

R.G. Associates, Inc.  
Investment Research/Investment Management  
201 N. Charles Street, Suite 806  
Baltimore, Maryland 21201

Jack T Ciesielski, CPA, CFA  
President

Phone: (410) 783-0672  
Fax: (410) 783-0687

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Ms. Susan Bielstein  
Director, Major Projects & Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

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Ms. Bielstein,

I wish to comment upon the FASB's proposal on a principles-based approach to U.S. standard-setting. Allow me to first remark upon on the circumstances surrounding this project. The past year has seen an astonishing number of business failures in a variety of different U.S. industries. In many cases, members of the accounting profession inside the failing firms or in the role of their auditors facilitated the failures - sometimes directly, sometimes indirectly. In response to being held culpable, many members of the profession - including the American Institute of Certified Public Accountants itself - embraced the "don't blame us, the system is what's broken" defense. The non-consolidation of certain subsidiaries at Enron because of an obscure, quirky rule (a point of endless fascination in the business press) has raised the possibility that perhaps there is something we might be doing better here in the United States when it comes to standard-setting. For years, accounting practitioners have bemoaned "standards overload," and perhaps those practitioners see in this proposal the path to a standard-setting regime that will issue less onerous standards. With perfect 20/20 hindsight, many investors and other interested observers have completely bought into the principles-based standards argument on the grounds that had such standards been in place in the United States, a debacle such as Enron (or others of 2002 vintage) could not have happened. The thinking goes like this: principles-based standards have been in use in the United Kingdom and in countries where International Accounting Standards Board standards are required - and there have been no similar financial catastrophes where standards of this ilk are in effect.

I believe that all of these justifications for moving to a principles-based standard setting approach grossly oversimplify matters or merely shift blame to another party. There's simply no way in the world to know whether or not capital would have been wasted in the same way had a different approach to standard-setting been in effect. (In fact, one could very easily argue that because principles-based accounting standards are open to interpretation by the preparer and auditor, there could have been even more accounting gamesmanship.) It's true that other countries employing principles-based standards have had no similar accounting meltdowns - but that isn't necessarily the reason. Little consideration is given to the fact that those countries do not have the same kind of capital market dynamics as the United States, dynamics that include a corrupting influence on managements to "make the numbers" four times a year and surpass market expectations (after doing all that was legally possible to set those expectations.) There has been a certain blood sport in the markets in the past decade that transcended how accounting standards have been developed. If accounting standards had been set by God on a principles-based approach and recorded by Moses on stone tablets in the 1990's, I think they'd have been applied in equally playful fashion in the United States. I can't

prove it - but neither can those who declare that excesses wouldn't have been possible under a principles-based approach.

If accounting standards have become overly complex, it's largely a reflection of the transactions being accounted for. Standards overload? Tell investment bankers to stop trying to innovate ways around the corners of accounting standards, whether principles-based or "rules-based." You can't do it; you might as well try to put a genie back in the bottle. Also, complaints about standards overload are a bit odd coming from accounting firms that offer management consulting services: how can they advise others on the complexity of running their businesses, when they profess to be unable to manage the complexity of running their own auditing businesses?

If an accounting standard produces relevant, useful information for investors, it doesn't matter whether it's "rules-based" or "principles-based." Some transactions might be better addressed using one approach than the other. For instance, accounting for pensions is a very rules-based area, and currently one that is subject to much debate. The debate doesn't concern whether or not a company made the necessary accounting for the pensions or if instead it skirted the accounting: much of the debate is over assumptions used by companies, a debate that can occur because the prescriptive requirements of Statement No. 87 made similar transactions at different companies accounted for in similar fashions, and disclosed them in an equivalent manner. If a less prescriptive approach had been used in crafting Statement No. 87, there might be a lot more confusion about pension accounting than already exists. Requiring all future accounting standards to be principles-based might be a short-sighted approach to standard-setting; it would be as if a tailor decided to make only one size of pants for all his customers.

No matter what approach is used to develop an accounting standard, if its execution is handled poorly by practitioners there will be no benefit to financial statement users. One outcome of any move to a principles-based approach would be greater use of judgment, on the part of both preparers and auditors, in applying standards. I cannot believe that auditors will prefer less guidance over more guidance and interpretation unless there is a significant change in the way lawsuits are conducted in the United States. So far, I am unaware of any changes in the legal environment that would make that happen.

In sum, I don't believe that the Board should move to a completely principles-based approach at this time. I would recommend that the Board considers toughening up scope exclusions and alternative accounting treatments as it develops new standards - success in that regard might alleviate some of the problems that have given rise to the debate over principles-based standards versus "rules-based" standards. My reasons are more fully explained in the following responses to the proposal's questions.

