Financial Accounting Foundation
2004 Annual Report

Financial Accounting Standards Board

Governmental Accounting Standards Board

Serving the Public Interest

Through better standards for financial reporting.

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, 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

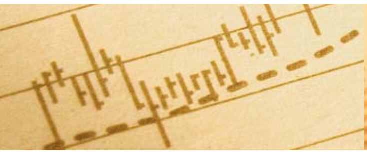
The Governmental Accounting Standards Advisory Council consults with the GASB on technical issues, project priorities, and other matters likely to concern the GASB.

Serving the Public Interest

The intent of financial reporting is to present useful information that supports decision making.

Serving the public interest, the FASB and the GASB establish and improve external financial reporting standards that require decision-useful information to be communicated that is relevant, reliable, comparable, consistent, and understandable.

Credible information is essential to maintain the confidence of investors, creditors, and other users of financial reports and contributes to greater efficiencies in the capital markets. Government financial reports also enhance public accountability and provide a basis for important economic, social, and other public policy decisions.



Letter from Robert E. Denham, Chairman Financial Accounting Foundation

Serving the Public Interest

The ultimate objective of the Financial Accounting Foundation (FAF) and its two standard-setting boards, the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB), is to serve the public interest by improving financial accounting and reporting standards. The FAF achieves this objective by fulfilling its charge of maintaining the two standard-setting Boards as independent, private-sector bodies, ensuring sufficient resources to accomplish their missions, and making Board appointments.

This report reflects on how each body fulfilled its responsibility in meeting that objective in 2004.

"Independence in standard setting is integral to the integrity of the Boards, and thus to the credibility of accounting standards. Protecting the independence of the standard setters and assuring effective oversight of the standard-setting process are core responsibilities of the FAF Trustees."

— Robert E. Denham

Independence

Independence in standard setting is integral to the integrity of the Boards, and thus to the credibility of accounting standards. The fundamental importance of independent private-sector accounting standard setting to our capital markets has long been recognized with respect to the FASB, and was reaffirmed by Congress in the Sarbanes-Oxley Act of 2002 and by the U.S. Securities and Exchange Commission (SEC) in its April 2003 Policy Statement.

Independence became a critical issue in 2004 in connection with the FASB's project on share-based payment. The FASB reopened this controversial subject in response to numerous requests from the investor community and many other parties, and because of its obligation to establish standards that improve financial reporting. As expected, this subject fostered much healthy public debate during an extensive open due process. On this one topic alone, over a 2-year period, the FASB held 60 public meetings, reviewed thousands of comment letters on a preliminary document and an Exposure Draft, conducted 4 public roundtables, conducted field visits, and met with a wide variety of constituents to ensure that all points of view were considered. In December, the FASB issued Statement No. 123 (revised 2004), *Share-Based Payment.*

While the Trustees of the FAF leave the complex task of accounting standard setting to the experts who make up the FASB and the GASB, the FAF has a responsibility to respond when the independence of the standard-setting process is at risk. This occurred during 2004 when legislative interference was threatened in connection with the share-based payment project. While we respect the right of Congress to set accounting rules if it chooses, we believe that doing so would dangerously compromise the independence of the FASB and, by politicizing standard setting, would compromise the credibility of the resulting accounting standards. Consequently, the Trustees issued a public statement expressing "[their] strong and unanimous opposition to any current or proposed legislation that would undermine the independence of the FASB by preempting, overriding, or delaying the FASB's ongoing effort to improve accounting for equity-based compensation or any other topic." Our message was reinforced when individuals and organizations stepped forward to express similar sentiment and to reiterate the message that if special interests are able, through legislation, to overturn expert accounting judgment, necessary and timely improvements in financial reporting will be delayed or denied. Congress has thus far chosen to leave accounting standard setting to an expert process conducted by the FASB and subject to SEC oversight, a choice that we believe is very wise.

Ensuring Adequate Resources

The mandated funding structure established by the Sarbanes-Oxley Act continues to help us meet the resource needs of the FASB. We thank the thousands of public companies and registered investment companies

"The mandated funding structure established by Sarbanes-Oxley continues to help us meet the resource needs of the FASB... The GASB, which receives no support through the Sarbanes-Oxley Act, continues to rely on the voluntary support of its constituents."

Frank C. Minter *William H. Hansell*

that provide the financial support that is so important to the FASB's standard-setting mission.

The GASB, which receives no support through Sarbanes-Oxley, must continue to rely on the voluntary support of its constituents. The FAF is deeply grateful to the GASB's constituents for their financial support, including state governments, which contributed one million dollars in 2004. However, the GASB's lack of a sufficient and stable funding base has necessitated the FAF's ongoing examination of available funding options.

One response has been the creation of a two-pronged development plan led by the FAF's development committee. The plan includes an FAF-driven fund-raising program that targets (1) cities and counties and (2) the user community. The larger cities and counties now receive an annual voluntary fair share assessment mailing that seeks a modest amount based on population size. In 2004, the program showed encouraging growth in its second year, both in funds raised and in the number of participants. The FAF extends its appreciation to those governments that have supported the GASB through this program. The FAF is currently developing a user campaign that will be initiated in 2005 to solicit support from those who benefit from the use of government financial reports.

Also launched this year is a voluntary bond fee assessment program. As announced in our last report, 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 developed a fee assessment program that, through a small fee based on municipal bond offerings, now provides another source of funding for the GASB.

With the cooperation and generosity of The Bond Market Association the program was launched in July. And, while it is expected to produce important financial support, additional sources of funding will need to be secured to meet the operating needs of the GASB.

Toward International Convergence in the Private Sector

In previous reports, we have noted that building and sustaining global capital markets require international convergence of accounting standards. To that end, the FAF Trustees and the members of the International Accounting Standards Committee Foundation (IASCF), the oversight bodies for the FASB and the International Accounting Standards Board (IASB) respectively, convened a historic first meeting in June 2004. Reports on convergence projects between the FASB and the IASB were presented by the Chairmen of each Board. The meeting provided a unique opportunity for the members of both Trustee bodies to become better acquainted with current and future projects and opportu-

"Recognizing the inefficiencies associated with the managing of thousands of accounting standards, rules, and regulations issued over the past 50 years...the FAF Trustees approved funding of a major, multiyear codification project."

Richard D. Johnson *Ned V. Regan*

nities for increasing cooperation. Among the numerous topics discussed was the Trustee's role in protecting the independence of the standard setters and assuring effective oversight of the standard-setting process.

The FASB and the IASB held two joint meetings during the year to advance their technical agendas, including establishing a project to develop a common conceptual framework that will be based on their existing frameworks. The Boards also continued joint work on several major projects including purchase method procedures, revenue recognition, and performance reporting, and on converging their standards in a number of targeted areas.

Toward Simplification—the FASB Codification Project

Recognizing the inefficiencies associated with the managing of thousands of accounting standards, rules, and regulations issued over the past 50 years by several accounting standard setters, and to help ensure that practitioners have considered all aspects of a particular research issue, the FAF Trustees approved funding of a major, multiyear codification project. The project, to be undertaken by the FASB, working with the cooperation of the American Institute of Certified Public Accountants (AICPA) and the SEC, will integrate all U.S. generally accepted accounting principles (GAAP) literature relating to nongovernmental entities into a single authoritative codification.

The FASB will also develop a searchable retrieval system that integrates and leverages the codification and the new standard-setting process.

The resulting benefits of this multiyear project will include access to all authoritative literature in one spot; immediate access to new guidance; reduced risk that a piece of literature may be overlooked; more consistent structure to ease research and, therefore, reduce research time; and context inclusion for a more complete understanding of the literature.

Outreach to Constituents

Both the FASB and the GASB have taken steps that further connect them to their respective constituencies.

To increase involvement by the small business community in the development of U.S. accounting standards, the FASB created the Small Business Advisory Committee. This 24-member group includes financial statement users (both lenders and investors), preparers, and auditors of small business financial statements and provides the Board with a rich diversity of perspectives and experience. The Committee meets formally twice a year, and we expect it to provide invaluable assistance to the FASB.

The FASB continues to receive varied perspectives and highly valued advice from members of the Financial Accounting Standards Advisory

Douglas R. Ellsworth

Barbara Hackman Franklin

Council (FASAC) and the User Advisory Council and from over 20 liaison groups with whom it regularly meets.

And, to ensure even greater accessibility to its constituents, the FASB initiated free access by webcast to the Board, Emerging Issues Task Force (EITF), and FASAC public meetings.

The GASB, with input from the Governmental Accounting Standards Advisory Council members, completed its comprehensive strategic plan, which provides a clear snapshot of its goals and objectives for the years ahead. Importantly, the plan includes a performance measurement component by which its efforts can be measured by both the GASB and its constituency. We applaud the GASB for its ongoing commitment to transparency and accountability.

Other Accomplishments

The FASB made significant contributions toward the improvement of U.S. financial reporting. In addition to the previously referenced Statement 123(R), the Board also made progress on a number of major projects, including revenue recognition, fair value measurement, liabilities and equity, and various issues relating to accounting for income taxes.

The GASB completed and issued Statements 43 and 45, which provide uniform reporting standards for state and local governments' costs and obligations related to postemployment healthcare and other nonpension benefits, commonly referred to as OPEB. When implemented, the Statements will provide citizens and other users of government financial reports with improved information about some of the most vexing issues facing governments today—the cost of providing postemployment benefits, the commitments that governments have made to those benefits, and the extent to which those commitments have been funded.

And, in 2004, the GASB issued a new standard to improve the usefulness of information provided in the statistical section of financial reports. The GASB also continued to provide guidance to local governments in support of implementation of Statement 34 (the new accounting and reporting model) and related standards.

New Board Member Appointments

Appointments are a key responsibility of the FAF. In 2004, as in the past, we have been fortunate to attract some of the most qualified and talented individuals in their field.

On July 1, 2004, we welcomed Robert H. Attmore as GASB Chairman, succeeding Tom L. Allen who completed his second term and was ineligible for reappointment. Bob is a former Deputy State Comptroller of New York State, where he provided leadership to a staff responsible for the State's accounting, financial reporting, and auditing. Bob served New York State in various key positions over a 23-year

"Both the FASB and the GASB have taken steps that further connect them to their respective constituencies."

Edward W. Kelley, Jr.

Lee N. Price

period. Before that, he was in public accounting. The FAF is grateful to Tom Allen for his many contributions to the GASB and is pleased to have been able to appoint Bob Attmore as the GASB's third chairman. Bob's broad experience and leadership skills will be a valuable asset to the GASB.

The FAF appointed Donald M. Young to a three-and-one-half-year term, effective January 1, 2005, to complete the term of Gary S. Schieneman, who resigned due to personal and family issues. Don, who most recently managed his own consulting and research firm, previously was Managing Director at PaineWebber/UBS. His career has been primarily as a technology analyst providing in-depth industry research and long-term investment advice on a broad range of technology companies. Don's career includes serving as Managing Director at Prudential Securities, as Senior Vice President at Lehman Brothers Inc., and as a Principal with Sanford C. Bernstein & Co., Inc. He also worked in the computer industry for Burroughs Corporation (the forerunner to Unisys Corporation). He is a graduate of the University of Michigan and holds an MBA degree from Harvard Business School. Don's duties will include serving as chairman of the User Advisory Council.

Edward W. Trott was reappointed by the FAF effective July 1, 2004. Ed, who joined the FASB in 1999, began a second term. Ed is a former partner of KPMG and a former member of the EITF and the AICPA Accounting Standards Executive Committee.

The FAF reappointed Paul R. Reilly to the GASB effective July 1, 2004. The reappointment is for 1 year as Paul has served 9 years of the 10 that a Board member may serve. Paul is a former Finance Director and Comptroller of the City of Madison, Wisconsin.

