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A cautionary note should be sounded regarding the requirement, which is

included in the Sarbanes-Oxley Act, that the Securities and Exchange

Commission should study the possible effects of a shift in the U.S. from a rule-

based accounting standards system to a principles-based approach to standard

setting. Indeed, it has been claimed, as pointed out by the FASB in its recently

issued proposal, that our tradition of issuing detailed rules that constitute U.S.

accounting standards allows companies to claim adherence to GAAP, which is at

times only technical in nature, and is carried out in the narrowest sense by

"connecting the dots", while ignoring and even violating the spirit of GAAP. A

switch to a system that is based on broad principles, such as the one being

developed now by the International Accounting Standards Board might serve,

therefore - so it is argued - as a superior alternative.

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It should be pointed out, however, that we have already two such overarching

principles: (1) The requirement of full and fair disclosure, which means that in the

preparation of financial statements, one ought to follow not only the letter, but

also the spirit of GAAP. (2) The materiality principle, according to which an item

is material if its inclusion in the financial statements, or exclusion from them, is

likely to affect the judgment of the reader. True adherence to these two broad

principles would have ruled out recognition of revenue prematurely, and other

falsifications of the financial statements that came to light recently. The question

that the SEC study and the FASB will have to address, therefore, is whether the

elimination of our present rule-based system, despite its admitted imperfections,

will inspire greater adherence to the spirit of GAAP, or will it result in more

misleading financial statements, in the knowledge that absent detailed rules, it

might be easy to engage in accusatory generalities about non adherence to

GAAP, but much harder to prove specific violations of such unwritten rules.

Sincerely,

Itzhak Sharav

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