

Memo

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To: **Financial Accounting Standards Board**
Date: January 03, 2003
From: Bruce L. Pepchinski
Subject: **FASB – Proposal For a Principles-Based Approach to U.S. Standard Setting**

The proposal to move to a principle-based approach in setting accounting standards is a move in the right direction. The profession must allow properly trained and experienced public accountants to embrace basic accounting principles and develop interpretations or rules of engagement based on industry specific needs and practices, as well as the changing financial market place.

The recent Corporate scandals have little to do with improper accounting standards or principles, and are rooted in the failures of accountants and other financial disciplines to stand by existing principles notwithstanding the impact on earnings or market performance.

Integrity, objectivity and competence must be present to allow the principles of accountancy to be applied in the business environment. Without those attributes, your entire standard setting processes will be for naught. Accountants should not be subjected to a “color by the numbers” approach. Rules and interpretations are the healthy adjuncts of a principle based profession, but must not govern the underling concept.

Basic accounting principles today and in the distant past have always specified the theory upon which revenue is to be recognized, expenses recorded and assets and liabilities valued. These principles or concepts must be reaffirmed. These principles must allow for interpretation in unique environments no different from what is experienced in other professions today (legal, medical ctal).

It is important for professional accountants to be allowed to apply principles to given situations. If we take for an example the extractive industry, we have two basic expense recognition alternatives for intangible drilling costs (successful efforts or full cost). While these do not represent principles of accounting, they do present alternative methods of expense and asset recognition. While the application of these alternative methods will provide for very different earnings impact in certain phases of a project, if consistently applied and properly disclosed informed readers can interpret the data. Here, we expect accountants, auditors and financial officers to implement a costing method based on a sound principle of expense recognition, consistently apply it and disclose the relevant details to the public. This perhaps is a good

example of the interdependencies between basic principles (expense recognition and asset valuations.)

Principles based standard setting allow accountants to practice accountancy as an art of communication, rather than based upon an empirical approach often associated with a science.

As an initial step the standard setting body of the profession must be in one place, bipartisan and without affiliations (political, corporate etal). The next step would be to reaffirm our conceptual framework and begin the process albeit long-term to review the codification of our current accounting standards in a principles based structure.

Our alliance with the IASB should be reaffirmed but I am questioning their ability to influence local county practices. We are currently seeing nationalism exert its unfortunate influence in certain European countries.

One final and perhaps controversial point, interpretive guidance should be provided in a manner with patterns better letter rulings from the SEC and the IRS. These are generally client and issue specific. Implementation guidance should be issued as well by the FASB, but as general and practical data in response to specific questions of principles rather than of industry application.

These views are those of the author and no way represent the views of Marsh & McLennan Companies Inc.

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