New Trustee Appointments

Four new Trustees were appointed in 2004 for three-year terms unless otherwise noted, effective January 2005. We welcome our distinguished new members W. Steve Albrecht, Associate Dean of the Marriott School of Management and Professor at Brigham Young University; Philip D. Ameen, Vice President & Comptroller, General Electric Company; James H. Quigley, Chief Executive Officer, Deloitte & Touche USA LLP (two-year term replacing Samuel DiPiazza); and Paul C. Wirth, Global Controller and Chief Accounting Officer, Credit Suisse First Boston.

On behalf of the FAF Trustees, I express our deepest gratitude to those who have completed their service to the FAF and for their commitment to the purpose of the organization. They are Samuel A. DiPiazza, Jr., Chief Executive Officer, PricewaterhouseCoopers; Judith H. O'Dell, President, O'Dell Valuation Consulting LLC; Stephen C. Patrick, Chief Financial Officer, Colgate-Palmolive Company; Jerry J. Weygandt, Arthur Andersen Alumni Professor of Accounting, University of Wisconsin-Madison; and Barbara A. Yastine, Former Chief Financial Officer, Credit Suisse First Boston.

Robert E. Denham
Chairman, Financial Accounting Foundation

"...we have been able to attract some of the most qualified and talented individuals in their field."

Eugene D. O'Kelly

Duncan M. McFarland

Interview with

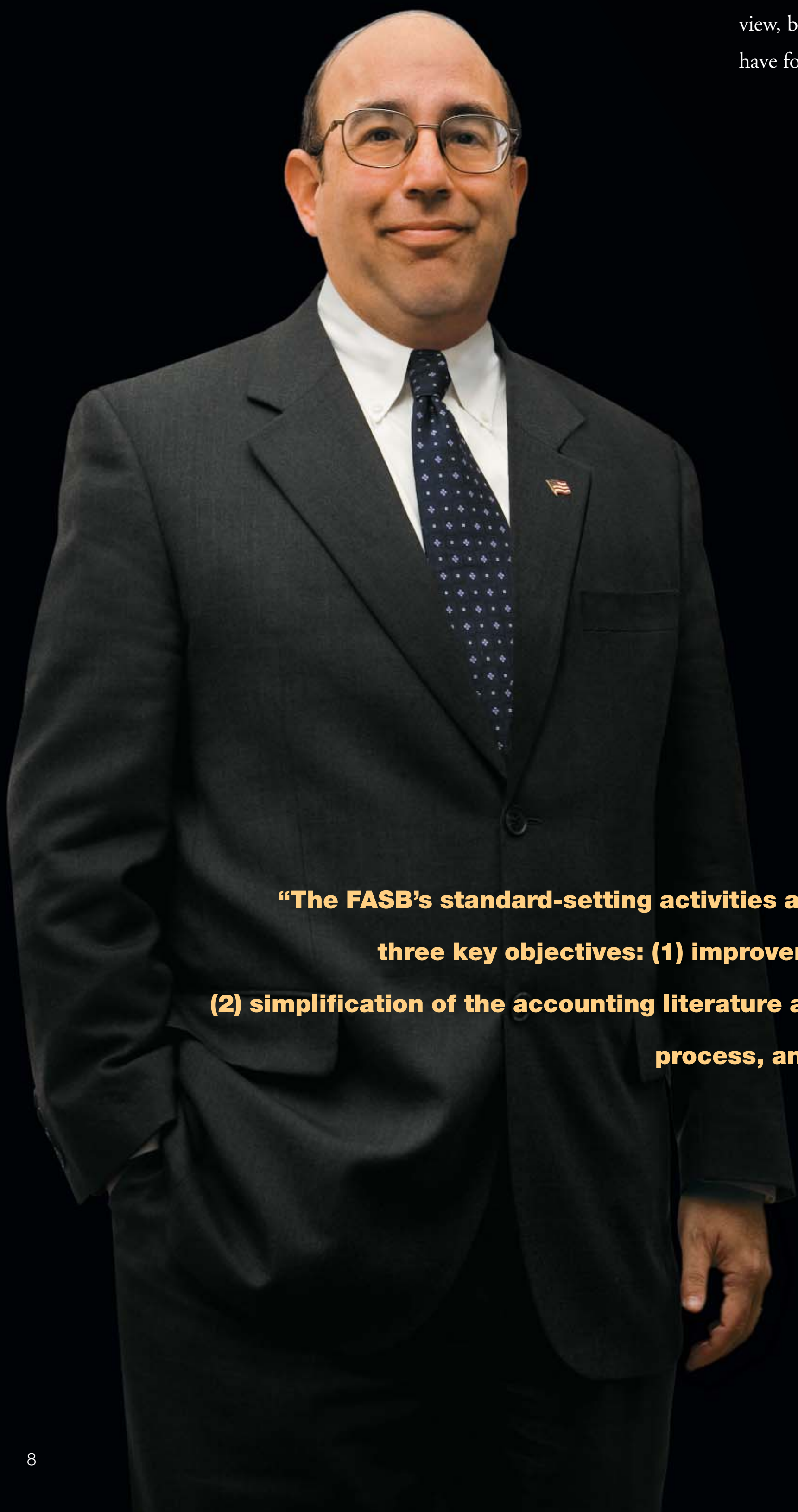
Robert H. Herz, Chairman

Financial Accounting

Standards Board

How would you characterize the current environment of financial reporting?

I see it not only as a very challenging time but also as a very interesting and exciting time for all of us involved in financial reporting. The past few years have been marked by many significant and important changes and reforms that have affected all of us in the financial reporting system. I also believe we are at a critical juncture and how we collectively and collaboratively continue to address and resolve the issues of improving the relevance, reliability, and comparability of financial information, both here and across the major capital markets of the world, will, in my view, be fundamental in determining the kind of reporting system we have for many years to come.



"The FASB's standard-setting activities are guided by three key objectives: (1) improvement of financial reporting, (2) simplification of the accounting literature and the standard-setting process, and (3) international convergence."

— Robert H. Herz

What do you see as the relationship between improvement to the financial reporting system and the pace of change?

On the one hand, we hear a lot from professional users of financial information, from some very thoughtful academics, and from others that there are a lot of areas of accounting and financial reporting that do not properly reflect economics and that need to be fixed. We also hear that the whole reporting framework needs to be modernized in terms of content, timeliness, mode of delivery, and use of technology.

I agree with many of these criticisms and suggestions. Many of the things we are currently doing at the FASB are aimed at improving the standards in key areas and improving the conceptual framework. And I'm a strong supporter of expanding the business reporting model and making better use of technology in reporting through such things as XBRL and a layered or click-down approach to communicating the information.

But, on the other hand, it is also very clear that there have already been a lot of major changes recently for the system to handle, not only in the form of new accounting and disclosure requirements, but also very importantly in other areas such as the Section 404 internal control requirements of the Sarbanes-Oxley Act. So it's not surprising that those on the front line, the preparers and auditors, are feeling stretched and tired.

So, I think we need to be sensitive to the ability of the system to handle further change in a short period. Clearly, further changes and improvements are needed, but I think these should be introduced and implemented at a measured pace that enables the system to move forward in an orderly and constructive way. And I feel that at the FASB we have tried to be sensitive to the current demands on people's time and resources by deferring the effective dates of several new standards and by providing for extended comment periods on proposals.

What are your thoughts concerning moving to a "principles-based system"?

With respect to a so-called principles-based system or what the SEC staff has called "objectives-oriented" standards, there has been lots of talk and calls for the standards to be more clearly cast in terms of overarching principles, and to get away from detailed rules, bright lines, and exceptions.

"In the face of evolving business models, growing complexity in financial instruments and converging international markets, investors in public companies are well served by the thought leadership and due process of the FASB in setting U.S. GAAP in order to maintain high quality financial reporting."

Rita J. Spitz
Principal
William Blair & Company, LLC

On the other hand, given the very important, and in my view necessary, reforms under Sarbanes-Oxley, there is clearly a heightened sense of attention to getting the financial statements right by companies, auditors, audit committees and Boards. But there also seems to be a real fear of being second-guessed by regulators, enforcers, the trial bar, and the business press, and that has, at least for now, very understandably seemed to reinforce the demand for detailed rules, bright lines, and safe harbors.

And we also continue to receive requests for scope exceptions and treatment alternatives from companies and industries seeking to preserve the status quo or to have accounting standards crafted to suit their particular business models.

So implementing a more principles-based or objectives-oriented approach is very challenging, and will require not only steadfast determination by standard setters, but also some important behavioral changes by others.

But I think it's the right way to go. I think we can do a better job of more clearly setting forth principles and objectives and then supporting them with good implementation guidance.

Can anything be done to simplify the authoritative literature?

I think that simplification of the authoritative literature is needed and is possible. Current U.S. GAAP for nongovernmental entities encompasses over 2,000 individual pronouncements issued in many different terms by numerous bodies over the last 40-plus years. It is categorized into a GAAP hierarchy — levels A, B, C, etc. — making it difficult to understand, and to use, and increases compliance risk. We have taken some important steps over the past few years to try to get the beast under control, including rationalizing the standard-setting structure itself by reducing the number of bodies that establish new GAAP, as well as reducing the number of different types of pronouncements, and by improving the Current Text and the FARS (Financial Accounting Research System) database. But more is needed, and so we are embarking on the development of a structured codification, by topic, of all the existing U.S. GAAP literature. This will be a massive undertaking spanning several years and requiring the integration and synthesis of all the GAAP literature. Once completed and verified this codification will become the authoritative source of GAAP, thereby allowing us to eliminate the GAAP hierarchy. Our surveys of constituents indicate strong support for this effort, the SEC staff favors it, and the FAF Trustees have approved it.

Some parties in the reporting system assert that it is more important to focus right now on making financial statements more reliable than more relevant. What are your thoughts on this?

We hear this in many guises, mainly from preparers, but also from some auditors and other parties. Again, part of this no doubt relates to the fear of second-guessing and the attendant desire to be able to point to something exact, something directly vouchable or verifiable, if called upon to defend one's accounting or auditing. And again, that's very understandable.

"FASB standards enable businesses to produce financial reports that provide transparency, credibility, and comparability necessary to present a clear picture of their financial information to interested parties."

David B. Rickard
Executive Vice President, Chief Financial Officer and Chief Administrative Officer
CVS Corporation

And concerning the potential further use of fair value measurements in accounting we hear things like "fair value—too subjective, I don't understand it, I don't like it, and I don't want to do it" or "I'm a traditional accountant—they never taught me this stuff." Like it or not, that is the real world of today's accountants and those are understandable concerns and challenges.

But we also hear from many, particularly professional users, that they want more information on current values and on the effects of market and other environmental changes on a company's financial position and results. And we hear from economists that some of our traditional accounting measures that are based on sunk costs, and often arbitrary multiyear allocations of cost are not representationally faithful of the underlying economics and not particularly decision useful.

So I think our big challenge is to try to figure out ways to provide what may be more relevant and useful information and ways to provide meaningful comfort on its reasonableness, without putting companies and auditors in the unfair position of having to assert that such information is exact, free from measurement uncertainty and subjectivity.

We are trying to do some of this in our projects on Fair Value Measurement and on Reporting on Financial Performance. Moreover, issues reflecting relevance versus reliability and for the use of fair value measurements in accounting will be key areas of focus in our major project to improve the conceptual framework. The SEC has done some good things in terms of MD&A (Management's Discussion and Analysis) and the disclosures on Critical Accounting Estimates, and maybe there are some things that might be done in terms of the content of the auditor's report.

Bottom line—both relevance and reliability are very important and neither of these should be subordinated to the other if we are to continue to improve the usefulness of financial reports to investors and the capital markets.