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**1. Do you support the Board's proposal for a principles-based approach to U.S. standard setting? Will that approach improve the quality and transparency of U.S. financial accounting and reporting?**

I support the proposal insofar as it means the development of accounting standards with fewer (or no) exceptions to their application. In short, a more disciplined approach to setting standards by limiting scope exceptions and alternatives that permit smooth reporting of operating results is what's needed. That alone would improve the quality and transparency of U.S. financial reporting. I do not support a principles-based approach if it means less prescriptive standards merely for the sake of artificial simplification to appease those who decry "standards overload."

**2. Should the Board develop an overall reporting framework as in IAS 1 and, if so, should that framework include a true and fair view override?**

The Board should develop an overall reporting framework as in IAS 1, as part of a concepts

improvement project which should address the conflicts between Statements 5 and 6 mentioned in the proposal and a framework for developing disclosure requirements.

Any overall reporting framework developed by the Board should not include a “true and fair override.” In the United States, such an override mechanism already exists in Rule 203 of the AICPA Code of Professional Conduct. Writing it into a concept statement would be redundant.

**3. Under what circumstances should interpretive and implementation guidance be provided under a principles-based approach to U.S. standard setting? Should the Board be the primary standard setter responsible for providing that guidance?**

As mentioned earlier, when the circumstances call for it, a standard might necessarily be prescriptive in nature anyway. It depends on the nature of the issue being contemplated by a proposed standard. (Recall the example with Statement No. 87.) Even if all standards are principles-based in the future, when additional guidance is required I would prefer to see it developed by the FASB. Logically, one would expect the implementation guidance to be more consistent with the intent of the standard if it is developed by the same player, rather than de facto standard-setters.

**4. Will preparers, auditors, the SEC, investors, creditors, and other users of financial information be able to adjust to a principles-based approach to U.S. standard setting? If not, what needs to be done and by whom?**

I don't believe that the entire U.S. financial reporting system is ready yet for a full-scale move to a principles-based approach. I believe that preparers would be able to handle a principles-based approach better than most other parties - that is, until it becomes necessary for them to interact with their auditors and the Securities & Exchange Commission. To have an effective principles-based approach, the system would need an assiduously independent auditing profession, one that would be unafraid of exercising judgment on the application of accounting principals without fear of reprisal from management - or having their judgment second-guessed by the SEC. The auditing profession as we know it today has been the butt of much criticism for its closeness to audit clients through its consulting businesses; its relationship with the SEC has also been strained in recent years. Neither situation is conducive to the kind of atmosphere I believe would be needed to make a principles-based approach effective. The inability of these two parties (auditors and the SEC) to handle a principles-based approach is enough to make it unworkable at this time.

Through the implementation of the Sarbanes-Oxley Act, the entire auditing profession is going through its most thorough overhaul since the creation of the Securities & Exchange Commission. Until we see the “new” auditing profession in action, and are able to examine its workings with the SEC and the Public Companies Accounting Oversight Board, moving to a completely principles-based approach at this time seems ill-advised.

As for creditors, investors, and other users of financial statements: I believe that they would have difficulty adjusting to a total principles-based approach. It sounds appealing to many of them at this time because they believe, rightly or wrongly, that it might have prevented certain “trick” accounting treatments from happening, such as non-consolidation of special purpose entities. (An earnest application of existing accounting standards might also have accomplished the same thing.) A total principles-based approach might also yield non-comparable results where users had expected consistency and relevance - and I think that most of them would find that unacceptable. A principles-based approach might also yield financial reporting that results in spikier reported earnings. For example, if Statement 133 was principles-based to the point where there were no hedging devices allowed and all derivative financial instruments were carried at fair value with changes in fair value were reflected in earnings, the result might be a more realistic - and more volatile -

depiction of earnings. Personally, I would consider this a vast improvement: accounting is supposed to show what happened, not what we would have liked to have happened. I believe that there are many other users who would accept increased volatility in earnings, if it means more truth in reporting events. It's not certain that all users will always accept increased transparency when it causes volatile earnings. That doesn't mean that truth in reporting should be suppressed or smoothed; my only point is that there could be more of an adjustment for users to make in adapting to a principles-based world than they currently perceive.

(Typically, preparers of financial statements profess to speak for users when they petition FASB for exclusions and alternative accounting treatments.)

**5. What are the benefits and costs (including transition costs) of adopting a principles-based approach to U.S. standard setting? How might those benefits and costs be quantified?**

I am not convinced that a complete adoption of a principles-based approach would have more benefits than costs under the current auditing and regulatory system in place today.

**6. What other factors should the Board consider in assessing the extent to which it should adopt a principles-based approach to U.S. standard setting?**

I think the most important factor is to see what kind of auditing/regulatory system emerges from the implementation of the Sarbanes-Oxley Act before rushing to a new standard-setting regime.

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That concludes my remarks on the proposal. If you have any questions, please do not hesitate to contact me. Best regards.

Sincerely,



Jack Ciesielski