



Letter of Comment No: 105
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Suzanne Q. Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 1125-001 *Proposal
for a Principles-Based Approach to U.S. Standard Setting*

Dear Ms. Bielstein:

The Association for Financial Professionals (AFP) welcomes the opportunity to comment on the *Proposal for a Principles-Based Approach to U.S. Standard Setting*. As the voice of the corporate finance and treasury profession, AFP supports the transition to a principles-based approach to U.S. standard setting.

A principles-based approach will help companies, auditors, and investors by reducing the complexity of accounting standards and increasing the quality, consistency and clarity of financial reporting. The well-documented accounting frauds of the past 12 months have shown that complex rules do not necessarily ensure that companies properly account for transactions. The crisis in confidence in today's markets is partially driven by complex accounting standards that have contributed to corporate malfeasance. AFP believes that principles-based accounting standards should help capture the economic substance of transactions because companies and their auditors will use professional judgment in determining how to apply the principles. Under a principles-based approach, there still will be a need for some interpretative and implementation guidance, due to the complexity of business arrangements. However, this alternative is preferred to the bright-line "rules-based" approach to standard setting, which we believe encourages more aggressive accounting.

The membership of AFP includes approximately 14,000 financial executives employed by over 5,000 corporations and other organizations. Our members represent a broad spectrum of financial disciplines; their organizations are drawn generally from the Fortune 1000 and middle-market companies in a wide variety of industries, including manufacturing, retail, energy, financial services, and technology. A significant number

of AFP members have a role in preparing and/or analyzing financial statements. AFP supports members throughout their careers with research, continuing education, career development, professional certifications, publications, representation to key legislators and regulators, and the development of industry standards.

Principles-Based Approach to Standard Setting

Under a principles-based approach, the Financial Accounting Standards Board (FASB) would issue broad accounting standards based on principles and fundamental concepts found in FASB's conceptual framework of accounting. Standards would have a limited amount of implementation guidance and few, if any, exceptions.

Preparers and auditors would be required to exercise professional judgment in applying principles-based standards. This application of judgment in the public interest is the difference between a technician and a professional. We believe that this professional judgment will result in more transparent financial reporting that better captures the economic substance of transactions, which is the underlying goal of accounting.

Under the current rules-based approach to standard setting, accounting standards include general principles to be followed. Rules-based standards, however, often contain a high level of interpretative and implementation guidance. The purpose of very specific guidance is to ensure comparability of accounting among companies, describe exceptions, and attempt to detail the accounting treatment for every possible circumstance. Exceptions create complexity because of the need to specify and limit the transactions that are exempt.

This level of specificity often leads to "financial engineering," -- designing a transaction so that the form exempts it from a perceived unfavorable accounting treatment even though in substance the transaction should be covered. For example, complex financial transactions have been developed for special-purpose entities (SPEs) which take advantage of accounting rules and enable companies to remove debt from their balance sheets. (A soon-to-be finalized FASB rule addresses this issue.)

Conceptual Framework of Accounting

According to FASB, its conceptual framework is a coherent system of interrelated objectives and fundamentals that is expected to lead to consistent standards. The framework also prescribes the nature, function, and limits of financial reporting. The framework consists of six Concepts Statements on the objectives of financial reporting, elements of financial statements, and recognition and measurement in financial statements. The Concepts Statements are expected to be the basis of future principles and standards.

AFP believes that there is a need for FASB to improve the Concepts Statements in order to enable a transition to a principles-based approach. First, there are internal inconsistencies. For example, Concepts Statements 5 and 6 have different definitions of revenue. Second, there is not a complete body of knowledge within the Concepts

Statements. FASB has noted that Statement 2 does not provide conceptual guidance for making tradeoffs among the qualities of reliability, relevance, comparability and consistency. Third, there is no framework in the Concepts Statements for developing disclosure requirements.