FASB Key Accomplishments in 2004

— Issued standard on share-based payment
— Created Small Business Advisory Committee
— Launched major, multiyear codification project
— Met need for timely guidance on Medicare and Jobs Creation Acts

What to Watch for in 2005

— Final standard on Fair Value Measurements
— Progress toward convergence with IASB
  - Developments toward a complete conceptual framework
  - Issuance of a common Exposure Draft on Business Combinations
— Guidance on Uncertain Tax Positions

How are constituents responding to the prospect of international convergence of accounting standards?

Broadly speaking, I think we are hearing two different points of view on convergence. The first is: "Why is international convergence taking so long?" which comes from many of the professional users, such as global equity analysts and institutional investors, many foreign-based multinationals, and some U.S.-based global companies. The other is: "I'm in favor of convergence, but make them do it our way," which is the response from many U.S. preparers.

We are trying to get on with it in a systematic way together with our colleagues at the IASB through coordinating our agendas, through joint projects on major subjects, through working together to improve the conceptual framework, and through proposing changes on both sides to reduce the number of specific areas of differences between U.S. GAAP and international standards. But convergence clearly means change, and we do need to make sure we adhere to thorough due process so that we ensure that it's not just convergence for the sake of convergence, but also helps improve the quality of the accounting standards and resulting financial reporting. Convergence is a process and a destination with many stations along the way.

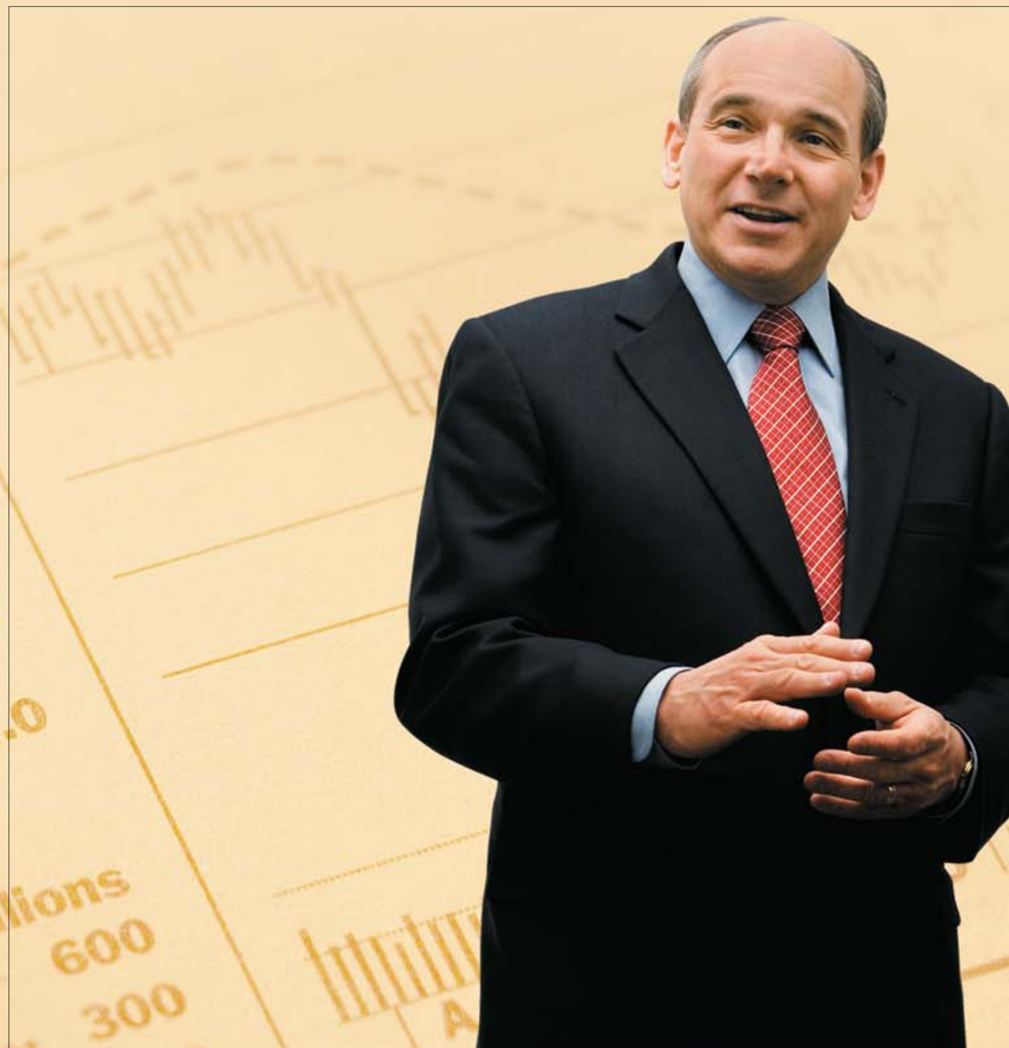
Some believe that the discussed changes such as fair value information and international convergence might be useful for large public companies but that those changes are not necessary or cost effective for private companies and small business. What is your view?

This is, of course, the issue of big GAAP/little GAAP or what is now being called differential reporting. It's certainly not a new issue, having been studied many times over the past 25 years with the conclusion each time being that a two-tier GAAP accounting system did not make sense in this country. So while we have often provided deferred effective dates on new standards for nonpublic companies, and recently also for small business issuers that file with the SEC, and reduced disclosures for nonpublic companies, we have not generally prescribed different accounting treatments for private and small business. But these are new times and perhaps a fresh look is in order. We recently formed a Small Business Advisory Committee to increase the voice and participation of this very important constituency in our activities, and the AICPA has been

"Small and mid-cap public companies and private entities make up a significant portion of our firm's client base. It is gratifying to see the FASB reach out to this community in its effort to learn the views of *all* constituents. The recent formation of its Small Business Advisory Committee is an example of this commitment."

Edward E. Nusbaum
Executive Partner & Chief Executive Officer
Grant Thornton LLP

studying this area. Small businesses are a very critical part of our economy and as standard setters we must ensure that our standards are cost effective, but we also need to ensure that they are conceptually sound and that they meet the needs of the users of the financial statements of these businesses.



Letter from

Richard J. Swift, Chairman

Financial Accounting Standards

Advisory Council

While much of the accounting profession focused its attention in 2004 on compliance with Sarbanes-Oxley, FASAC members also concentrated on supporting the FASB's efforts on many issues both technical and procedural. The Board reaches out for input from FASAC and its other advisory groups in many ways, from regular meetings and annual surveys about the Board's priorities, to participation in field visits and ad hoc consultations. In 2004, the Board created the Small Business Advisory Committee. Several members of FASAC with ties to the small business community also serve on that committee; FASAC members representing the user community also serve on the User Advisory Council.

FASAC is unique. Its diverse membership includes CFOs, CEOs, and controllers from businesses large and small, domestic and foreign; accounting practitioners with technical and audit expertise who serve companies of varying size, public and nonpublic; analysts from the buy-side and the sell-side; and others including a venture capitalist, an investor relations expert, an economist, a securities lawyer, and several regulators. Those individuals with differing perspectives meet four times each year not only to give their own views to the Board but also to discuss the issues and hear each others' views. All participants—FASAC members, FASB Board and staff members, and interested observers—have the opportunity to listen and learn as all sides of an issue are discussed. Starting in 2004, each FASAC meeting was broadcast over the web, further widening the opportunity for constituents to witness the Board's due process in action.

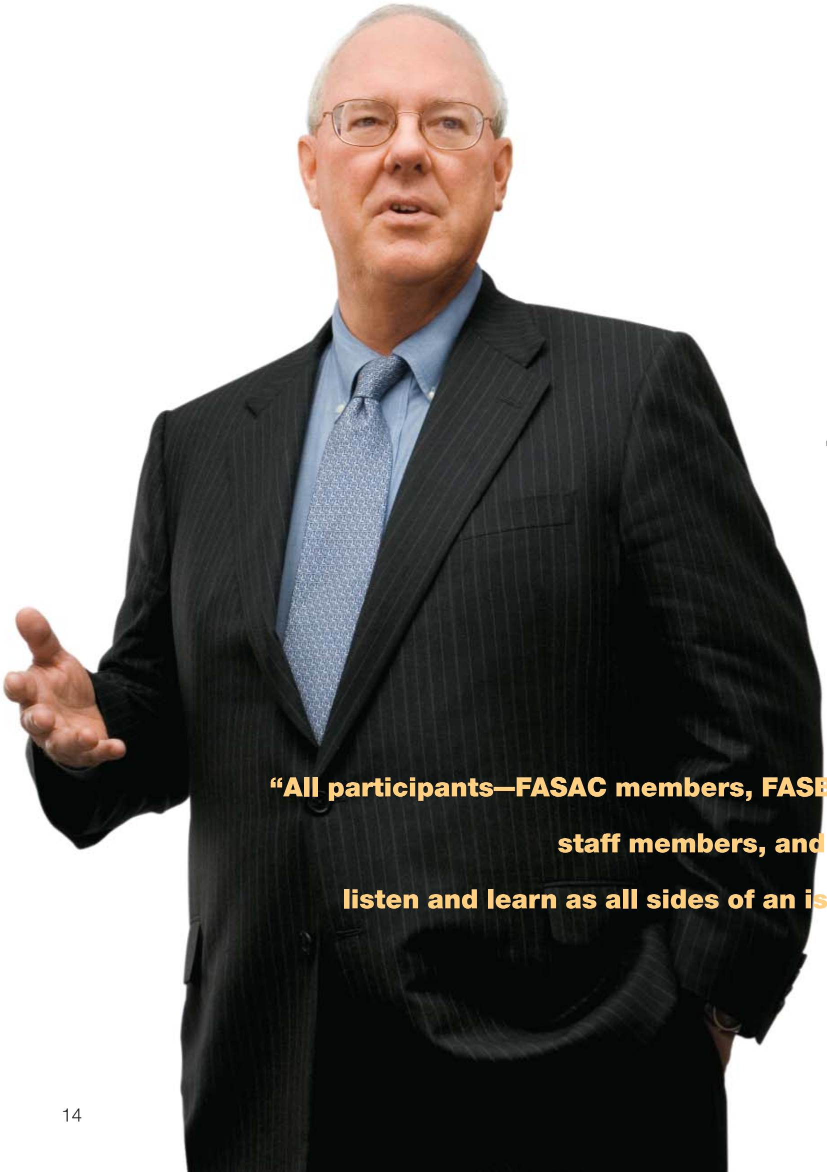
At every meeting in 2004, the Board set aside time to hear from FASAC members about the current business environment and its implications for standard setting. Much of those discussions focused on the challenges companies face with compliance issues, particularly Sarbanes-Oxley, and therefore did not necessarily impact the Board's standard-setting activities directly. However, the Board listened to FASAC members' concerns and responded by extending comment periods on certain proposals and by pushing back implementation dates for certain new standards.

On technical issues, FASAC discussed the conceptual framework, international convergence, and the projects on fair value, revenue recognition, liabilities and equity, liability extinguishment, and income tax issues. FASAC members also provided input to the Board on procedural issues relating to how the Board communicates with its constituents and on its codification initiative.

We acknowledge with thanks the FASAC members whose terms expired this year and welcome those who will be joining us in 2005.

