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Director
Financial Accounting Standards Board

Re: Comments on—Proposal: Principles –Based Approach to U. S. Standard Setting

1. In principle I support the move to a principles-based approach to standard setting. Conceptually it is superior to the historic US approach and, realistically, it is time to join the rest of the world. However, I am not confident that there will be a quantum improvement in accounting.

2. I believe the FASB and other standard setters have bought into a fundamentally flawed theory or philosophy of accounting. The “decision-usefulness” theory of accounting is a “grounded theory” which is the result of data in search of a rationale. I suggest the FASB read George Staubus’s book, *The Decision Usefulness Theory of Accounting (2000)*, (ISBN: 0-8153-3444-3). In it he takes credit for initiating the concept during his dissertation research in the 1950’s. He suggests that the theory came from his observation that accounting apparently was being done for some purpose and it seemed to be useful in decision making. Thus, the “decision usefulness” theory was born. This is hardly an intellectually disciplined approach to theory building. Moreover, it seems to me a bit presumptuous on the part of accountants to assume they know what data is informative, what decision makers need to know, and what the decisions are.

3. The FASB and its forerunners, since the mid-1930’s, have also bought into the idea that the focus of the work of accountants is financial reporting: the preparation of tightly structured financial statements and highly technical, frequently obtuse disclosure.

This idea has its roots in the Securities Act of 1933 and the Securities and Exchange Act of 1934. There is a historic, implicit assumption, unproven in research, that financial statements and related disclosures communicate in a useful, meaningful way. In my opinion, if the Jenkins' Committee report is looked at carefully and objectively, without making excuses for the inadequacies of financial reporting and GAAP, it reveals that the current reporting model does not communicate effectively and the usefulness of the alleged information contained in the reports is dubious. I suggest that the current model is far less successful in providing information useful for decision making than we would like to admit.

4. In my opinion, the FASB would do accounting, accountants, managers, investors, creditors, and the global financial markets a real service, if it returned to the historic purpose of accounting: providing data useful for evaluating the stewardship of management. That is, accounting is done to enable accountability. The need has not changed since the parable of the talents in the Bible.

5. The current model reflects its origin in a different era philosophically and technologically. From the nineteen-thirties forward professional accountants have delivered accounting rules and procedures based on their belief that they knew best what was needed in the way of financial, entity based accounting and economic information for decision making. We have believed that the entity had to prepare that information for the readers/users, because there was no practical way technologically to provide the information in any other way. This is the classic "producer mentality". There is little substantive evidence that the situation has changed in the post Jenkins' Committee Report period. The evidence from the Jenkins' Committee Report is that accountants do not know what users need, except in a very broad, generic way. Furthermore, XBRL, The Internet, and modern tele-communications and computer technology have enabled direct data distribution. Essentially, accountants can now focus on getting the data right and providing an explanation for what was done and why. The problem of "reporting" should be shifted to the user, who can shape reports that communicate and inform in

direct response to their needs. If the data is correct and the reports are misleading or wrong, the user has only him/herself to blame.

6. Rules do not make for good information or data, nor will a “principles-based” approach to standards. Principled people make the difference. Rules provide a screen behind which bad people can do bad things. Good accounting rules, GAAP, did not protect society from the bad people at Enron, Worldcom, or any company that choose to engage in fraudulent business reporting. If the focus of accountants and public auditors had been on monitoring and reporting on the stewardship of managers, holding them accountable for their performance, would we be dealing with the consequences of Enron, et al? Would we, the US taxpayers have had to provide hundreds of billions of dollars, to cover the losses related to the savings and loan debacle? I think not.

7. In my opinion, it will be very difficult to establish a principles-based approach to accounting. It will be hard to find people of principle to do the work. It will be even more difficult to find people of principle who will implement the standards in practice. The FASB’s commitment to “due process” is a nice idea, but the consequence is mediocrity at best and prostitution at worst.

8. I am not at all confident that there is much of a constituency for principles-based anything. We have become accustomed to expediency and short-term self-interest. The performance of the FASB in terms of dealing with issues of importance, e. g. price-level accounting, the accounting for SPE’s, accounting for derivatives, etc. is disappointing and indicative of an unwillingness or inability to get serious and get real.

9. On a more general, principles-based view of accounting, auditing, and regulation, the failure of the FASB and the AICPA to demand the resignation of Harvey Pitt and demand the appointment of a tough, knowledgeable, energetic head of the oversight board is dismaying. It would appear that there is little real, affective interest in principles and the public interest in the US or internationally, for that matter. In April of 2002, at the European Accounting Association Congress in Copenhagen, one of the leaders of the

International Auditing Standards Committee was asked (by me): what is the public interest? The cynical answer: "Keeping the regulators happy." I am not optimistic that there is much interest internationally in a principles-based approach to accounting or auditing either.

10. I have attached several research papers that I have been involved in. They discuss various aspects of financial reporting. You might find the content illuminating.

1. The Jenkins Committee Report: Success and Failure--Where Do We Go From Here? (1997)
2. Toward Global Generally Accepted Financial Accounting Principles (2000)
3. The Failure of Accounting Research to Improve Accounting Practice: A Problem of Theory and Lack of Communication (with Figures in a separate file.) (2001)
4. Cost With Time Can Yield Reliable AND Relevant Financial Accounting Information (2002)

Sincerely,

Wm. Bruce Schneider