Stacey Sutay

Subject:

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----Original Message----

From: Jingwei Liao [mailto:jliao@horizon.csuhayward.edu]

Sent: Friday, March 19, 2004 2:59 AM

To: Director - FASB

Cc: dsatin@csuhayward.edu

Subject: File Reference 1200-400

Dear MP&T Director,

I am a student in an accounting theory class at California State University, Hayward, and I have read the exposure draft of "Accounting Changes and Error corrections—A Replacement of APB Opinion No. 20 and FASB Statement No. 3". I believe this draft will improve accounting practices.

First, this draft requires retrospective application for the cumulative effect of changes in accounting principle. This will benefit most of the accounting information constituencies.

For managers, recording the accumulative effect of accounting changes in net income of the period of the change under the opinion 20 results in a dramatic decrease or increase in the reported net income in the period of the change. However this change is not a result of manager's operation in that period. This makes net income of that period a less hard measurement of manager's effort. However, manager's bonus will still be based on the reported net income, which reflects the carryover effects of previous periods instead of her/his real contribution in the current period. Under the new draft, the cumulative effect of changing accounting principles will be retrospectively applied over applicable periods. This way managers' bonus will be more closely related to their performance.

For investors, recording accumulative effect into one period makes investors difficult to assess the company's current financial performance. Retrospectively applying the cumulative effect improves the comparability among different periods. This help investor better assess firm's financial performance over time, and make it easier for investors to predict firm's future performance. Moreover, this draft increases convergence with the proposed international financial reporting standards. This makes it easier for potential international investors to compare financial statements between international companies, and helps them make better investment decisions.

For the firms, following the new draft will result in smoother reported income. Smoothed income reduces the probability of debt violation. Moreover, companies with smoothed earnings are often rewarded by securities market in the form of higher stock price, because smoothed earnings allow investors to make a better prediction of firm's long run value.

Second, this draft offers specific guidance for implementation. It not only specifies the situation under which retrospective method is applicable. This proposed statement also makes the retrospective application the presumed transaction method for new accounting standards, which clarifies the accounting practice for the issuance of a new accounting pronouncement which is not covered in Opinion 20.

However, I still think this exposure draft has some room to improve. Although this exposure draft gives guidance for the application of retrospectively allocating the cumulative effect of the changing accounting principles, it does not give detailed guidance on how to determine the situation under which it is non applicable. This gives room for management's manipulation. For example, for IOP firms, if the cumulative effect of changing accounting principle is positive, they have an interest not to use the

retrospective method because doing so would reduce the net income of the current period. They may take advantage of ambiguities concerning the applicability of the retrospective method. To avoid this type of manipulation, the new draft should be more specific about the situation under which the retrospective method is required, and under which alternative methods should be used.

In general, I think this exposure draft will enhance accounting practices by improving comparability and the quality of financial reporting. However, more attention should be given to distinguish between applicable and non-applicable situations.

Sincerely, Jingwei Liao