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Ms. Suzanne Q. Bielstein
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Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Attn: File Reference No. 1125-001

RE: Proposal: Principles-Based Approach to U.S. Standard Setting

Dear Ms. Bielstein:

America's Community Bankers ("ACB")¹ is pleased to offer comments on the Financial Accounting Standards Board's ("FASB") Proposal: Principles-Based Approach to U.S. Standard Setting, dated October 21, 2002.

ACB Position

ACB appreciates FASB's objectives in developing a principles-based approach to standards setting in order to improve the quality and transparency of accounting and financial reporting in the United States. ACB agrees that the accounting and financial reporting system must present financial information that reflects the underlying economics of transactions. The financial reporting system must be flexible enough to enable users of financial statements to understand the value and risk exposures in business enterprises rather than rely on a system that adheres to an inflexible formal structure.

While a principles-based accounting framework is attractive in concept, there are numerous practical issues that raise concerns and need to be addressed before adoption. Rather than immediately embracing a new principles-based framework, ACB urges FASB to retain and improve the current system and recognize that a substantial transition period would be required should FASB move to a more "principles-based" standards-

¹ ACB represents the nation's community banks of all charter types and sizes. ACB members, whose aggregate assets exceed \$1 trillion, pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities.

setting framework. Specifically, ACB urges retaining substantial guidance and interpretation that helps users and preparers of financial statements. ACB also recognizes that there will continue to be circumstances in which exceptions will need to be granted under any financial accounting system. Both users and preparers find value in such guidance as it increases the likelihood that similar transactions will be accounted for in a comparable manner. ACB is concerned that minimal guidance will place smaller enterprises, including community banks with limited resources, at a disadvantage in applying standards in a principles-based regime. In addition, ACB encourages FASB to provide examples and clarifications of what is meant by “principles.” Regardless of the changes FASB makes in the standards-setting approach, ACB requests that the organizations engaged in the standards-setting process, including FASB and the Securities and Exchange Commission (“SEC”), coordinate policy making among themselves and with the bank regulators. Finally, we agree with the remarks recently made by FASB Chairman Herz to a group of ACB members. He made a persuasive case that a principles-based system should be adopted only after thorough consideration of all the issues involved and after the concerns of all parties have been addressed.

Agreement with FASB Objectives in Developing a Principles-Based System

ACB agrees with the objectives as outlined in the introduction to the proposal. The system of accounting standards and its underlying conceptual framework must help present and potential investors, creditors and others make investment, credit, and other similar decisions. Such information needs to be relevant and reliable. To be relevant, the information should help users of financial information to predict future outcomes and confirm prior expectations. To be reliable, the information must represent economic activity in a manner that is faithful, verifiable and economically neutral with respect to the transactions being reported. Consistent with the objectives of relevance and reliability, economic activity and transactions should be reported in a comparable manner. That is, to quote from the proposal, “Comparability is achieved when similar transactions are accounted for similarly and different transactions and events are accounted differently.” (Page 1)

ACB agrees that it is increasingly difficult for the accounting profession to deliver on these objectives within a framework that is more detailed and complicated. These challenges, though, are a reflection of the complexity of today’s capital markets and transactions. Accounting standards must provide the flexibility to enable preparers to accurately represent the details of such transactions and events.

Continued Guidance and Interpretation is Necessary

Despite the articulated advantages of a principles-based system, we remain skeptical about the degree to which a purely principles-based accounting standards-setting regime will lead to clearer and more transparent financial presentations and disclosures in practice. At the outset, we should also state our conviction that, regardless of the accounting regime, the quality of the auditing process, as well as corporate governance, remains the significant issue in effective financial reporting. Quoting Governor Susan

Bies of the Federal Reserve's Board from a speech entitled "Effective Accounting and Disclosure" on November 7, 2002, "Successful implementation of a principles-based approach is, however, dependent on cultural changes occurring in the accounting and auditing profession and effective oversight. Without these two factors, a principles based approach could easily be used as the basis for manipulating financial information for reasons other than improving its quality and transparency. Principles alone, however, can not ensure good financial reporting, which leads me to the integrity of the audit process."

In a sense, the present accounting system has always been principles-based, that is, it is based on a guiding set of accounting standards based on a set of underlying concepts. Over time, the accounting standard-setters have added interpretations and clarifications in large part to reduce the potential for abuse and confusion.

As the goal of accounting and financial reporting is to reflect accurately the economics of transactions and business enterprises, we want to ensure that a principles-based approach does not restrict the flexibility necessary to present economic events in a dynamic capital markets environment characterized by financial innovation and new product development. A principles-based system should not eliminate accounting alternatives that best represent the substance of a transaction. Thus, we are convinced that it will be necessary to allow for selective accounting exceptions. Should a principles-based framework be adopted, a "true and fair view override" should be included as is in place in the International Accounting Standard (IAS) 1 (Revised): Presentation of Financial Statements. This is an exception from compliance with a requirement that would be "so misleading that it would conflict with the objectives of financial accounting and reporting". (Page 7, Footnote 5)

Guidance and interpretation of accounting principles will continue to be needed. Both financial statement preparers and users benefit from specificity provided though such advice, because it leads to comparable accounting treatment for similar transactions. An elimination of guidance and interpretation is likely to result in different firms and auditors treating the same transactions differently. Until changes in behavior and oversight of the auditing process is in place, the removal of interpretation and reliance on principles also will expand the potential for abuse.