Richard J. Swift

Richard J. Swift
Chairman, Financial Accounting Standards Advisory Council



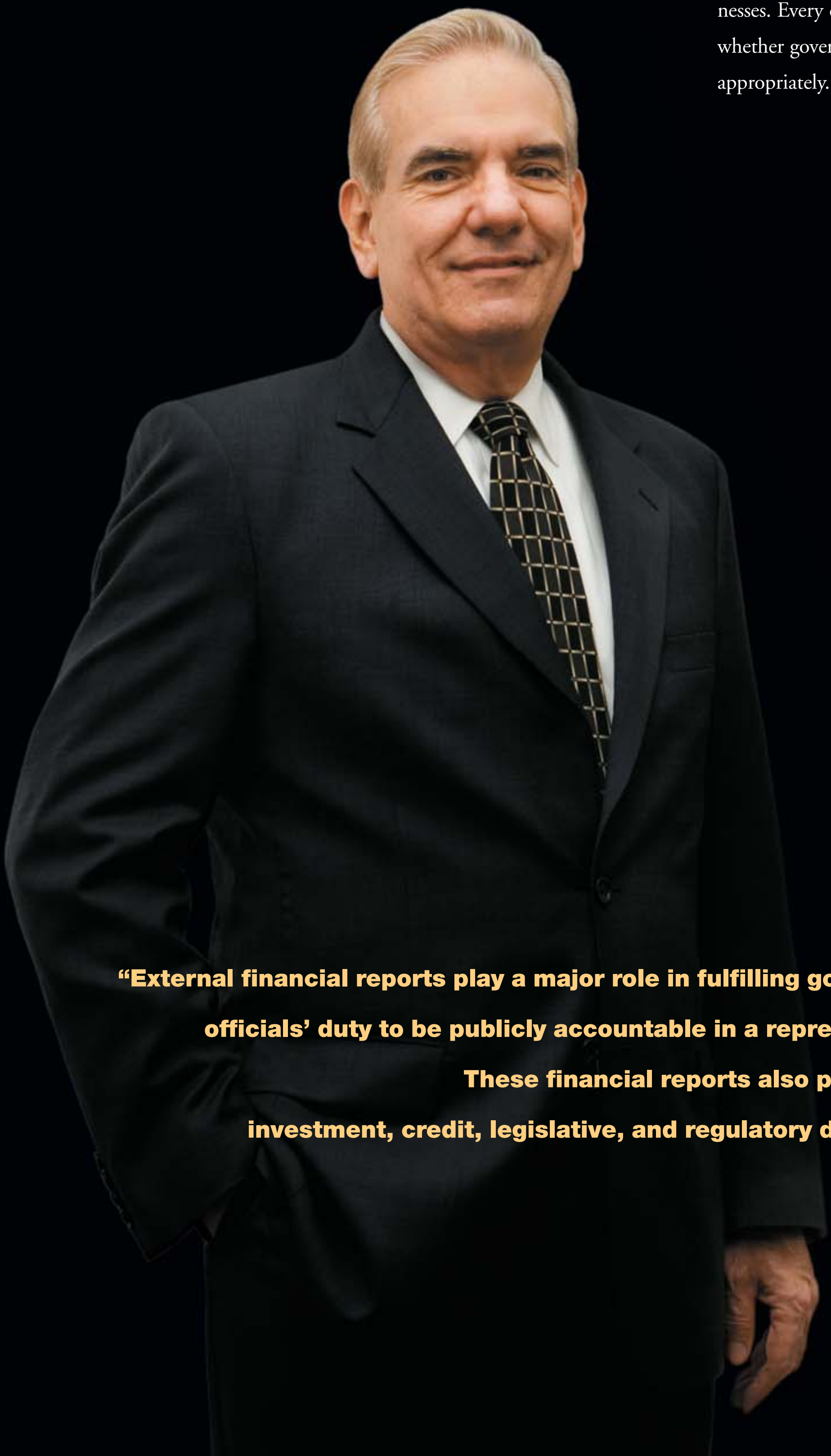
"All participants—FASAC members, FASB Board and staff members, and interested observers—have the opportunity to listen and learn as all sides of an issue are discussed."

— Richard J. Swift

Interview with Robert H. Attmore, Chairman Governmental Accounting Standards Board

How would you characterize the current environment of financial reporting?

Understandably, the current reporting environment is marked by increased scrutiny and demands for greater accountability and improved decision-utility of information being communicated. Much more attention and resources are being focused on financial reporting due, in large part, to corporate scandals involving deficient financial reports. However, continuing requests for more complete and transparent financial reporting are also relevant to governments, which have a responsibility to be accountable to a far wider range of report users than do businesses. Every citizen and taxpayer of a community has a right to know whether government officials are raising and using public resources appropriately.



"External financial reports play a major role in fulfilling government officials' duty to be publicly accountable in a representative democracy. These financial reports also provide a basis for making important investment, credit, legislative, and regulatory decisions."

— Robert H. Attmore

In the current challenging environment, the GASB will continue to seize the opportunity to increase the usefulness and understandability of governmental financial reports that follow GAAP. We are also researching the reasons for noncompliance with GAAP by some governments for the purpose of determining how best to encourage more governments to adopt and follow GAAP in their financial reporting.

As the new GASB Chairman, what have been the biggest surprises or the things that you least expected to encounter?

There really haven't been any major surprises; I spent considerable time monitoring Board meetings and talking with Board members and staff before my term began and, as a result, I think I was well prepared before joining the Board. Probably the most unexpected thing I've encountered is that, after 20 years of the GASB's existence, some people are still asking why we need a separate accounting standards board for government. That tells me that we need to do a better job of communicating information about the distinguishing characteristics of the governmental environment and their impact on financial reporting for governments. We accept that challenge, and that is something we will focus attention on in the near term. The only other issue worth mentioning is that I'm devoting more time and attention to developing and maintaining relationships on behalf of the GASB than I originally anticipated. Fortunately, I enjoy that aspect of my responsibilities, so it's not a concern.

Looking back at 2004, what were some of the more significant events and accomplishments for the year?

One of the most significant events of the year was the retirement of Tom Allen, who served admirably as the GASB's Chairman from July 1995 to June 2004. Tom demonstrated great leadership skills during his time as Chairman, particularly in directing the financial reporting model project

"GASB's improvement of the financial reporting model has brought to light information previously unavailable from debt issuers that now enables more comprehensive financial analysis."

Anne G. Ross
Senior Vice-President and Manager
Roosevelt & Cross, Inc.

to completion in June 1999. The resulting Statement 34, which has been described as the most significant change in modern-day governmental financial reporting, will be a lasting tribute to Tom.

Although some of the faces at the GASB have changed, the Board's mission has remained the same—to establish and improve standards of state and local governmental accounting and financial reporting. Among the Board's significant accomplishments for the year were the issuances of some important new financial reporting standards that will further improve governmental financial reporting.

After several years of research and deliberations, two new Statements were issued that establish financial reporting and disclosure requirements for postemployment benefits other than pensions (OPEB). Statement 43 addresses financial reporting by OPEB plans, and Statement 45 addresses accounting and financial reporting by employers that provide OPEB. The guidance in the new OPEB Statements is consistent with the approach used for pension plans. Employers will accrue the cost of providing other postemployment benefits, such as retiree healthcare, in a reasonable and equitable manner over the periods that employees work, instead of recognizing these costs on a "pay-as-you-go" basis. An accrual-basis measurement of annual OPEB costs is made using an approach that seeks to harmonize, where appropriate, accounting with actuarial methods and assumptions. The new standards also require presentation of schedules that show the funding status of the OPEB plan.

GASB Key Accomplishments in 2004

— Established reporting requirements for recognition of retiree healthcare and related benefits

— Implementation of Statement 34 and related standards by smaller governments

— Completed strategic plan

What to Watch for in 2005

— New standard on Termination Benefits

— New Concepts Statement on Communication Methods

— Implementation of strategic plan

— Increased focus on constituent relations, education, and communications

Another important new Statement that will assist users with assessing a government's economic condition was issued during the year and will affect governments that include a statistical section as part of their financial reports. Statement 44 updates and expands the requirements for the statistical section to put into context, and improve the usefulness of, trend information presented. It will also encompass new government-wide information available from implementation of Statement 34.

How significant an impact do you expect the new OPEB standards to have on governments?

As noted earlier, because most governments are currently recording OPEB expenses on a pay-as-you-go basis, those governments will, for the first time, need to disclose significant actuarial-based unfunded liabilities related to commitments for retiree healthcare and similar postemployment benefits. Unfunded actuarial liabilities related to prior years' service can be amortized over a period of up to 30 years, but once effective, Statement 45 requires employers to begin recording expenses for the annual required contribution for OPEB. In addition, to the extent that the annual required contribution for OPEB exceeds the amount that is actually funded, a government will be required to report a liability on the statement of net assets. Because of the significance of the new requirements, we are encouraging governments to begin planning for the implementation of Statement 45 as soon as possible.

As the last group of governments is now completing their Statement 34 implementation efforts, what has been the reaction to the new reporting model?

As might be expected, reaction to the implementation of Statement 34 has been mixed among preparers and users. Like many things that represent significant change, some preparers express an initial resistance, then acceptance, and in many cases eventually agreement and support. However, given the broad nature of the changes required by Statement 34, there will likely always be a small number of individuals who object to some portion of the new financial reporting model. At this point I'd say, on balance, we are hearing many more positive comments than concerns, especially from those who have prepared two or three years of financial statements following Statement 34. We are clearly hearing that the level of effort goes down significantly after the first year when new systems and procedures are in place. Also, many of those who have implemented the new reporting model say that it wasn't as bad as they had thought it might be, or were led to believe. I should also note that more than 3,000 governments actually implemented Statement 34 earlier than required.

MD&A information has been very popular with report users. In addition, report users are beginning to take advantage of other new information available, although they are interested in seeing more years of comparable information to better understand trends. Our user research tells us that although some users haven't yet determined how best to use the new government-wide information, most indicate that they plan to incorporate it into their analyses in the future as more data become available. Clearly the new information enhances accountability and helps answer basic questions about changes in a government's financial position, and the extent to which current-year taxpayers have provided adequate resources to support current-year services.

Since joining the GASB as Chairman, you have made the development and implementation of a new strategic plan a top priority. What are some of the key features of the new plan?

A new GASB strategic plan covering 2005–2009 was completed in January 2005 and is available for review on our website at www.gasb.org/strategicplan.pdf. This plan, which includes vision and mission statements, core values, and goals and objectives, is intended to communicate direction. The plan does not set radical new directions for the GASB, but it does include subtle shifts in emphasis such as more focus on constituent relations, communications, and education efforts. It will serve as a tool to help us set priorities and allocate our limited resources. The plan is built on the concept of managing for results, and it identifies specific desired outcomes and includes outcome-oriented performance measures to help us track and report our actual results. The methodology employed in developing this plan follows the guidance provided in the service efforts and accomplishments (SEA) research materials that the GASB staff have been producing and encouraging experimentation with.

What are some of the major challenges that you anticipate the GASB will be facing in the future?

After 20 years of operating with a limited formal conceptual framework, it is now time to develop a more comprehensive set of Concepts Statements to guide future standards development. The Board is currently working on two Concepts Statements, relating to communication methods and elements of financial statements. The next Concepts Statements to be addressed are likely to involve measurement attributes and recognition criteria. All of these will be challenging projects to make sure they are appropriate for the governmental environment and that they adequately recognize its unique or distinguishing characteristics.

Other future challenges include determining how best to report on a government's economic condition, which represents a composite of current financial health and the ability to meet both future financial obligations and commitments to provide services. It could include the notions of fiscal capacity—which is a government's ongoing ability and willingness to raise revenues, incur debt, and meet its financial obligations as

"Local governments like Fairfield truly benefit from following GASB standards because those standards generate confidence in financial reporting and help achieve a greater level of public trust. Our bond rating, currently a AAA, also clearly benefits from conformance with GASB standards."

they come due—as well as service capacity—which is a government's ongoing ability and willingness to supply the capital and human resources needed to meet its commitments to provide future services.

Service efforts and accomplishments research is ongoing, with staff encouraging experimentation and monitoring the implementation of suggested criteria for communicating performance results. In 2006, staff members are expected to summarize the results of their research and formulate recommendations for the Board to consider regarding the potential for adding a project on SEA reporting to the GASB's current technical agenda.

