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Letter of Comment No: 30
File Reference: 1125-001
Date Received: 12/2/02

December 2, 2002

Ms. Suzanne Bielstein
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File Reference No. 1125-001
FASB Proposal – Principles-Based Approach to U.S. Standard Setting

Dear Ms. Bielstein:

Enclosed is our letter of comment on the FASB's Proposal, *Principles-Based Approach to U.S. Standard Setting*, dated October 21, 2002.

If you have any questions concerning our comments, please contact Robert Kueppers at (203) 761-3579 or Robert Uhl at (203) 761-3705.

Yours truly,

Robert Uhl
Partner
Deloitte & Touche LLP

Dear Sirs:

We are pleased to comment on the October 21, 2002, FASB Proposal, *Principles-Based Approach to U.S. Standard Setting* (the "Proposal"). We support the Board's efforts to reassess its current approach to standard setting with a view to identifying any necessary improvements. We believe a movement toward a principles-based approach will provide a stronger foundation for the convergence of accounting standards around the world.

Historically, the shaping of U.S. financial accounting and reporting standards has been a dynamic process reflecting an increasingly complex and sophisticated business environment, responses to previous abuses in financial accounting and reporting, and the impact of political/economic pressures. Increasingly competing pressures on the standard setting process have forced the Board to strike a delicate balance among many factors including relevance and reliability; the need for decision-useful information and practical considerations; and conceptual standards and desires to limit earnings volatility. As a result, U.S. financial accounting and reporting standards have become increasingly and unnecessarily complex.

We are supportive of an approach that would result in standards that are less complex. At the same time, we would not be supportive of a solution to simply provide less guidance in order to reduce complexity. We agree with the Board that a principles-based approach will require more judgment in applying the standards. However, if the standards are appropriately developed, we do not think it necessarily should result in a significant divergence in application of the standards or an inordinate burden of interpretation on preparers of financial statements and their auditors.

While the Board has characterized its Proposal as a movement toward a principles-based approach, we believe that the differentiation between so-called "principles-based" standards and "rules-based" standards is highly judgmental and does not fully address the underlying concern regarding U.S. financial accounting and reporting standards. Rather, we believe that the Board is better served to develop the necessary process to facilitate the development of effective financial accounting and reporting standards. The process should provide a foundation for future standard setting and a means to evaluate existing standards.

We believe the Board should adopt a formal process to be applied in the development of all future standards with the objective of producing standards that can be readily understood and applied consistently without the need for detailed guidance. These objectives can be achieved if a conscientious effort is made to limit arbitrary bright lines, scope exceptions, accounting alternatives for similar transactions, and alternative accounting applications of the conceptual framework.

The process should ensure that accounting standards:

- Articulate clearly the fundamental governing criteria to be used in making accounting decisions.

- Provide necessary supplemental guidance based on and consistent with the fundamental governing criteria.
- Provide sufficient level of detail to ensure the standard can be operational in practice and result in consistency of application.

The process should ensure that the Board:
- Evaluates alternative criteria and selects the fundamental governing criteria to be used in the standard based on its ability
  - To be applied to a wide variety of similar transactions and across industry lines, without use of arbitrary bright lines, and without exceptions; and
  - To produce reasonable and understandable results consistent with the underlying economics.
- Considers the need to use, and when appropriate adopts, secondary governing criteria to avoid arbitrary bright lines in situations in which the fundamental governing criteria cannot be easily applied.
- Challenges proposed scope exceptions and exceptions to the fundamental governing criteria with a view that such exceptions should be rare.
- Limits the bases of exceptions to fundamental governing criteria when such exceptions cannot be avoided, so that the exceptions are not applied broadly by analogy.
- Challenges inconsistencies with existing industry and other standards and considers the desirability of amending them so as not to provide alternative accounting treatments for similar transactions and items.
- Challenges inconsistencies in interpretation or application of the conceptual framework and the need to reconsider the approach being taken in the standard being proposed or to amend the conceptual framework to improve it and eliminate the inconsistencies.

If the Board can successfully develop standards using such a process, then we believe that the quality of U.S. financial accounting and reporting will improve.

We believe that much of the burden for the successful implementation of a principles-based approach rests with the Board. The Board has the key role and responsibility to provide the means for this approach to work effectively.

A key aspect in the process of establishing effective standards is consistency with the conceptual framework and other standards. As identified in the Proposal, certain aspects of the conceptual framework are incomplete, internally inconsistent, or ambiguous. We believe an effort to improve U.S. financial accounting and reporting standards without the appropriate focus on improving the underlying conceptual framework would be imprudent and result in a flawed approach. Therefore, we would characterize a project to address and improve the conceptual framework as a necessary condition precedent for an effective redevelopment of accounting standards.

