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Financial Accounting Standards Board
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File Reference: 1125-001 – Proposal for a Principles-Based Approach to U.S. Standards Setting

Johnson & Johnson is pleased to comment on the proposal for a Principles-Based Approach to U.S. Standards Setting.

We commend the Board's commitment to improving financial accounting standards. We generally believe that a broader, more principles based approach to standards setting will contribute to better financial reporting. We also believe that such an approach is in line with the Board's efforts to contribute to the harmonization of accounting standards at the international level.

While current accounting standards are based on concepts or principles, we believe the standards have become increasingly complex and detailed and, in many cases, have clearly become detailed rules. While these rules have addressed specific situations, they have also led to the following:

- (a) In certain areas, the standards have become too detailed and complex. SFAS 133 is a good example of an overly complex set of rules, which is very difficult to implement.
- (b) A specific rule based standard is not flexible and may quickly be unable to deal with new, specific situations or products. Again, the area of derivatives comes to mind.
- (c) Financial engineering around the rules is possible in a rule-based framework. This may lead to transactions not being recorded in accordance with their economic intent.
- (d) Rule based standards lead to 'exceptions to the rules'. Scope exceptions generally do not enhance comparability and transparency.
- (e) Interpretation and implementation guidance, with different levels of authority, adds to complexity.

Accounting standards in the U.S. are based on a conceptual framework. This conceptual framework could be the basis for a Principles-Based standards setting approach. Thus, a first and important step to such an approach, in our opinion, would be to review the conceptual framework (the concepts statements) for its completeness and consistency.

Standards based on a complete and consistent conceptual framework will contribute to quality financial information, as they would be easier to understand. However, implementation might also be difficult and become more subjective:

- (a) While simplification is a good idea in certain areas, rules will still be needed in a principles based standard environment; the Board will have to find the proper balance between the conceptual framework and the implementation guidance. Insufficient implementation guidance may lead to different answers based on who renders the professional judgment. It could lead to inconsistency in financial reporting.
- (b) Enforcement may become more difficult, as more judgment would be permitted.
- (c) Some of the current (broad) "rules" may have to become "principles". Example: some of the rules (hedge accounting) in SFAS 133.

We would not be in favor of a true and fair override. Principles based accounting standards imply the use of professional judgment. If such judgment is properly applied, we see no need for an override.

We have reviewed the attachments to the proposal. Attachment B represents a revised Statement 34 under a principles based approach. The presentation format represents a combination of principles (in bold) and rules. We would prefer to show the principles in a separate (first) paragraph or as a separate standard as it will make them more prominent.

We recognize this proposal represents a major project that will require significant time and resources and a restructuring of the current standards setting and implementation guidance environment.

We thank you for taking our comments into consideration and will be pleased to discuss these with you.

Sincerely,

Stephen Cosgrove

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