November 21, 2002

Dear Mr. Herz:

I am writing to you on behalf of the California Public Employees’ Retirement System in support of your recent proposal for a principles-based accounting system in the United States.

At CalPERS, we believe that many of the issues associated with the recent flood of accounting scandals can be traced to corporate executives who applied the letter of the accounting law rather than the spirit. For example, the accounting debacle at Enron might have been prevented if Enron had consolidated on to its balance sheet its enormous exposure to special purpose entities (SPEs). It is well-known that, under a principles-based system of accounting, such as that promulgated by the International Accounting Standards Board, SPEs must be consolidated with the financial statements of the controlling corporation.

Our current system of Generally Accepted Accounting Principles (GAAP) attempts to have a precise rule for every business transaction. Yet, it is impossible for this rules-based system to anticipate every possible accounting situation. Indeed, certain business transactions are created to exploit the “gaps” in GAAP. This results in loopholes that may be exploited by the accounting profession.
While a principles-based accounting system may not prevent every accounting scandal, fewer loopholes should result in less accounting shenanigans, and this is what a principles-based system is designed to address. It is much more difficult to defeat the spirit of the law stated in an accounting principle than it is to find a loophole in a rules-based system.

We support your efforts to move in this direction.

Sincerely yours,

Mark Anson

cc: CalPERS Board of Administration