I also anticipate that electronic financial reporting will become an increasingly important topic for the Board to be considering in the future. It is essential that we recognize the need to ensure that GASB standards remain relevant in an environment in which paper-based financial reports are likely to become less relevant over time. Therefore, we added a research project to the GASB technical plan this year to begin gathering more information on the state of electronic reporting by governments as well as the progress being made by others who are studying and experimenting with electronic reporting.

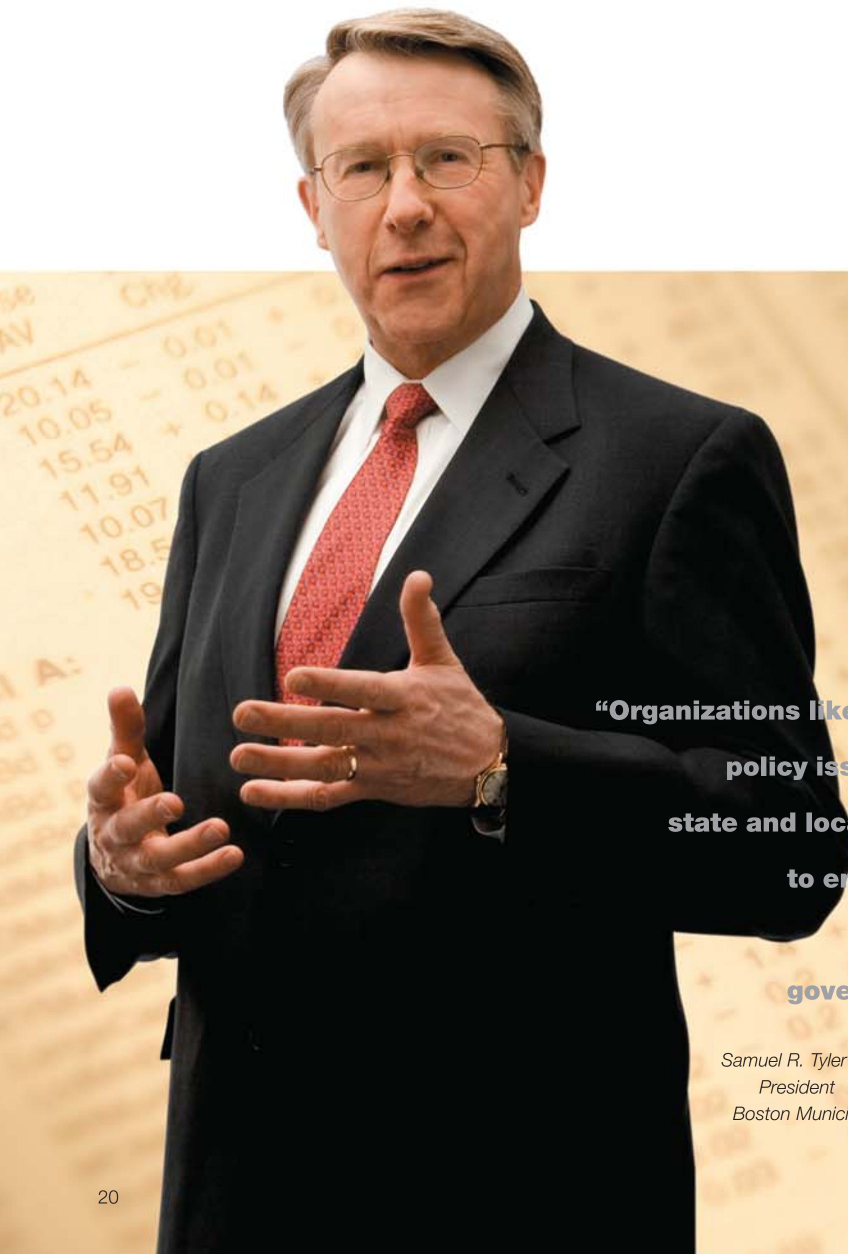
What should we expect from the GASB in 2005?

We expect to finalize a Concepts Statement regarding communication methods and a new standard on accounting for termination benefits during the second quarter of 2005. Plans also call for the issuance of two new Implementation Guides addressing OPEB and the statistical section, as well as a Comprehensive Implementation Guide update.

Due process documents scheduled to be released for review and feedback during the year include pollution remediation obligations, and sales and pledges of receivables and future revenues. Due process remains vital to the GASB's ability to issue effective standards. We will be exploring methods to increase participation in the GASB's due process throughout 2005.

Although no pronouncements or due process documents are expected on these topics in 2005, the Board will also be deliberating issues relating to projects dealing with derivatives and hedging, intangible assets, economic condition, fund balance reporting and a Concepts Statement regarding elements of financial statements.

Therefore, 2005 should prove to be an interesting and challenging year for the GASB team.



"Organizations like ours that provide analysis and facts on public policy issues to promote more responsible and efficient state and local government depend on GASB standards to ensure that basic financial information is publicly available to evaluate the fiscal health of governments and hold them accountable."

Samuel R. Tyler
President
Boston Municipal Research Bureau

Letter from

Harvey C. Eckert, Chairman

Governmental Accounting

Standards Advisory Council

The Governmental Accounting Standards Advisory Council (GASAC) continues to play an important role in ensuring that the GASB receives timely counsel as the Board deals with the important accounting and financial reporting issues of the day. The 29-member GASAC brings a diverse set of experience and views to the table that are reflective of the GASB's constituency. The opportunity to draw on that experience has proven to be invaluable to the GASB over the years.

The GASAC kicked off 2004 with a meeting in March. The focus of this Advisory Council meeting was on several significant items on the GASB's technical agenda including complex issues associated with the derivatives and hedging project.

The July meeting afforded the GASAC another opportunity to meet with an important constituent group of the GASB. This year we had the privilege of meeting with members of the National Association of College and University Business Officers during their annual conference in Milwaukee, Wisconsin. These meetings offer both the GASAC and the GASB the opportunity to better understand constituent issues and a forum to help the constituents understand the importance of GASAC, the what's and the why's of GASB pronouncements, and the status of current GASB projects. The GASAC members and the GASB members and staff look forward to the next constituent group meeting this summer with the National Association of State Budget Officers in Baltimore, Maryland.

At the July meeting, the GASAC was provided with an early opportunity to offer feedback during the development of the GASB's new strategic plan. We assisted the Board and staff in clarifying the GASB's primary goals and objectives.

At our November meeting, we continued our discussion of the GASB's strategic plan by providing input on strategies associated with the Board's 4 goals and 15 objectives. We were pleased with the important role that the GASAC played in assisting the GASB in completing its strategic plan. While significant portions of the July and November meetings were devoted to the strategic plan, we also fulfilled our responsibility to provide input on the GASB's technical agenda and to assist the GASB in its communication activities.

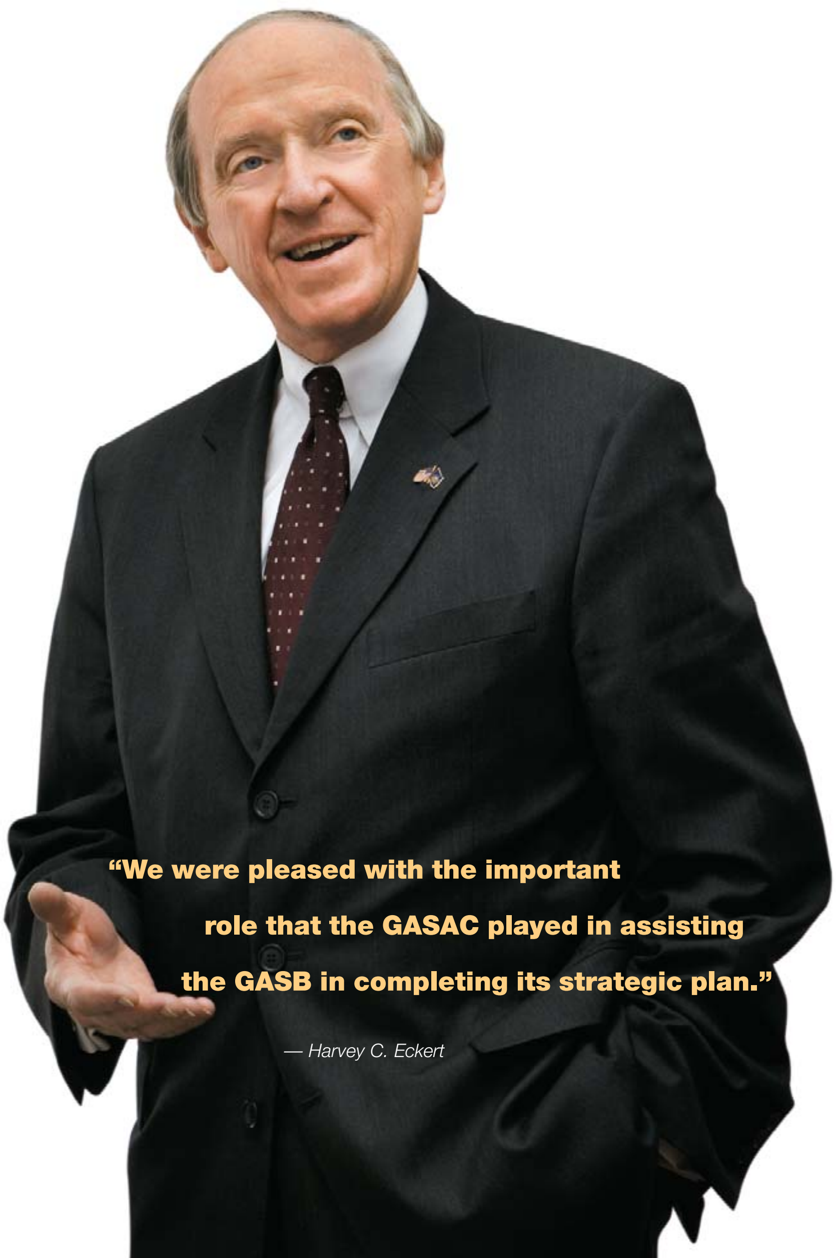
In addition to the projects noted earlier, we provided the Board with input during the year on the following projects: other postemployment benefits, communication methods concepts, tobacco settlements, the statistical section, net assets restricted by enabling legislation, pollution remediation obligations, elements of financial statements concepts, and sales and pledges of receivables and future revenues.

I am pleased to note that many GASAC members provided volunteer support to the FAF's fundraising activities in support of the GASB. GASAC members made follow-up telephone calls in connection with the FAF's annual Voluntary Fair Share Assessment Mail Campaign that reaches out to the largest city and county governments.

I would like to acknowledge the efforts of GASAC members whose terms end in 2004 and to extend a warm welcome to our new GASAC members.

This report will be my last as GASAC chairman, as my term concludes at the end of June 2005. The nine and a half years I have spent in this position have been some of the most rewarding of my career. I leave knowing that with the new strategic plan in place, the proper direction has been set for both the GASB and the GASAC. I look forward to watching this plan unfold in the months and years ahead.

Harvey C. Eckert
Chairman, Governmental Accounting Standards Advisory Council



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Terms expire on June 30 of the year indicated.

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2008

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Katherine Schipper,
2006

Leslie F. Seidman,
2006

Edward W. Trott,
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Donald M. Young,
2008

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 Comptroller of Texaco Inc.

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

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 managed her own consulting firm.

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

Mr. Young was Managing Director at PaineWebber/UBS and most recently managed his own consulting firm.

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Completed Service in 2004

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Governmental Accounting Standards Board

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Terms expire on June 30 of the year indicated.

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Cynthia B. Green,
2006

William W. Holder,
2005

Edward J. Mazur,
2007

Paul R. Reilly,
2005

Richard C. Tracy,
2006

James M. Williams,
2007

About GASB Members

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

Mr. Attmore was the Deputy State Comptroller of New York State.

