Letter of Comment No: 102 File Reference: 1125-001 Date Received: 1/3/03

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Matthew L Schroeder Managing Director Director of Accounting Policy



January 3, 2003

Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116
By email to: director@fasb.org

Re: File Reference 1125-001, Proposal for a Principles-Based Approach to U.S. Standard Setting

Dear Ms. Bielstein:

We appreciate the opportunity to comment on the above-referenced Proposal (the Proposal). We support the Board's initiative to develop a principles-based approach to standard setting. We believe the U.S. capital markets need a standard-setting process based on broadly-written principles rather than the complex, rules-based approach that currently underpins U.S. generally accepted accounting principles. We believe a principles-based approach to standard setting could produce higher-quality accounting standards that more accurately reflect economic substance, promote greater responsibility and accountability on the part of market participants who prepare and utilize them and, ultimately, result in greater confidence in the relevance and accuracy of financial statements.

In the Attachment we respond to the specific issues raised in the Proposal. In summary:

We support the Board's proposal for a principles-based approach to standard setting.
 We believe such an approach will improve the quality and transparency of U.S. financial accounting and reporting.

- We believe the Board should develop an overall reporting framework similar to that
 contained in IAS 1, which should include a true and fair view override. However,
 such an override should be permitted only in rare circumstances when compliance
 with generally accepted accounting principles would be misleading and a departure
 from those principles is necessary to achieve a fair presentation and only with robust
 disclosure and SEC review.
- Under a principles-based approach, we believe interpretive and implementation
 guidance will continue to be required to ensure comparability is achieved. We believe
 the Emerging Issues Task Force has functioned effectively over the last two decades
 in providing timely and practical interpretive and implementation guidance. We
 believe the EITF can and should continue to function in a similar role under a
 principles-based approach to standard setting. We also believe the AICPA should
 continue to play a role through the issuance and update of specialized industry
 guidance.
- The exact steps to be taken to strengthen our accounting and reporting system and to enhance investor confidence need to be crafted carefully and will involve not only changing our approach to developing accounting standards but also will involve changing the regulatory environment in which the capital markets operate. The Proposal questions whether there will be sufficient "buy-in" by affected constituencies—preparers, auditors, and users of financial statements, and accounting standard setting and regulatory bodies—for a principles-based approach to work in practice. We agree these are valid concerns and that significant legal, regulatory, and behavioral shifts will be needed for a principles-based approach to achieve its potential. Such shifts should and will be evolutionary. Thoughtful and farsighted management of these shifts holds the key to success.

Thank you for the opportunity to provide you with our feedback. If you have any questions regarding our comments, please do not hesitate to contact me at 212-357-8437.

Sincerely,

Matthew L. Schroeder

Responses to Specific Issues

 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 proposal for a principles-based approach to standard setting. We believe such an approach will improve the quality and transparency of U.S. financial accounting and reporting.

U.S. generally accepted accounting principles account for the vast majority of global economic activity, have been held up as the model for the whole world, have served the U.S. and global capital markets well for many years, and generally are viewed as the best accounting standards in the world. However, as a result of the recent crisis of confidence in the way U.S. companies do business, there is new interest in a less rules-based and more principles-based approach. We believe U.S. standard setters may learn from the more principles-based approaches used by standard setters in several countries in the developed world and should adapt the best of these characteristics to the U.S. system with the ultimate goal being international convergence of accounting principles.

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?

We believe the Board should develop an overall reporting framework similar to that contained in IAS 1. We agree the framework should include a true and fair view override. Consistent with IAS 1, we believe such an override should be permitted only in rare circumstances when compliance with generally accepted accounting principles would be misleading and a departure from those principles is necessary to achieve a fair presentation. In such circumstances, a company should disclose (i) it has departed from a generally accepted principle to achieve a fair presentation, (ii) the principle from which it departed, (iii) the nature of the departure, including the treatment the principle would require, (iv) the reason application of the principle would be misleading in the circumstances, (v) the treatment adopted, and (vi) the impact of the departure on the company's financial position, results of operations, and cash flows. For public companies, use of the override should require the registrant's auditor to file a "preferability" letter with the SEC explicitly agreeing with the registrant's conclusion, regardless of materiality.

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?

Under a principles-based approach, we believe interpretive and implementation guidance will continue to be required to ensure comparability is achieved. We believe the Board's Emerging Issues Task Force has functioned effectively for the last

nineteen years in providing timely and practical interpretive and implementation guidance. We believe the EITF can and should continue to function in a similar role under a principles-based approach to standard setting. However, the EITF's composition should be broadened (e.g., to include more representatives of user groups) and its process may warrant closer Board supervision (e.g., greater involvement in its deliberations and ratification of its consensuses). In addition, we believe the AICPA has played a valuable role for many years in addressing industry-specific and limited-scope accounting and reporting issues. We also believe the AICPA should continue to play a standard-setting role in the future, although its activities should be limited to narrow, industry-specific matters and the Board should exert greater oversight of its standard-setting processes and pronouncements.