An impediment to successful conversion to a process that uses a principles-based approach in establishing standards would be non-acceptance by regulators and users of financial statements of the potential diversity in interpretation of a standard by financial statement preparers and auditors. The Proposal appropriately identifies that standards incorporating a principles-based approach may result in different interpretations for similar transactions and events. These different interpretations, made in good faith, all may be appropriate applications of the standard. We cannot effectively judge the ability of regulators, investors, creditors, and other users to adjust to a principle-based approach to U.S. standard setting. Before moving forward with the Proposal, we believe the Board must obtain agreement with these constituencies.

Lastly, we encourage the Board to coordinate with the International Accounting Standards Board (IASB) during its evaluation of the standard setting process. Any process changes should be shared and, to the extent possible, coordinated with the IASB to promote convergence. While the IASB generally has avoided unnecessary detailed guidance in their standards, it is not clear that they have conscientiously considered the need to have a process in place for the development of their standards that promotes uniform interpretation.

Our views on the specific issues raised in the Proposal and certain other comments are discussed in the Appendix to this letter. If you have any questions concerning our comments, please contact Robert Kueppers at (203) 761-3579 or Robert Uhl at (203) 761-3705.

Yours truly,

APPENDIX

DELOITTE & TOUCHE COMMENTS
FASB PROPOSAL

PRINCIPLES-BASED APPROACH TO U.S. STANDARD SETTING

Issue 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?

We support the Board's efforts to reassess its current approach to standard setting with a view to identifying any necessary improvements. We believe that if the Board focuses on the process used to develop standards then the quality of U.S. financial accounting and reporting will improve.

While the Board has characterized its Proposal as movement toward a principles-based approach, we believe that the differentiation between so-called "principles-based" standards and "rules-based" standards is highly judgmental and does not fully address the underlying concern regarding U.S. financial accounting and reporting standards. Rather, we believe that the Board is better served to develop the necessary process to facilitate the development of effective financial accounting and reporting standards. The process should provide a foundation for future standard setting and a means to evaluate the existing standards.

We believe that the Board should adopt a formal process to be applied in the development of all future standards with the objective of producing standards that can be readily understood and applied and interpreted consistently without the need for detailed guidance. These objectives can be achieved if a conscientious effort is made to limit arbitrary bright lines, scope exceptions, accounting alternatives for similar transactions and alternative accounting applications of the conceptual framework.

The process should ensure the accounting standards:

- Articulate clearly the fundamental governing criteria to be used in making the accounting decisions.
- Provide necessary supplemental guidance based on and consistent with the fundamental governing criteria.
- Provide sufficient level of detail to ensure the standard can be operational in practice and result in consistency of application.

The process should ensure that the Board:

- Evaluates alternative criteria and selects the fundamental governing criteria to be used in the standard based on its ability
    - To be applied to a wide variety of similar transactions and across industry lines, without use of arbitrary bright lines, and without exceptions; and

- To produce reasonable and understandable results consistent with the underlying economics.

- Considers the need to use, and when appropriate adopts, secondary governing criteria to avoid arbitrary bright lines in situations in which the fundamental governing criteria cannot be easily applied. For example, the fundamental governing criteria for consolidation of another entity is control. In situations in which control cannot be assessed, use of a secondary governing criteria such as majority of the risks and rewards is more appropriate than an arbitrary bright line such as the amount of outside equity.
- Challenges proposed scope exceptions and exceptions to the fundamental governing criteria with a view that such exceptions should be rare.
- Limits the bases of exceptions to fundamental governing criteria when such exceptions cannot be avoided, so that the exceptions are not applied broadly by analogy.
- Challenges inconsistencies with existing industry and other standards and considers the desirability of amending them so as not to provide alternative accounting treatments for similar transactions and items.
- Challenges inconsistencies in interpretation or application of the conceptual framework and the need to reconsider the approach being taken in the standard being proposed or to amend the conceptual framework to improve it and eliminate the inconsistencies.

If the Board can successfully develop standards using such a process, then we believe that the quality of U.S. financial accounting and reporting standards will improve.

A key aspect in the process of establishing effective standards is consistency with the conceptual framework and other standards. As identified in the Proposal, certain aspects of the conceptual framework are incomplete, internally inconsistent, and ambiguous. We believe an effort to improve U.S. financial accounting and reporting standards without the appropriate focus on improving the underlying conceptual framework would be imprudent and result in a flawed approach. Therefore, we would characterize a project to address the conceptual framework as a necessary condition precedent for an effective redevelopment of accounting standards.

Issue 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?

While it would be preferable to comprehensively document the U.S. GAAP reporting framework, we do not believe this project requires a top priority. Comparatively, the International Accounting Standards Committee had a compelling business need to develop an overall reporting framework in order to establish an international reporting framework among many divergent country practices.

