

**The FAF at 50
It's all about Independence and Improvement**

**By
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Good evening, everyone. What a wonderful evening to celebrate a great success story. I offer my sincere congratulations to everyone in this room who has been part of that story.

I was honored to be asked to share some remarks about the Financial Accounting Foundation and its history and impact in honor of this important milestone. I must admit, though, that I smiled at the irony and the sharp contrast to my first exposure to the FAF many years ago. How so?

Nearly a ¼ century ago, I received a phone call from Arthur Levitt, Chairman of the SEC. Chairman Levitt said, “Jack, I need you to serve your country.”

I said, “Mr. Chairman, I think I’m too old to be drafted, but please let me know what you have in mind.” And he asked if I would consider serving on the Board of Trustees for the Financial Accounting Foundation. With due respect to Chairman Levitt, I said, “I’d be happy to do anything you ask, of course, but could you explain to me what the Financial Accounting Foundation is?”

I had never heard of the organization. Nor had I heard of the GASB—the Governmental Accounting Standards Board. Of course, I *had* heard of the FASB—the Financial Accounting

Standards Board—but I’m not sure I could have spelled it if you spotted me the “F” and the “A.” Shame on me.

Think about it. I was the leader of one of the largest investment firms in the world, and I didn’t understand who actually constructed the financial reporting building blocks (designed in Norwalk, Connecticut) upon which the capital markets, owners of companies, and providers of capital depend. I was actually embarrassed at that reality.

That said, within six months, I was swept up in the missions of these organizations. And I realized that what they did mattered *enormously* to the millions of people—and companies—dependent on capital markets in this country. In reality, we are all so fortunate that people had the foresight 50 years ago to set up the FAF and that its stewards have been so committed to its success for half a century.

And today, as we celebrate the organization’s history and success, ***three core aspects*** of that success are apparent to me (even if they were completely unknown to me halfway through that period!)

- First, **the FAF model is the right one, and it’s essential to the integrity of our financial system.** After a few fits and starts in the early stages of designing an effective system for setting accounting standards, the FAF model has not only endured, but it has succeeded wonderfully.
- Second, **“Independence”** has been a vital part of the success formula. Independence alone isn’t enough, though. It must be ***“Earned Independence”*** and the FAF has indeed earned its independence by focusing its attention on the right constituents—owners and providers of capital—while ensuring that *all* constituents are part of the standards setting process.
- Third, a commitment to ***continuous improvement***. The FAF has improved its processes and evolved to meet owners’ needs and markets’ challenges. And that’s

been core to maintaining and enhancing the Foundation's impact. Most important, that commitment has helped ensure that ***our capital markets are the most transparent, liquid, and trusted in the world***. Every American benefits from those traits.

So, I'll spend a few moments on each of these concepts:

First, the essential—if underappreciated—role the FAF plays in the global financial system.

Fortunately for me, my 'light bulb' moment about the importance of what happens at the FAF was triggered by that phone call from the SEC Chairman. *Unfortunately* for most people, the world's best accounting standards are mostly taken for granted and only get to center stage at a point of controversy, or at a crossroads:

- Think about how we collectively learned about **stock options accounting** early in this century, in the debate over whether tech firms should treat stock options as compensation. A very high-profile issue on Wall Street and in Washington—and a great debate that was resolved the right way.
- Think about how most people have learned about the important role of the GASB, as, for example, the issue of **accounting for public pensions** has come to the fore. That's not something that most folks pay attention to on a regular basis. But transparency to the citizenry on a topic like this is vital to the financial future of our governments and our country.
- And, of course, we can think about the role of accounting, and accounting standards, more generally in both the genesis of the **global financial crisis of 2007–2009**, and the resolution of that crisis.

Unfortunately, these were all points of controversy that raised the FAF's profile. I say 'unfortunately' because it was controversy that shined a light on the great work done in

Norwalk, not the great work alone. In that regard, the job of accounting standard-setters is like the role of food safety inspectors, airline safety officials, or building code inspectors. As a general rule, you don't want to see these folks in the news.

Speaking as someone who has spent a career in the investment business serving millions of large and small investors alike, I know that the ability of firms like Vanguard to put money to work on behalf of individuals and institutions *depends absolutely* on the integrity of the financial-reporting regime in the United States. And that, in turn, begets immense trust in the integrity of our capital markets.

The bedrock of that reporting regime is U.S. GAAP, which—while far from perfect—is universally acknowledged by investors as the gold standard of both inputs and outcomes with respect to financial reporting. Over the decades, the rest of the world has sought to emulate it and to create processes that reflect its best practices.

