's talk about your leaving the FASB. Did you consider serving a second term?

EJ: Of course. I had told the foundation when I accepted it that my commitment was for five years and only five years. I would have been sixty-seven at the end of that five years and

I thought maybe that was an appropriate time to retire. I was interested in coming out here to better weather than Connecticut. But of course, I considered it. It was a very exhilarating time to be at the FASB and I felt that I enjoyed it. I enjoyed the people that I worked with, both at the FASB and elsewhere. I felt that we had made good progress. I was proud of what we'd accomplished. But I ultimately decided that I wouldn't go on. I would've been seventy-two by the time I completed another term.

JS: Did you offer any advice to the trustees about the FASB before you left, for instance, about the voting structure? I know that it was changed a few years later.

EJ: I was never happy with a voting structure that was other than a majority. I felt that impeded our ability to make progress.

JS: But many of the decisions were unanimous.

EJ: Yes, right. That was my style, to work towards a unanimous vote. So maybe I didn't need to worry about it. The agenda was such that it would be much more difficult to get a standard out if it was five to two and I didn't want to have that impediment.

As for the number of board members, which went from seven to five and now they're going back to seven, I felt that was a big mistake to go to five because there's so much work that goes on outside of the board room. All of these constituencies you have to meet with and keep involved, all of the speeches, all of the efforts that have to be made, internationally particularly now, that take time and you need seven members to cover all the bases and still monitor and take the leadership on individual standards, which have become more and more complex and difficult over the years. I thought it's a big mistake to go to five and I'm glad they're going back to seven.

JS: Did you offer any input on their search for a successor?

EJ: Yes, I was part of the search process, not only for my successor but for each board member. I felt that I wanted a seat at the table and I was provided with that. I wanted my successor to be appointed as soon as possible, so that we could have a good transition. When Bob Herz was selected in January or February before I left in June, I immediately provided an office for him at the FASB and he spent quite a bit of time there. We had an opportunity to go over everything. He had the run of the place and could participate in any of the meetings we had. I think we had an excellent transition.

JS: Did you offer any advice to your successor, Bob Herz?

EJ: Well, sure. (Laughter.)

JS: What did you tell him?

EJ: I don't know.

JS: You don't know or you don't want to repeat it?

EJ: (Laughter.)

JS: I'm kidding.

EJ: You know, Bob, like I was when I came in, was a student of standard setting and was involved in almost everything and was a member of the IASB. He was well in place. He didn't have many surprises.

JS: Before we finish up, I'd like to talk in general terms about two things; first, the relations between the FASB and the SEC. Senator Phil Gramm once argued that he felt that the Securities and Exchange Commission had too much influence over the standard setting process. Did you find this to be the case?

EJ: Well, it's a fine line. Certainly we wanted to work cooperatively with the SEC and they wanted to work well with us. I think it was to everybody's benefit and to the economy's benefit that if the SEC had an issue, the FASB addressed it if it could in any way. I don't think it was good for the SEC to arbitrarily reach conclusions on financial reporting issues. It was better to have the full due process of the FASB involved.

Generally, that worked well. There were areas, particularly with respect to the EITF, where they had issues that they for sure wanted discussed. They brought them up and we debated them and generally put them on the agenda. I think if they were insistent, it would have been appropriate for us to put them on the agenda, probably, anyway.

But we had an excellent working relationship with them. I think it's when they wanted to get more involved than they should have in who's going to be an FASB board member or something like that. We certainly sought their input. But we didn't want them dictating that. At the end of the day, I don't think there were any cases where they did.

JS: How much difference do you think that the personalities at the SEC made? For instance, did the change from Arthur Levitt to Harvey Pitt make a difference in the relations?

EJ: Interpersonal interaction is key in this area. Everybody has their own style. Bob Herz's style is not quite my style and Harvey's was not quite Arthur's style. It is learning how to work together that's important and having the open line of communications, which we did with both Arthur and with Harvey. I didn't work as long with Harvey. Of course, he wasn't there as long either. (Laughter.) But I still talk to Harvey Pitt occasionally on certain issues. He had a different style than Arthur.

JS: What about the chief accountants of the SEC? Did you know Michael Sutton or Lynn Turner or Robert Herdman before you took over?

EJ: Absolutely. I worked closely with Mike Sutton. I didn't work as closely before he became chief accountant with Lynn Turner. What was the third one?

JS: Robert Herdman.

EJ: Oh, yes, Bob Herdman. Yeah, Mike Sutton, Bob Herdman, myself, we were all on the EITF together. We all worked on SEC matters together. We all had the same or very similar responsibilities with our firms, so we talked to each other all the time. You know, Mike came to work for the FASB for a while after he left Deloitte and before he became chief accountant; so yes, very close relationships. I've known every chief accountant since Andy Barr, including Andy Barr, all of them since then.

JS: Of course, Andy Barr served for over fifteen years, I think, and his successor served for a number of years as well.

EJ: Yes.

JS: In your five years at the FASB, you dealt with three different chief accountants. Do you think that the rate of turnover is a problem?

EJ: I think it's just the nature of things these days. If you look at the SEC from the legal perspective, the lawyers, you know, there has always been a turnover. That's just part of their progress, part of their career path. If you want to be in securities law, you spend two years at the SEC. You know when you go in and your supervisor knows when you go in that you're going to be leaving in two years. We don't have that tradition at the accounting level. I think generally it's better if they stay a little longer.

JS: Let's talk about the second issue that I wanted to touch on before we finish up, the FASB and the Congress, relations between the two. Do you think that the accounting standards setting process has become too politicized?

EJ: I think it's the nature of the era we live in. Everything's politicized today, it seems. That's why it's so important to keep the bases covered in Washington by the FASB, because there seems to be so much influence by various lobbying groups, various constituencies of the FASB, the business community and others that have strong lobbying presence in Washington.

We have to overcome and counter that, not in an antagonistic way, but just making sure that members of Congress and regulatory agencies and the Treasury Department and the Federal Reserve and the banking regulators all understand what the FASB is about, why it's important to keep it in the private sector, how we go about our full due process, so that we can make independent and objective decisions. That takes a lot of time. It's absolutely important and must continue. I think it's a big part of the chairman's job at the FASB.

JS: Do you have any final thoughts before we wrap up?

EJ: Not that I can think of, no. Thank you, Jim.

JS: Well, thank you very much. It was a pleasure talking to you.

EJ: Thank you.

[End of Interview]