If the Board can successfully develop standards using the process discussed above, the need for a true and fair override in an overall reporting framework is de minimus.

Nevertheless, if the Board ultimately endorses the introduction of a true and fair override in an overall reporting framework, we believe, at a minimum, that the term must be clearly defined, its use should be limited to extremely rare and unique circumstances, and its use should require full disclosure in the financial statements. We believe IAS 1, Presentation of Financial Statements, as amended, provides a good starting point for these safeguards.

Issue 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?

We believe that an amended conceptual framework and effective financial accounting and reporting standards would minimize the market need for interpretive and implementation guidance. Accordingly, an over-abundance of interpretive and implementation guidance may demonstrate a need to revisit the effectiveness of Board's process and/or the specific standard.

In any case, we believe that the Board should be the primary standard setter for providing any interpretive and implementation guidance. If the Board does not take ownership of this process, then we believe that there is a credible risk that other organizations (audit firms, industry groups, investor groups, etc.) will develop informal processes to produce a significant amount of interpretive and implementation guidance to assist preparers in applying principles-based standards. Any de facto organization issuing interpretive and implementation guidance may not apply an appropriate level of diligence in the process, which could lead to impairing the credibility of financial accounting and reporting standards.

Issue 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?

We agree that a principles-based approach will require more judgment in applying the standards, but we do not think it necessarily should result in an inordinate burden of interpretation on preparers of financial statements or their auditors and divergent application of the standards. We believe much of the burden for the successful implementation of a principles-based approach rests with the Board. The Board has the key role and responsibility to provide the means for this approach to work effectively. The Board will have to re-evaluate and provide new discipline to the process in which it establishes and articulates its standards to ensure that they can be applied uniformly without the need for undue highly technical interpretation.

An impediment to successful conversion to a process that uses a principles-based approach in establishing standards would be non-acceptance by regulators and users of financial statements of the potential diversity in interpretation of a standard by financial statement preparers and auditors. The Proposal appropriately identifies that standards incorporating a principles-based approach may result in different interpretations for similar transactions and events. These different interpretations, made in good faith, all may be appropriate applications of the standard. We cannot effectively judge the ability of regulators, investors, creditors, and other users to adjust to a principle-based approach to U.S. standard setting. Before moving forward with the Proposal, we believe the Board must obtain agreement with these constituencies.

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

We believe that the Proposal appropriately identifies the associated benefits and costs. However, we note that the costs to rewrite the conceptual framework and existing standards may be more onerous than reflected in the Proposal. In addition, the Board must consider the most appropriate transition to a principles-based approach to standard setting. We believe that the remaining costs including the risk of widely and numerous different interpretations, de facto standard setters, and abuse can be reasonably minimized if the Board adopts a formal process to facilitate the development of effective financial accounting and reporting standards.

We do not believe that changes to the U.S. standard setting approach necessarily impairs comparability. A renewed focus on the conceptual framework, coupled with a movement away from arbitrary rules and a limitation on exceptions in standards should promote more comparability.

Furthermore, we do not believe that the proposed changes to the U.S. standard setting should increase the risk of second-guessing of preparer judgments by auditors, regulators, or investors. If the accounting framework is improved and the financial accounting and reporting standards are effective, we believe that the risk of second-guessing is diminished.

The Proposal notes that a new standard setting approach could lead to abuse, whereby the principles in accounting standards are not applied in good faith consistent with the intent and spirit of the standards. We do not believe that this would necessarily be the case. We note that those who engage in financial fraud will do so irrespective of the quality of standards.

We also strongly advise that the intent of the reassessing the standard setting process should not be reduced to an effort to simply limit the number of paragraphs or eliminate bright lines in a standard. Rather, the assessment should follow a greater objective to produce high quality financial accounting and reporting standards. For example, we do not believe that Attachment B to the Proposal appropriately represents a measured improvement in FASB Statement No. 34, Capitalization of Interest Cost (FASB 34). In our view, the redrafting of FASB 34 does not effectively reconcile the standard to the underlying conceptual framework, particularly the definition, recognition, and measurement of an asset.

While a one-time, comprehensive revision of existing standards to convert to principles-based standards is theoretically preferable than a piecemeal approach, we acknowledge that this alternative may not be practicable. Accordingly, we recommend that the Board develop the most appropriate approach to phase-in principles-based standards during its deliberations to avoid a temporary increase in internal inconsistencies among the standards during the transition period.

Issue 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?

We encourage the Board's efforts to reevaluate the effectiveness of the U.S. financial accounting and reporting standards in coordination with the other major standard setters, in particular the IASB. We believe working together, in partnership, with the world's standard setters would ensure that the best approach to standard setting is followed and promote convergence toward the highest quality financial reporting.