----Original Message----

Letter of Comment No: 126

File Reference: 1125-001 Date Received: 1/8/03

From: <u>John.McEnerney@banking.state.ny.us</u>

[mailto:John.McEnerney@banking.state.ny.us]
Sent: Wednesday, January 08, 2003 11:56 AM

To: director@fasb.org

Subject: File Reference 1125-001: Response to FASB proposal for a

principles-based approach to U.S. standard setting

The New York State Banking Department (the Department) appreciates the opportunity to respond to the Financial Accounting Standards Board's (the Board's) proposal for a principles-based approach to U.S. standard setting. The Department agrees with the need to replace standards filled with detailed rules and exceptions in favor of standards based on broad principles. Such principles must be clear to avoid the ambiguities as currently seen in the Financial Accounting Concepts Statements. The Department has pushed for such an approach in its recent responses to the Board on proposals relating to derivatives and consolidation of special-purpose entities.

Responses to the specific questions raised in the proposal follow.

## 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?

The Department supports the Board's proposed approach. Quality and transparency will be improved by making preparers and auditors rely more on logical thinking and good judgment than on research and analogizing skills. The success of a transformation to broader principles will depend on all interested parties, but especially independent auditors, to "step up" to the challenges required by this cultural change. One likely casualty will be comparability between financial statements. However, comparability should improve over time as the approach becomes more accepted and ingrained.

## 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?

An overall reporting framework would be beneficial by helping all interested parties understand the context of principles-based standards and accounting in general. The framework should include several key observations: (1) accounting must recognize the economic substance of transactions over their form; (2) any accounting regime more sophisticated than a cash basis standard contains numerous judgments and estimates on which parties in good faith may disagree; (3) all accounting standards are subject to manipulation; (4) questionable or aggressive accounting cannot be justified by the lack of explicit guidance prohibiting such specific accounting; and (5) footnote disclosures must focus on current, key information.

While the principles-based approach should greatly reduce the need for a true and fair override, the Department does not object to including the override from American Institute of CPAs Rule 203.

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?

Guidance, when determined to be needed by the Board, should be kept limited and broad. The Board should issue guidance when widespread practices are inconsistent with standards. Concise standards supplemented by extensive implementation guidance will make the approach more about semantics than substance. The Board should be the only recognized body to provide such guidance. Otherwise, the Board's efforts will be impaired by de facto rules from various sources.

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?

The Department expects a difficult cultural change. However, the difficulties involved should not deter the Board from taking this necessary and significant step. All parties involved, but especially the Board and the SEC, need to establish and strengthen the importance of independent auditors' good faith judgments to provide auditors with an adequate defense against litigation based on second-guessing their judgment. The good faith judgments of preparers and auditors should be explicitly disclosed within financial statements. The SEC and other regulators need to accept some diversity in practice based on good faith judgments of preparers and auditors, while strongly disciplining those preparers and auditors who distort financial reporting.

Principles-based standards will require extensive educational support in colleges and in continuing professional education.

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

The primary benefits will come from having financial statements that are more understandable and more closely reflect actual economics. This is especially important in order to restore credibility to accounting and financial reporting in the wake of recent scandals. An additional benefit will be to more closely align U.S. and international accounting standards. Costs will include missteps in the early transition stage, losing some comparability between institutions, and the expense of retraining financial statement preparers, auditors, and users to implement and understand the new approach. The Department does not believe that benefits or costs can be fully and accurately quantified.

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?

A primary question the Board will need to ask is whether to achieve the shift to principles-based standards in a gradual or a swift manner. While the Board may be

advised to allow ample time for a new approach, once the Board moves toward principles-based standards setting it should be able to move quickly to make this approach effective.

Please feel free to contact John McEnerney, Chief of Regulatory Accounting, by phone at (212) 709-1532 or by email at <a href="mailto:john.mcenerney@banking.state.ny.us">john.mcenerney@banking.state.ny.us</a> if you would like to discuss our views.