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 retired 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 retired Director of Audits for the City of Portland, Oregon.

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

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*New members in 2005

Completed Service in 2004

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Carrolton, TX

Beth Stenberg
Financial Advisor
Louisville/Jefferson County (KY) Metro Government

Marcia L. Taylor
Assistant Manager
Mt. Lebanon, PA

Financial Accounting Standards Board

Statement No. 151, *Inventory Costs (an amendment of ARB No. 43, Chapter 4)*

Statement No. 152, *Accounting for Real Estate Time-Sharing Transactions (an amendment of FASB Statements No. 66 and 67)*

Statement No. 153, *Exchanges of Nonmonetary Assets (an amendment of APB Opinion No. 29)*

Statement No. 123 (revised 2004), *Share-Based Payment*

Exposure Draft, *Accounting for Conditional Asset Retirement Obligations (an interpretation of FASB Statement No. 143)*

Exposure Draft, *Fair Value Measurements*

The FASB issued thirteen Staff Positions in 2004.

Governmental Accounting Standards Board

Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*

Statement No. 44, *Economic Condition Reporting: The Statistical Section (an amendment of NCGA Statement 1)*

Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*

Statement No. 46, *Net Assets Restricted by Enabling Legislation (an amendment of GASB Statement No. 34)*

Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefit Expenditures/Expense and Liabilities by Cost-Sharing Employers*

Exposure Draft, *Communication Methods*

Exposure Draft, *Accounting for Termination Benefits*

Financial Contents

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 to the Boards 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 private sector, not-for-profit and state and local governmental entities.

Overall Financial Results

The year 2004 produced the second consecutive period yielding a significant operating surplus and strong net investment income for the Foundation. These were preceded by several years reflecting operating deficits and negative investment returns. Mandatory funding for FASB as a result of the implementation of provisions in the Sarbanes-Oxley Act of 2002, as well as a turnaround in the performance of the financial markets, contributed significantly toward the positive results of the last two years.

For 2004, the Foundation reported an increase in unrestricted net assets of $15,400,000, which includes a $561,000 non-cash credit to reflect the required adjustment to the minimum pension liability under its Employees' Pension plan. Although the accumulated benefit obligation under this plan increased 6% for 2004, the fair value of the plan's assets grew by a much larger amount (11%), resulting in the required minimum pension liability reduction. The minimum liability for this plan has been reduced to approximately $110,000 at December 31, 2004. The total net asset increase for the Foundation for 2004 also reflects the operating surplus for the year of $11,408,000, and net investment income of $3,431,000. The operating surplus was impacted by $25,355,000 of accounting support fee revenues for FASB pursuant to the system of mandatory assessments against public companies provided by Sarbanes-Oxley, and $13,056,000 in net subscription and publication revenues. The portion of net subscription and publication revenues not needed to fund operating expenses in 2004 was re-invested in the Foundation's reserve fund. Impacted by a continued improvement in financial market results, reserve fund investment income totaled $3,146,000 in 2004, nearly matching 2003's net income performance for the fund of $3,283,000. Investment income from cash equivalents and short-term investments more than tripled to $285,000 in 2004, as mandated funding for FASB provided additional funds available for short-term investing over the entire year.

The continued shift in financing sources for FASB was primarily responsible for total net operating revenues for the organization increasing $6.5 million (19%) for 2004 to $40.7 million. This overshadowed a $425,000 (3%) increase in combined net subscription and publication sales for both Boards for 2004. Contributions increased $431,000 (23%) for the year, due to larger donations attributable to GASB. Total operating expenses for the organization grew by $3.1 million (12%) in 2004 to $29.3 million.

Salaries and employee benefits have comprised over 75% of the total operating expenses for each of the last five years. Total salaries and wages increased by $2,148,000, or 13.1%, in 2004 to $18,573,000, reflecting a higher headcount level during the year for the FASB technical staff, including practice fellow positions, as well as general merit increases for all personnel. Employee benefit costs increased by $396,000, or 10.0% during 2004 to $4,363,000, due to the impact of the aforementioned growth in the FASB technical staff, as well as increases in health insurance premiums for all personnel and higher net periodic benefit cost under the Foundation's Postretirement Health Coverage Plan.

Total occupancy and equipment expenses in 2004 were $1,915,000, $35,000 (1.9%) above the 2003 total. Depreciation and amortization expenses increased $246,000 in 2004 to $612,000, due mainly to certain improvements relating to construction of expanded office space being initially amortized over a relatively short period of time, as the termination date of the currently amended lease occurs in 2006. Depreciation expense on personal computers and associated networking equipment was also higher in 2004, in part due to equipment needs to service employees occupying the expanded office space.

Other operating expenses include, among other items 1) consulting, legal and audit fees, 2) several types of other professional costs, 3) search and relocation expenses for Board and staff members, 4) meeting and travel expenses, 5) office and computerized systems support expenses, 6) liability insurance, 7) fees to the Public Company Accounting Oversight Board for acting as the FASB's agent in collecting accounting support fees and 8) expenses associated with GASB's service efforts and accomplishments activities. These other operating expenses increased $310,000, or 8.7%, in 2004 to $3,874,000, due to higher amounts paid by the FASB for research consultants and for certain meeting and international travel related expenses associated with that Board.

A discussion of the Foundation's various 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. FASB's accounting support fees for 2004 amount to $25,355,000, substantially ($5,658,000, or 29%) higher than the prior year total, due to the 2003 cancellation of invoices for certain non-U.S. security issuers which were not reallocated to the U.S. issuers. 2003 represented the initial calendar year of invoicing and collecting fees from issuers. The fees for that year amounted to $19,161,000 of revenues from the U.S. sector. In addition, 2003's revenues also included $536,000 of fees for non-U.S. issuers of securities that trade in U.S. markets.

Accounting support fees for 2005 are expected to be approximately $20,244,000, substantially ($5,111,000, or 20%) less than 2004, as the Foundation's reserve fund has been replenished to its targeted level of one year's budgeted operating expenses (see Investments section that follows).

Contributions

Contributions for 2004 and 2003 are shown in the table below.

(Dollars in thousands)

FASB		GASB		Total	
2004	2003	2004	2003	2004	2003
$123	$263	$2,211	$1,640	$2,334	$1,903

With the exception of contributed services, all contribution types were discontinued for the FASB in 2003 and replaced by the abovementioned mandatory fees system. The value of contributed services for FASB includes amounts in each period for those members of the Foundation's Board of Trustees who have elected to waive their right to be compensated. In addition, included are the services of a practice fellow donated to the Board for all of 2003, and for a portion of 2004.

Total contributions to GASB increased $571,000 during 2004 to $2,211,000. This is due primarily to an individual contribution of $500,000 received from The Bond Market Association. In addition, $67,000 was received through a voluntary bond fee assessment program launched in 2004 that The Bond Market Association administers. The assessment is paid on a voluntary basis by municipal security issuers on applicable offerings and collected by underwriters of those offerings. The Alfred P. Sloan Foundation remitted $90,000 in 2004 as their initial installment under a new three-year commitment providing a total of $415,000 in financing for support of the GASB's research on service efforts and accomplishments activities. Having met the criteria for this grant, a total of $191,000 of Sloan funds were recognized as contribution revenues during 2004, including certain amounts received in prior years. Corresponding revenues for the service efforts work in 2003 were $207,000. State government support increased $31,000 in 2004 to $1,000,000. The Government Finance Officers Association contributions decreased $16,000 in 2004 to $170,000. Municipal government support increased $27,000 in 2004 and reached $123,000. Insurance industry organizations and all other supporters, including the value of contributed services, generated $160,000 of support for GASB in 2004, a decrease of $22,000 from the 2003 level. Beginning in 2003 all FAF fundraising programs were realigned to solicit support exclusively for the GASB.

Subscription and Publication Sales

Total net subscription and publication sales were $13,056,000 in 2004, $425,000, or 3.4%, higher than 2003's amount of $12,631,000. Total subscription and publication sales increased $379,000, or 2.7%, in 2004 to $14,554,000, while direct costs of publications dropped $46,000, or 3.0%, to $1,498,000. 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 increased $55,000 in 2004 to $12,657,000. Sales derived from FASB's document and loose-leaf subscription services declined by $148,000, or 3.2%, in 2004 to $4,542,000, due mainly to lower loose-leaf revenues and the final recognition in 2003 of a portion of the annual complimentary subscriptions provided to voluntary contributors in 2002. The sales value of FASB complimentary subscriptions was reclassified from contributions to subscription and publication revenues for all applicable contributions received through the end of 2002. Sales of *Original Pronouncements, Current Text* and other annual bound publications increased by $48,000, or 2.7%, in 2004 to $1,802,000 as both the 2003 and 2004 summaries of proceedings of the FASB's *Emerging Issues Task Force* were initially available for sale during the 2004 calendar year. Sales of Statements, Interpretations and other final due process documents decreased by $21,000, or 5.0%, in 2004 to $400,000. Revenues earned from electronic licensing and royalty arrangements continued to increase ($173,000, or 3.1%) in 2004 to $5,721,000, due to higher sales volume in the commercial publisher marketplace. Finally, sales of Research and Special Reports, along with revenues obtained from seminars, public records and all other sources, increased $3,000 in 2004 and aggregated $192,000. In 2003 FASB made its Statements available for downloading without charge from the Board's website. This has since been expanded to include access to Interpretations, Technical Bulletins, FASB Staff Positions on technical matters and certain *EITF* materials.

The direct costs of $1,240,000 to produce and distribute FASB publications were $15,000, or 1.2%, lower in 2004. FASB cost of sales for 2004 include approximately $128,000 associated with the development of a comprehensive and integrated codification product encompassing all authoritative U.S. GAAP literature. Expenditures for this product are expected to be significantly larger in 2005 as the Board increases the time and resources devoted to this development.

GASB subscription and publication sales increased substantially ($324,000, or 20.6%) in 2004 to $1,897,000. Sales of Statements, Special Reports and other final documents decreased by $13,000, or 7.6%, to $157,000. This reflects a slight decline in sales of implementation guides and other publications associated with the standards on the revised financial reporting model for governmental entities introduced several years ago. Revenues yielded from GASB's subscription based products increased significantly (by $87,000, or 12.4%) in 2004 to $790,000, due to expanded efforts to reach subscribers in the public accounting marketplace. Revenues from electronic licensing and royalty agreements also increased notably ($194,000) against 2003 levels and totaled $507,000 for 2004. This reflected significant increases in sales to both the Big Four public accounting firms and commercial publishers. Revenues from the *Codification* and *Original Pronouncements* annual bound editions were $93,000, or 32.3%, higher in 2004 and aggregated $381,000. Sales of these bound books are cyclical and impacted by the particular annual release date, typically sometime during the third or fourth quarter of each calendar year. Lastly, revenues earned from all other sources were $37,000, or 37.4%, lower for GASB in 2004 and stood at $62,000. This decrease was attributable to the elimination of certain payments received under publications agreements with major public accounting firms. In 2004 GASB made its due process documents available for downloading without charge from the Board's website.

Direct costs of $258,000 to produce and distribute GASB publications decreased $31,000, or 10.7%, from 2003, due to lower 2004 printing and distribution costs achieved with several different types of products. These included subscription plans, due process documents (no longer printed in bound booklet form), annual bound editions and research and special reports.

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 $26.4 million and $18.7 million of receipts for the Board in accounting support fees for the years ended December 31, 2004 and 2003, respectively. This has had a profound effect on the Foundation's liquidity over the past two years, and $10,303,000 of cash and short-term investments remain on hand at December 31, 2004, much more than the amounts present in periods prior to 2003. The majority of these funds have been utilized to meet operating needs in 2005, as cash receipts from accounting support fees are not expected until the second quarter. Investment income from cash equivalents and short-term investments increased $195,000 to $285,000 in 2004, due to the higher cash balances available for investment for the full year. In addition, the interest rate yields applicable to these funds were higher in 2004. Investment income results in 2003 were held down by lower interest rate yields and the fact that the first receipts of accounting support fees did not take place until September of that year.

