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Attached is an article that I wrote and will be sent out in our OECD corporate affairs newsletter around the world. As someone who has worked for several years under both systems and responsible for policy guidance on these matters to OECD member and non-member countries, I believe you are on the right track regarding this matter. However, I would like you to draw into focus the concept that both principles and detail guidance is needed.

The following issues or concepts should be followed:

1. Principles (policy) is necessary. These should be broad based concepts and kept simple and should be overriding concepts in all cases.
2. Guidelines, explanations, case law all need to feed up to principles and should never contradict principles. When a guideline does not help due to a unique situation or when economic developments have created a new instrument than we should look up to principles and professional judgement.
3. IFRS principles do not provide enough detail. GAAP provides detail and should also provide principles. They both need to be brought together.
4. The Global audit profession (mostly US) based primarily on GAAP uses extensive audit program checklists to guide young auditors through the process. To go to a pure principles based will create a bigger systemic problem in auditing because these young auditors do not have the experience not to be guided by audit checklists. Audit efficiency would also be compromised and Audit firms are already going through a crisis with the restriction on the type of services that can be provided. Complex issues that need to go up (to look up from guidelines to principles) should be by exception and require more senior level professionals to make the determination. This would be true if it is a staff auditor at a CPA firm or the accountant at the company.
5. Accounting for a global system will require broad based principles but also guidelines and detail guidance. This is as true in developed countries as transition countries. In fact transition countries are statutory in nature and are currently finding it hard to adapt to the Anglo-Saxon concepts of IAS.

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Which Accounting Standard is Better?

By: John R. Rieger

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Introduction:

There are a lot of confused people in the world as they listen to the current debate regarding accounting standards after the Enron/Andersen debacle. Are International Accounting Standards based on broad principles better than United States Accounting Standards based on extensive rules? If this is the case why has the SEC refused to allow European companies to list on the US stock exchanges unless they reconcile to GAAP? Before Enron within the accounting community we heard that United States accounting was superior. Now we have somewhat of a silence from the America side with European critics promoting the more principle based accounting. It seems that each side had a tendency to promote their own preferences when it was in their political advantage.

Could Enron have happened in Europe? Perhaps not to such an extent, but not so much due to accounting standards but more due to the accounting/auditing regulations or perhaps it should be referred to as restrictions. Principles based accounting allows and requires a greater degree of professional judgement than a rule based system. In reality a company and audit firm with an interest to subvert the system and cheat the public would be successful under either accounting system.

The business freedom in the United States has its advantages and its disadvantages. Freedom allows a company to innovate, to respond to economic changes, to respond to new ideas. This is why United States companies continue to outperform companies in other countries. Excessive rules and regulation limit and restrict these attributes. Regulation may control excessive abuses but often has the negative effect of being an administrative burden. Controls will limit and perhaps reduce the risk of an Enron event but with reduced risk and increased controls will be reduced returns and restricted growth.

Now, back to our question of which accounting methodology is better. The truth is that both in their current state are inadequate in today's economic environment. However, after saying this both do contain the components needed for an effective accounting system.

The solution needed for this problem of financial disclosure is for a proper melding of the two frameworks of IFRS (IASB) and GAAP (FASB). To simply adopt one concept over another would still leave gaps in the system of financial disclosure. However, the melding of the two could solve the problem.

Explanation:

1. The accepted flow for the development of rules usually start with a problem (or concept); what are we trying to accomplish? It starts with complete, fair, consistent, and accurate financial disclosure so an investor is properly knowledgeable of the necessary facts to make an informed decision. From this basic premise we establish an outline for

certain disclosure documents. In the accounting world they are the balance sheet, income statement, cash-flow statement, and related notes. This is our goal.

2. We start with establishing principles (policy) that accomplish our goal of full and fair disclosure using these basic disclosure documents. This is what principles based accounting attempts to cover. This is the working premise for all the IFRS's (IASB) and in that matter GAAP does also. They (primarily the IASB) have developed broad-based guidelines that while they will have overreaching coverage and may be better at catching non-compliance, they lack in explanation, guidance, and detail placing greater responsibility upon the professional auditor.

3. From broad based policies, so that we have proper explanation and detail we need guidelines that will help us understand what these principles mean and how they should be applied (full and fair disclosure) in real life and also how to properly perform the task. While these guidelines will not cover all situations, they will probably cover the majority of the situations. This is the current structure of GAAP (FASB). The FASB evolved this way to be rules based but has focused too much on rules and has become detached from policy. Without an overreaching policy, rules in a dynamic economic environment will fail in being able to keep up with all the situations and circumstances. Professionals need to have the capacity to draw conclusions based on experience using broad policy when rules do not apply to their specific situation.

What we want is:

a. An integration of policy (IFRS) that provides broad-based statements of position with integrated guidelines (GAAP) to the broad-based policy. We want guidelines that feed into the principles. However, if we run into a situation that does not fit our guidelines we look up to the broad-based principle to see if we have violated those rules.

b. It is absolutely necessary to have this integration in the system because the US Audit staffing model is based on young accountants (usually only a few years out of college) performing much of the work with limited conceptual ability however, they can usually follow audit check lists. It is this system that allows the greatest efficiency in the audit process. They are often not trained nor have the experience to work at the conceptual policy level. The system can be set up to identify exceptions (when we need to move up to the principle level from the guideline level) which would then be the responsibility of a more qualified professional that could look at an issue at the policy level to make the professional determination. This will also keep the accountant in-charge engaged and the audit firm aware of issues in the audit and also responsible for the challenges and problem areas of the audit.

c. The SEC and the FASB has been critical of the IASB (very vocally at least until Enron) suggesting that the IFRSs are not adequate for the sophisticated US markets. From the point of providing detailed guidelines they are correct. However, they are more policy oriented, which might have exposed issues about Enron or WorldCom to the markets. However, the weakness of IFRSs is in the lack of guidelines that is required to the army of auditors needed to audit global companies. The use of only principle based accounting would limit those qualified to a more mature and conceptually educated level and would create a systemic problem within the global audit firms. Both policy and guidelines are needed for an effective and efficient audit system.