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?

The Proposal questions whether there would be sufficient "buy-in" by affected constituencies—preparers, auditors, and users of financial statements, and accounting standard setting and regulatory bodies—for a principles-based approach to standard setting to work in practice. Similarly, the Proposal identifies concerns about SEC enforcement actions and related litigation that may result from an environment in which financial statement preparers and auditors are called upon to apply a greater degree of professional judgment in a wider range of circumstances. We agree these are valid concerns and that significant legal, regulatory, and behavioral shifts will be needed for a principles-based approach to achieve its potential. Such shifts should and will be evolutionary. Thoughtful and farsighted management of these shifts holds the key to success.

Preparers. First and foremost, accounting is the responsibility of corporate management. It is entirely appropriate to expect senior management to ensure financial statements reflect the economic reality of their companies' financial positions, results of operations, and cash flows. We believe responsible management will eagerly embrace a principles-based approach to standard setting.

Auditors. Next is the issue of auditor independence, which must exist in appearance and in fact for a principles-based approach to work. Under the Sarbanes-Oxley Act of 2002 (the Act), auditor independence has been significantly strengthened. Among other provisions, the Act prohibits auditors from providing nine categories of non-audit services to public audit clients and requires audit firms to rotate the lead and concurring audit partners after five years of service. Audit committees must preapprove all audit and permitted non-audit services and such services must be disclosed. Audit committees must develop policies and processes that ensure there is no doubt the company's auditors work for them. Audit committees also must perform a rigorous annual review that, at a minimum, includes negotiating audit fees and considering factors that might influence a decision to replace the auditor. Nothing must compromise an audit firm's ability to conduct pressure-free audits. The creation of the Public Company Accounting Oversight Board (PCAOB) also should result in more effective "audits of the auditors" compared with the prior accounting-industry-

administered "peer review" process. However, it is imperative that PCAOB is independent of the accounting industry and is led by experienced and knowledgeable business people. The SEC must be prepared to step in directly whenever and wherever it believes the PCAOB is not fulfilling its role.

Regulators. The SEC has a long history of effectiveness and has earned a reputation as one of the most effective federal regulatory agencies. But the recent wave of stunning corporate failures has exposed severe regulatory shortcomings and the SEC is struggling to maintain its role as the protector of investors against abuses in the marketplace. The SEC has lost ground in its efforts to keep up with the growth of business and the expansion of stock ownership. The SEC is understaffed and under funded at a time when its mandate to police the stock market has never been more important. Funding for the SEC must be increased.

Investors and creditors. Users of financial statements must play a larger role in the development of accounting standards. We believe the Board's recent initiatives to establish a user advisory council and hold a series of user forums is an appropriate first step toward achieving this objective.

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 do not believe a principles-based approach to standard setting will be a panacea for deficiencies in the current accounting standards framework. We recognize the potential drawbacks to a principles-based approach compared with current practice. In particular, we acknowledge that principles-based standards may lead to diversity in practical application. In addition, some suggest a principles-based approach could create greater opportunities for abuse if the standards provide the opportunity for applying them in bad faith or in ways that are inconsistent with their spirit and intent.

However, we do not believe these concerns outweigh the potential benefits of moving toward a principles-based approach. For example, the above-cited criticisms of a principles-based approach may be equally leveled at the current rules-based system. The current detailed rules, exceptions, and implementation guidance can lead to situations in which economically identical transactions yield different accounting outcomes, frustrating the goals of comparability and reliability of financial statements. Moreover, companies determined to abuse accounting guidance likely will do so whether that guidance takes the form of detailed "rules" or broad "principles." In fact, many of the widely-publicized accounting abuses of the last year relate to situations in which entities appear to have knowingly circumvented existing rules. Principles, like rules, can be broken or ignored by those intent on doing so.

On balance, we believe movement toward a principles-based approach to standard setting will be a step in the right direction. We believe the Proposal, together with measured changes in the capital market regulatory environment, could produce higher-quality accounting standards that more accurately reflect economic substance, promote greater responsibility and accountability on the part of market participants

who utilize them and, ultimately, result in greater confidence in the relevance and accuracy of financial statements.

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 believe the Board's constituents would be well served if, as part of a principles-based approach to standard stetting, the Board wrote standards using "plain English." Some of the complexity of the Board's recent standards is due to the use of "FASB speak"—a language well understood by Board members, FASB staff, and the minority of the Board's constituents with sufficient resources to monitor Board developments continuously. However, the majority of the Board's constituents are not able to attend (in person or by phone) FASB or EITF meetings and do not regularly participate in the analysis and development of standards through the comment letter process. For these constituents—notwithstanding the Board's extensive and commendable outreach programs—understanding the reasoning and subtleties of certain aspects of many of the Board's standards is difficult, if not impossible. For many companies, understanding the meaning of various provisions of many standards requires the use of outside experts and consumes valuable management time, increasing the cost of the financial reporting process.