It is important that a mechanism remain in place to provide guidance and clarification by the standards-setters. In that regard, we are pleased to see in the proposal the statement that "The Board would need to establish guidelines sufficient to identify situations in which interpretive and implementation guidance is appropriate." (Page 9) In fact, it is our view that the level of interpretive guidance is likely to be greater than is contemplated in the proposal. Understanding the importance of the accounting and auditing profession to exercise sound judgment, the recent volume of interpretive rulings reflects the importance of guidance provided in recent years. The need for further clarification because the development of both Statement 133 and Statements 141 and 142 speaks to this point.

The absence of interpretive guidance creates at least three types of risks. First, for a financial presentation to be beneficial to investors and other users of financial statements,

similar transactions should receive comparable accounting treatment. Minimal guidance opens the way for diverse interpretations of accounting standards. A second risk is that, in the absence of guidance, as the proposal discusses on page 9 under the section “Benefits and Costs”, a de facto class of standard setters of larger companies who have the resources to invest in opinions through their auditors may emerge. This type of “standards-setting” would operate without the current system of due process. Such an environment would lead to a set of “rules” developed by large organizations potentially to the disadvantage of smaller enterprises, including community banks. A similar plausible scenario may be the development of two sets of accounting standards, one set of standards for large audit clients able to invest in standards-setting and risk analysis, and another set for smaller firms unable to make such an investment. A third risk is that the proposed principles-based approach scenario may result in extremely conservative, as opposed to fair, application of principles by audit firms in order to avoid adverse reaction from banking regulators, the SEC, and plaintiffs’ attorneys.

We are concerned about the transition from a rules-based to a principles-based system. During that interim period, we may be operating under a hybrid system – part rules-based and part principles-based – which may cause a great deal of confusion and uncertainty in the accounting profession. In addition, to implement a principles-based standards-setting system, FASB will need to develop new concept statements. To do so will require FASB to invest substantial resources, which may delay issuance of additional and necessary interpretive guidance on existing standards. In such a transition, we question whether preparers and standards-setters will be able to use and rely on the existing literature and conclude that more time is needed prior to adoption.

Clarify What is Meant by Principles

To better understand the effect and result of a principles-based approach envisioned by FASB, ACB requests examples of “principles” and clarification of what is meant by “principles”. It may very well be that certain “principles” are not universally applicable to all industries. Take the example of “fair value accounting”, an issue that has been on the FASB agenda for some time. In August 28, 2002, the FASB tentatively adopted a new work plan which reflects an accelerated effort to publish a new accounting standard on disclosures about fair values of financial assets and liabilities with the intention of writing rules to be effective at the end of 2003.

The fair value concept, though, is not applicable to most of the assets and liabilities on a bank’s balance sheet. Any valuation method for customer loans or deposits, which does not consider the full value of the customer relationship, fails to provide objective, reliable and comparable measurements. Both loans and deposits and their inherent relationships are fluid in a very complex relationship to global and local economic conditions. The complexity of the relationships between financial institutions and their customers may make it impossible to develop a simple, reliably reproducible methodology that can enhance the usefulness and comparability of financial statements. The intellectual and conceptual problems involved in measuring the fair value of customer relationships may result in loans and deposits being valued solely on the basis of the present value of

estimated cash flows. Such an approach would be incomplete, misleading and not indicative of the actual value of an institution's account bases.

Standards-Setter Coordination

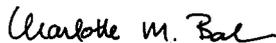
The proposal refers to the number of organizations currently involved in offering interpretive rulings. The affected organizations include Accounting Standards Executive Committee of the AICPA ("AcSEC"), the Emerging Issues Task Force ("EITF"), Derivatives Implementation Group ("DIG") and the SEC. Regardless of the standards-setting structure that emerges, ACB strongly urges coordination among the bodies participating in the accounting standard setting process as well as coordination with the banking regulators.

In addition, for a principles-based approach to be implemented, it would require all participants in the capital markets to accept the outcome of the standards-setting system that provides less interpretive guidance and leaves more accounting policy implementation to judgment. Specifically, a greater reliance on judgment with less interpretive guidance will have an effect on SEC enforcement action and related litigation. This set of issues would need to be resolved before a principles-based system could be implemented.

In conclusion, a principles-based system is an attractive concept and would appear to offer the opportunity for a more easily understood and flexible system. Yet, implementation raises significant practical challenges. We cannot envision an accounting system that does not require a good deal of interpretive guidance. Furthermore, the required "culture change" in the accounting industry, auditing industry oversight and corporate governance issues should not be minimized. At best, a transition to a principles-based system must be viewed as a long-term project. It is not a panacea, and would require a substantial transition period, if adopted.

We appreciate having this opportunity to present our views to FASB. Please contact Steve Davidson at (202) 857-3158 or sdavidson@acbankers.org regarding questions or clarification of our views.

Sincerely,



Charlotte M. Bahin
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Senior Regulatory Counsel