The transition to a principles-based approach must be accompanied by more widespread dissemination and use of the Concepts Statements. FASB acknowledges in the prefaces to Concepts Statements that FASB itself is likely to be the most direct beneficiary of the guidance. However, the successful application of principles-based accounting standards will depend on the exercise of professional judgment in the public interest. Therefore, preparers and auditors will need an understanding of the Concepts Statements to use as guidance in analyzing new or emerging financial reporting issues.

Oversight of Development of Interpretive and Implementation Guidance

A principles-based approach to standard setting should reduce the amount of interpretative and implementation guidance needed. However, due to the complex nature of business arrangements and fair value accounting, there will still be a need for some guidance. Like the standards, this interpretative and implementation guidance must be based on the comprehensive principles found in the conceptual framework.

FASB could develop the guidance, as necessary, or defer to current related rule-making entities, such as FASB's Emerging Issues Task Force (EITF) or the Accounting Standards Executive Committee (AcSEC), which is part of the American Institute of Certified Public Accountants. The purpose of these groups, which consist mostly of volunteer practitioners, is to establish accounting rules to resolve implementation issues that arise. To ensure consistency and adherence to principles, FASB must be directly involved in the direction and development of guidance delegated to the EITF or AcSEC.

FASB currently has a project to simplify and codify the standard setting process, a process that AFP endorses and encourages. FASB is planning structural changes to the roles, compositions, and processes of other standard-setting bodies, such as the EITF and AcSEC. FASB has proposed that, after a transition period, the AcSEC discontinue issuing broad accounting standards and only work on implementation guidance. FASB also plans to be directly involved in the EITF's agenda and deliberations and to formally ratify the EITF's final decisions.

Currently, each group (FASB, EITF and AICPA) separately publishes and distributes its literature, in print and electronic format. To improve the ability to retrieve all accounting literature on specific topics, FASB is considering whether accounting standards should incorporate, by reference, related literature issued by others. FASB also is exploring the development of an online database that will include all accounting literature.

Recommendations

As the voice of 14,000 corporate finance, treasury, and accounting professionals in all industries, AFP is concerned about all aspects of financial reporting. AFP has a special

interest in improving the accounting and reporting process because our members not only prepare financial statements but also analyze them for investment purposes. Since our members see both sides, they are especially mindful of the need for simplification in preparation of financial statements and clarity and transparency in financial reporting.

Principles-based approach to setting accounting standards. AFP believes that there should be a transition to a principles-based approach to standard setting in the United States and that FASB should be the primary entity that sets U.S. accounting standards. The application of reasoned professional judgment in the public interest will result in financial reporting that better captures the true economic substance of transactions. Financial reporting will be more transparent and of higher quality because opportunities for financial engineering will decrease. Further, principles-based standards will reduce complexity in the standard setting process and in the application of standards. We further recommend that FASB consult with other organizations that have implemented a principles-based approach, such as the American Academy of Actuaries, which represents actuaries in all practice areas.

Conceptual framework of accounting. AFP strongly encourages FASB to improve the conceptual framework of accounting by resolving inconsistencies and completing the body of knowledge. Under a principles-based approach, it is essential that there be fundamental concepts on which subsequent accounting standards can be built. In addition, the concepts will help preparers and auditors to determine the accounting treatment for transactions not covered under existing standards.

Interpretative and implementation guidance. AFP encourages FASB to continue to recognize that there is a need for interpretative and implementation guidance under a principles-based approach. FASB should allow, under its direction and approval, the EITF and AcSEC to continue to issue interpretative and implementation guidance, within clearly defined authorization and scope. These groups are closer to industry and thus will be the first to identify implementation issues. FASB's oversight will ensure that subsequent accounting guidance is aligned with the conceptual framework and existing standards. In addition, FASB should continue with efforts to develop a unified electronic database of all accounting literature. This will greatly simplify and reduce the costs of preparing, auditing and analyzing financial statements.

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On behalf of our 14,000 members, AFP appreciates the opportunity to comment on the FASB proposal. If you have any questions, please contact Gregory Fletcher, AFP's Director of Financial Accounting and Reporting, at (301) 961-8869.

Sincerely,



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