I can tell you that this broad recognition of the importance of integrity in financial reporting is a truly great thing. But, none of us should ever take the integrity of the financial reports we see for granted. The integrity of our financial reporting system must be *protected, preserved, and continuously evaluated*.

That brings us to independence and improvement . . .

When I had the privilege to chair the FAF, as part of the strategic planning process for our organization, the trustees who oversaw the FASB and the GASB took a step back and asked themselves a simple question: “*What matters* in standard-setting and financial reporting if those processes are to serve their intended purpose in the capital markets and the various government agencies of the United States?”

The good news is there was a simple answer: *Independence and improvement*. It's a pretty straightforward articulation of the test that should be applied to what happens at the FAF.

Independence is absolutely critical. The standard-setters must be independent of corporate, political, or other outside pressures and interests. That's not to say, of course, that they can live in an ivory tower.

Independence in the establishment of accounting and reporting standards was set as a base principle decades ago. The people who established the FASB 50 years ago and the GASB some 15 years later knew exactly what they were doing.

But, to be clear, independence is not a right, ***it's a privilege***. It's a privilege that's *earned* through many parts of the process, but the most important, in my view, is this:

- It's a privilege that's earned by ***both*** listening to *and* hearing the concerns, challenges, opportunities presented to the FASB and the GASB in that outreach process. Listening *and* hearing may sound redundant. Trust me, it's not. Listening is easy. Hearing—and processing the information you hear—is harder. Over my ¼ century of engaging with, and watching, the standard setting boards, I believe this is where they have improved the most.

Neither the beneficiaries of the boards' work nor the standard-setters themselves should take independence for granted. The beneficiaries should cherish it and defend it. The standard-setters should understand that it's a privilege they must earn continually.

And, then there's, continuous improvement. . .

Simply put, accounting standards must always be able to evolve and improve.

One of the criticisms that is easy to throw at the standard-setting process is this: "It's a bureaucracy that has to perpetuate itself, so they will create new standards." It's a fair

observation. Change without improvement is just change for change's sake and places unnecessary burdens on participants in the process. But if the job of accounting standard-setters was simply to create new standards, it would be an easy job.

We can never presume that today's reporting mechanisms capture the increasing complexity and globalized nature of entities to which we allocate capital. And standards must continuously be improved in a manner that benefits the providers of capital *and* the financial reporting regime broadly. It's a high bar.

Early in my time as the FAF chair, I conducted a series of listening sessions with constituents. Near the end of each session, I'd ask them two questions. First, "Holding the end result of any particular standard aside, since we will all have different opinions, do you have confidence in, and value, the Board's due process?" The universal answer:

"Absolutely."

I closed each session with this two-part query: "I hear all the issues, I hear all the complaints, I hear all the criticisms. I have a simple question for you: Is financial reporting today better than it was five years ago and ten years ago?" And the answer was universally: **"Yes, it is."**

My follow-up question was, "Then why has financial reporting become so complex?" In summary, what I heard was: **"Because the world is more complex."**

If our providers of capital are to be confident in the integrity of financial statements, those reporting regimes have to represent the complexity of the real world. **In other words, they have to evolve and improve.** The FASB and GASB have done just that.

Close

So, why does what happens in Norwalk matter and why is it worthy of celebration?

I believe the answer is really simple and straightforward. And it's directly related to the profession in which I've spent my career—investing on behalf of clients, large and small, to create better financial futures. It's inarguable that deep, liquid, transparent, and low-cost capital markets are the engine that drives the economy, creates trust in those markets, and, yes, allows better futures to be built for people and institutions. Better futures for:

- The entrepreneur who can finance an IPO, take her company public, and create thousands of jobs.
- The first-time homebuyer who obtains less-expensive financing because his mortgage can be securitized and accounted for correctly by the financial institutions that participate in the process.
- The local government that has the benefit of low-cost capital through structured trusted, liquid markets for their debt securities.
- The essential worker investing for retirement through her employer's 401k plan.

That's ***what*** matters. That's ***why*** it matters. That's ***why*** we celebrate 50 years of *impact, evolution, and success* at the Financial Accounting Foundation tonight.

And, I hope you join me in toasting the FAF's next 50 years of Independent Standard Setting as well.

Thank you very much for allowing me to share my perspectives with you this evening, and, again, ***Congratulations*** to all who have made the past 50 years worthy of celebration.