Reserve Fund Investments

The reserve fund was established by the Foundation 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 budgeted operating expenses for the entire organization. The fund is also intended to finance any major capital expenditures that cannot be supplied from operating resources, and to provide funding as needed to support any operating deficits of the GASB. Reserve fund assets are unrestricted, but require Trustee approval for use in continuing operations.

For the years ended December 31, 2004 and 2003, $1,500,000 and $2,000,000, respectively, was transferred out of the reserve fund to finance current and future operating deficits of the GASB. During 2004 a total of $17,600,000 was invested in the reserve fund from operations, the majority of this amount represented by receipts from FASB subscription and publication sales. An additional $2,000,000 was invested in the reserve fund from operations in the first quarter of 2005. As the targeted reserve fund investment level was reached during 2004, a portion of net subscription and publication revenues is expected to be available to fund operations, and the aggregate amount of accounting support fees calculated for 2005 was accordingly reduced by approximately $5.1 million.

In order to meet working capital requirements, a total of $5,250,000 was transferred from the reserve fund to operating cash during 2003 prior to the initial receipt of accounting support fees. In late 2003 a total of $6,000,000 was then re-invested in the reserve fund once it was determined that the FASB support fees could meet operating needs for the foreseeable future.

Reserve fund investments are maintained within the guidelines of the investment policy for the fund established by the Trustees' Finance Committee. At December 31, 2004, approximately 68% of the fund's market value was invested in an equity index fund, 29% in a fixed income index fund, with the balance represented by money market investments. The net transfers from operating cash of $16,100,000 in 2004 helped generate investment income of $3,146,000 (net of investment management fees of $68,000) for the year, thus increasing the reserve fund balance to $39,829,000 at December 31, 2004. Unrealized appreciation on the fund's equity index investments was mainly responsible for the positive investment results in 2004.

Years Ended December 31 (dollars in thousands)	2004	2003
Operating revenues:		
Accounting support fees - FASB (Note 2)	$ 25,355	$ 19,697
Contributions:		
FASB	123	263
GASB	2,211	1,640
	2,334	1,903
Subscription and publication sales:		
FASB	12,657	12,602
GASB	1,897	1,573
	14,554	14,175
Less - Direct costs of sales:		
FASB	1,240	1,255
GASB	258	289
	1,498	1,544
Net subscription and publication sales:		
FASB	11,417	11,347
GASB	1,639	1,284
	13,056	12,631
Net operating revenues	40,745	34,231
Program expenses:		
Salaries and wages:		
FASB	12,379	10,284
GASB	2,519	2,484
Administrative	1,649	1,588
Total salaries and wages	16,547	14,356
Employee benefits (Note 4)	3,612	3,258
Occupancy and equipment expenses (Note 6)	1,144	1,077
Other operating expenses	1,939	1,658
Total program expenses	23,242	20,349
Support expenses:		
Salaries and wages	2,026	2,069
Employee benefits (Note 4)	751	709
Occupancy and equipment expenses (Note 6)	771	803
Depreciation and amortization	612	366
Other operating expenses	1,935	1,906
Total support expenses	6,095	5,853
Total expenses	29,337	26,202
Operating revenues greater than expenses	11,408	8,029
Short-term investment income (Note 3)	285	90
Reserve fund investment income (Note 3)	3,146	3,283
Credit for additional minimum pension liability (Note 4)	561	1,177
Increase in unrestricted net assets	15,400	12,579
Net assets at beginning of year	28,950	16,371
Net assets at end of year	$ 44,350	$ 28,950

See notes to these financial statements.

As of December 31 (dollars in thousands)	2004	2003
Current Assets:		
Cash and cash equivalents	$ 2,009	$ 2,393
Short-term investments (Note 3)	8,294	11,197
Accounting support fees receivable (Note 2)	13	1,027
Contributions receivable	352	249
Subscription, publication and other receivables	1,725	1,172
Less : Allowance for doubtful accounts	(189)	(140)
Inventories	231	202
Prepaid expenses and other current assets	250	156
Total current assets	12,685	16,256
Noncurrent Assets:		
Furniture, equipment and leasehold improvements, at cost, net of accumulated depreciation and amortization (Note 5)	1,261	898
Intangible asset - pension accrual (Note 4)	249	281
Reserve fund investments (Note 3)	39,829	20,583
Total noncurrent assets	41,339	21,762
Total assets	$ 54,024	$ 38,018
Current Liabilities:		
Accounts payable, accrued expenses and other current liabilities	$ 995	$ 555
Accrued payroll and related benefits	606	530
Current portion of accrued pension costs (Note 4)	110	463
Current portion of accrued postretirement health care costs (Note 4)	2,049	—
Current portion of accrued rent expense (Note 6)	379	312
Unearned publication and other deferred revenues	4,540	4,262
Total current liabilities	8,679	6,122
Noncurrent Liabilities:		
Accrued pension costs (Note 4)	525	432
Accrued postretirement health care costs (Note 4)	—	1,857
Accrued rent expense (Note 6)	284	544
Unearned publication and other deferred revenues - long - term	186	113
Total noncurrent liabilities	995	2,946
Total liabilities	9,674	9,068
Net Assets – Unrestricted	$ 44,350	$ 28,950

See notes to these financial statements.

Years Ended December 31 (dollars in thousands)	2004		2003	
Cash flows from operating activities:				
Cash received from contributors	$ 2,088		$ 3,069	
Cash received from publication sales	14,401		15,657	
Cash received from accounting support fees	26,369		18,670	
Interest and dividend income received	1,063		476	
Cash paid to suppliers and employees	(29,420)		(27,152)	
Net cash provided by operating activities		14,501		10,720
Cash flows from investing activities:				
Proceeds from sales or maturities of reserve fund investments	$ 10,210		$ 12,438	
Purchases of reserve fund investments	(27,023)		(11,533)	
Proceeds from sales or maturities of short-term investments	40,724		3,000	
Purchases of short-term investments	(37,821)		(12,039)	
Purchases of furniture, equipment and leasehold improvements	(975)		(422)	
Net cash used in investing activities		(14,885)		(8,556)
Net increase (decrease) in cash and cash equivalents		(384)		2,164
Cash and cash equivalents at beginning of period		2,393		229
Cash and cash equivalents at end of period		$ 2,009		$ 2,393
Reconciliation of increase in net assets to net cash provided by operating activities:				
Increase in unrestricted net assets for the period		$ 15,400		$ 12,579
Adjustments to reconcile increase in net assets to net cash provided by operating activities:				
Credit for additional minimum pension liability	(561)		(1,177)	
Depreciation and amortization	612		366	
Unrealized gains on reserve fund investments retained	(2,309)		(5,070)	
(Gains) losses on sales of reserve fund investments	(124)		2,133	
Provision for losses on accounts receivable	59		58	
Decrease in contribution, subscription, support fee and other receivables	348		1,769	
(Increase) decrease in inventories	(29)		5	
(Increase) decrease in prepaid expenses and intangible assets	(62)		34	
Increase in accounts payable, accrued expenses and employee benefit accruals	1,009		254	
Increase in unearned publication and other deferred revenues	351		77	
Decrease in accrued rent expense	(193)		(308)	
Total adjustments		(899)		(1,859)
Net cash provided by operating activities		$ 14,501		$ 10,720

See notes to these 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, obtaining funding for, 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 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 costs for the production, marketing, publication distribution and library activities of the Foundation. Foundation services for finance, human resources, facilities management, information systems, public relations, development and general administration assistance are reflected as support expenses in the accompanying statements of activities. Fundraising expenses included in those statements aggregated approximately $156,000 in 2004 and $231,000 in 2003.

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, ultimate 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 include $536,000 for certain non-U.S. 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 2004 and 2003 for the GASB were met by the end of each period. Contributions reported for the FASB in both periods consist entirely of contributed services, as all voluntary cash contribution sources were replaced beginning in 2003 by the system of mandatory fees assessed against issuers of securities, as provided by the Sarbanes-Oxley legislation.

Many individuals have contributed significant amounts of time to the activities of the Foundation, the Standards Boards and the Advisory Councils without being compensated. 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 councils, committees and 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 visits. Members of the Board of Trustees are eligible for compensation for their services, with each having 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.* Other than Trustee compensation, all of the services described above have been deemed not to meet the recognition criteria of that Statement. The value of contributed services recognized in the statements of activities was approximately $143,000 and $283,000 in 2004 and 2003, respectively.

In the second quarter of 2004, the GASB received a conditional commitment which provides for a total contribution of $415,000 over a three-year period, beginning in July 2004, to fund research activities leading to the consideration of a technical project on service efforts and accomplishments of state and local governments. In late 2000, the GASB received a similar three-year conditional commitment for the same research work providing for total contributions of $682,000 beginning in early 2001. Conditional commitments to contribute are recognized as revenues when the conditions on which they depend are substantially met. Accordingly, GASB contributions for 2004 and 2003 include approximately $191,000 and $207,000, respectively, relating to these conditional commitments.

Subscription Plans, Loose-Leaf Subscription Services and License Agreements
Revenues from these publication sources are recognized over the life of the applicable subscription, loose-leaf service or license period, in many instances one year. 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, among other reasons, to the nature of the maturity period.

Investments
The Foundation's investments are reported at fair value, with carrying amounts determined using market values 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 not extending beyond the termination date of the current office lease, which is September 30, 2006. See Note 5 for further information regarding these assets.

2. Accounting Support Fees

The Sarbanes-Oxley Act provides for federally mandated funding for the FASB through annual accounting support fees assessed against and collected from issuers of securities, 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 represented 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 2004 and 2003 are as follows:

Year ended December 31	2004	2003
Accounting Support Fees invoiced to issuers:		
For U.S.-based entities	$24,670,000	$19,161,000
For non-U.S.-based entities	685,000	536,000
	25,355,000	19,697,000

Year ended December 31	2004	2003
Program expenses:		
Salaries and wages:		
FASB	$12,379,000	$10,284,000
Administrative	1,405,000	1,276,000
Total salaries and wages	13,784,000	11,560,000
Employee benefits	2,897,000	2,547,000
Occupancy and equipment expenses	890,000	815,000
Other operating expenses	1,470,000	1,181,000
Total program expenses	19,041,000	16,103,000
Support expenses:		
Salaries and wages	1,575,000	1,602,000
Employee benefits	595,000	560,000
Occupancy and equipment expenses	618,000	642,000
Depreciation and amortization	568,000	322,000
Other operating expenses	1,283,000	1,299,000
Total support expenses	4,639,000	4,425,000
Total expenses	$23,680,000	$20,528,000
Excess FASB support fees (expenses) for applicable period	$ 1,675,000	$ (831,000)

The non-U.S. invoices relate to that community's share of FASB accounting support fees for the applicable calendar year. During 2004 $26,369,000 of accounting support fees were collected, and $13,000 of fees remained in receivables at December 31, 2004. In both 2004 and 2003 FASB paid approximately $209,000 to an agent under an agreement to invoice and collect the Board's accounting support fees.

Any differences between FASB's expenses for an applicable calendar year and the amount of accounting support fees recognized as revenues for that period will be incorporated into the calculation of support fees for subsequent periods, subject to adjustments for non-cash expenses and certain other cash requirements not reflected in the statements of activities, such as capital expenditures. 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 inevitable differences between actual and expected costs for the Board are reflected in subsequent year support fee calculations. The accounting support fees are subject to review by the Securities and Exchange Commission.

3. Investments and Investment Income

Investments are as follows:

At December 31	2004	2003
Short-term:		
Investment company mutual funds	$ 8,294,000	$11,197,000
Reserve fund:		
Common trust funds:		
Equity index fund	$27,120,000	$12,369,000
Fixed income index fund	11,519,000	7,214,000
Cash and money market securities	1,190,000	1,000,000
	$39,829,000	$20,583,000

Investment income consists of the following:

Year ended December 31	2004	2003
Short-term:		
Interest, including return on cash equivalents	$ 212,000	$ 87,000
Net unrealized gains	73,000	3,000
Total short-term	$ 285,000	$ 90,000
Reserve fund:		
Interest and dividends	$ 780,000	$ 386,000
Net realized and unrealized gains	2,434,000	2,937,000
	3,214,000	3,323,000
Less: advisory fees	(68,000)	(40,000)
Total reserve fund	$3,146,000	$3,283,000

Reserve fund assets are maintained within the guidelines of the investment policy established by the Foundation's Finance Committee for those sources and are unrestricted, but require 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 postretirement health coverage plans.

The following amounts are included in operating expenses pursuant to the Foundation's pension plans and postretirement health coverage plan for the periods presented:

Year ended December 31	2004	2003
Defined contribution pension expense	$1,114,000	$1,039,000
Defined benefit pension expense	833,000	872,000
Postretirement health coverage expense	367,000	274,000
	$2,314,000	$2,185,000

The principal actuarial assumptions utilized for 2004 and 2003 to determine costs and benefit obligations for the defined benefit pension plans and the postretirement health coverage plan are as follows (not all assumptions are applicable to all plans):

At December 31	2004	2003
Discount rate	5.75%	6.0%
Rate of increase in compensation levels	4.5%	4.5%
Long-term rate of return on pension assets	8.0%	8.0%
Health care cost trend rate for following year	9.0%	10.0%

The initial health care cost trend rate assumption was increased in 2003 to reflect market conditions at the time, future expectations of healthcare inflation and the Foundation's then recent cost experience. The assumed rate declines by 1.0% annually to an ultimate level of 5.0% after 2008.

All of the actuarial assumptions are reviewed by the Finance Committee of the Trustees annually. The expected long-term return assumption 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 pension plan's assets over the past twelve 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 at retirement, as defined, is deemed not to have been met. The targeted pension benefit is a calculated 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. The calculation of the defined pension benefit incorporates assumptions relative to the mix of fixed income and equity investments maintained by an employee for the employer payments made on behalf of that employee pursuant to the defined contribution plan. The actual mix of investments maintained in an employee's defined contribution account may differ from the assumed ratios. 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 2004 and 2003 are as follows:

Year ended December 31	2004	2003
Service cost	$265,000	$101,000
Interest cost	665,000	663,000
Expected return on plan assets	(599,000)	(469,000)
Amortization of prior period net losses	485,000	578,000
Amortization of prior service cost (credit)	17,000	(1,000)
Defined benefit pension expense	$833,000	$872,000

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

Year ended December 31	2004	2003
Change in plan assets		
Fair value of plan assets, beginning of year	$ 7,707,000	$ 6,080,000
Employer contributions	500,000	500,000
Actual investment income on plan assets	781,000	1,440,000
Benefits paid	(410,000)	(313,000)
Fair value of plan assets, end of year	$ 8,578,000	$ 7,707,000
Change in benefit obligation		
Projected benefit obligation, beginning of year	$11,299,000	$10,429,000
Service cost	265,000	101,000
Interest cost	665,000	663,000
Actuarial losses	340,000	419,000
Benefits paid	(410,000)	(313,000)
Projected benefit obligation, end of year	$12,159,000	$11,299,000
At December 31		
Underfunded status of plans	$(3,581,000)	$(3,592,000)
Unrecognized net actuarial losses	4,303,000	4,629,000
Unrecognized prior service cost	180,000	198,000
Net amounts recognized	$ 902,000	$ 1,235,000
Amounts recognized in the financial statements		
Intangible asset	$ 249,000	$ 281,000
Accrued pension costs	(635,000)	(895,000)
Provision for minimum pension liability – cumulative	1,288,000	1,849,000
Net amounts recognized	$ 902,000	$ 1,235,000

The actuarial losses for the periods presented above result from, among other factors, changes in actuarial assumptions, including lowering the discount rate in each year, to 5.75% at December 31, 2004. The amounts recorded in the financial statements are the effects of measuring the minimum pension liability at December 31, 2004 and 2003 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 credits recorded in the statements of activities for 2004 and 2003 for the minimum pension liability include the effects of accounting for the reduction in the minimum liability during each period of $353,000 and $871,000, respectively. At December 31, 2004 the minimum liability under the Pension Plan was approximately $110,000.

The accumulated benefit obligation for the Employees' Pension Plan aggregated $8,688,000 and $8,171,000 at December 31, 2004 and 2003, respectively. The projected benefit obligation and accumulated benefit obligation for the Supplemental Executive Retirement Plan, which is unfunded, was $423,000 and $248,000, respectively, as of December 31, 2004, and $489,000 and $354,000, respectively, as of December 31, 2003. There were no benefits paid under the unfunded plan for the years ended December 31, 2004 and 2003. The Foundation expects to contribute approximately $939,000 to its Employees' Pension Plan during 2005.

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 the employees' remaining service periods. Any prior service costs due to plan amendments are recognized over similar service periods.

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

At December 31	2004	2003
Equity securities	78%	76%
Debt securities	20%	24%
Other investments	2%	—

The Finance Committee of the 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 diversify through allocation assets under the Plan and to retain, as necessary, investment managers and advisors. The Foundation has chosen to retain a professional investment manager who maintains complete discretion over investment decisions, within recommended asset allocation ranges noted below. The investment manager's performance is monitored by the Committee quarterly, and these two parties meet in person at least once annually.

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 to hold 65 to 80 percent of the portfolio's market value in equity investments and 20 to 35 percent in fixed income investments. All securities included in the Pension Plan's investments must be marketable. Several types of investments are prohibited without the express consent of the Committee, including real estate, oil and gas, venture capital funds, 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 projected to be paid under the Foundation's pension plans:

Year ended December 31	
2005	$ 657,000
2006	547,000
2007	601,000
2008	641,000
2009	718,000
2010 - 2014	4,376,000

Health Coverage Plan

The Foundation sponsors a postretirement health coverage 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 at the same level under the health care plan then in effect for active employees. The annual cost of coverage beyond the date of retirement is then shared between the Foundation and the retiree, with the Foundation responsible only for the amount not exceeding 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 coverage expense for 2004 and 2003 are as follows:

Year ended December 31	2004	2003
Service cost	$118,000	$ 83,000
Interest cost	182,000	153,000
Amortization of prior period net losses	101,000	72,000
Amortization of prior service credit	(34,000)	(34,000)
Net periodic postretirement health coverage expense	$367,000	$274,000

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

Year ended December 31	2004	2003
Change in benefit obligation		
Accumulated benefit obligation, beginning of year	$ 3,118,000	$ 2,432,000
Service cost	118,000	83,000
Interest cost	182,000	153,000
Actuarial losses	374,000	601,000
Benefits paid	(175,000)	(151,000)
Accumulated benefit obligation, end of year	$ 3,617,000	$ 3,118,000
At December 31		
Underfunded status of plan	$(3,617,000)	$(3,118,000)
Unrecognized net actuarial losses	1,520,000	1,247,000
Unrecognized prior service cost	48,000	14,000
Accrued postretirement health care costs	$(2,049,000)	$(1,857,000)

The Foundation currently funds retiree health care benefits on a cash basis. In 2005 the Foundation expects to contribute approximately $2,500,000 to its Postretirement Health Coverage Plan to begin providing for retiree health care benefits in current and future periods. Gains and losses that occur because actual experience differs from that assumed, and from changes in actuarial assumptions, are amortized over the employees' remaining service periods. The actuarial losses for the past two years result from changes in actuarial assumptions, including lowering the discount rate in each period, down to 5.75% at December 31, 2004, and increasing the health care cost trend rate to 10.0% in 2003. In addition, the actual increases in health coverage premiums for both 2004 and 2003 were much larger than the respective increases anticipated a year earlier.

The amortization of 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, 2004:

	One % Point Increase	One % Point Decrease
Increase (decrease) in total of service and interest costs for the year	$28,000	$(24,000)
Increase (decrease) in accumulated benefit obligation	229,000	(202,000)

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

Year ended December 31	
2005	$ 228,000
2006	255,000
2007	269,000
2008	283,000
2009	290,000
2010 – 2014	1,544,000

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 was signed into law. In the second quarter of 2004, FASB issued its Staff Position FAS 106-2 addressing accounting and disclosure requirements related to that Act. As permitted by the FASB staff position, the Foundation has not recognized in its accounting for the postretirement health coverage plan any effects of the Act in its financial statements for the years ended December 31, 2004 and 2003. As such, measurements of the accumulated postretirement benefit obligation and net periodic postretirement health coverage 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. The Foundation is currently unable to conclude whether the prescription drug benefits provided under its health coverage plan are actuarially equivalent to Medicare Part D, and thus qualify for the federal subsidy provided by the Act. Accordingly, the future determination of actuarial equivalency could result in changes to information reported about the plan.

5. Furniture, Equipment and Leasehold Improvements

These assets consist of the following:

At December 31	2004	2003
Furniture and equipment	$5,700,000	$5,261,000
Leasehold improvements	2,982,000	2,446,000
	8,682,000	7,707,000
Accumulated depreciation and amortization	(7,421,000)	(6,809,000)
	$1,261,000	$ 898,000

6. Lease Commitments

The Foundation currently occupies office space in a single building pursuant to an operating lease. Total rental expense for office space and equipment amounted to approximately $1,711,000 and $1,673,000 in 2004 and 2003, respectively. The operating lease for the Foundation's occupied office space commenced April 15, 1988 and the current extension expires on September 30, 2006. Accrued rent expense for escalating minimum lease payments, initial rent abatement and a leasehold improvement allowance amounted to $663,000 and $856,000 at December 31, 2004 and 2003, respectively, and is reflected in liabilities in the accompanying statements of financial position. The accrued rent expense liability is being amortized over the remaining term of the operating lease for occupied space. In the first quarter of 2005 the Foundation executed an agreement that provides for additional office space in a second building, for which occupancy is not expected to take place until sometime during the second quarter.

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

Year ended December 31	
2005	$2,119,000
2006	1,629,000
2007	67,000
2008	67,000
2009	22,000
Total minimum lease payments	$3,904,000

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 accounting and financial reporting process.

The Trustees of the Foundation, through its Audit Committee, oversee 1) the organization's financial and accounting policies, practices and reports, 2) the system of accounting and related internal controls and the competence of persons performing key functions within that system and 3) the scope and results of annual 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 annually on the financial statements, and the auditors have direct access to the Audit Committee with and without the presence or knowledge of management.

In response to recommendations and regulations stated in prior years 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 and maintained 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 public company recommendations and regulations where appropriate. The charter referred to above 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 potentially requiring enhancement and/or clarification. This effort is continuing in light of the audit committee and internal control provisions included in the Sarbanes-Oxley Act of 2002, and the related Securities and Exchange Commission's and Public Company Accounting Oversight Board's rules. A current version of the Audit Committee's charter is available through the office of the Foundation's 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

Robert E. Denham, Chairman and President
Financial Accounting Foundation

Joseph LaGambina

Joseph S. LaGambina, Executive Vice President
Financial Accounting Foundation

To the Board of Trustees of the
Financial Accounting Foundation

We have audited the accompanying statements of financial position of the Financial Accounting Foundation as of December 31, 2004 and 2003, 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, 2004 and 2003, 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.

McGladrey & Pullen, LLP

New Haven, Connecticut
February 15, 2005

Financial Accounting Foundation

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