December 14, 2002

To The Director Letter of Comment No: 79 File Reference: 1125-001

Date Received: 12/14/02

Financial Accounting Standards Board

Sub: Comments on Principles-Based Approach to US financial Accounting Standards. (File Reference 1125-001)

Dear Sir

Please consider this letter as an expression of my interest to submit the comments on the proposal for "Principles-Based Approach to US Standard Setting". Recently accounting professionals have expressed their concerns about the quality and transparency of US financial accounting and reporting. Many are concerned particularly about the complexity of applying the current "rule-driven" accounting standards based on FASB's conceptual framework that was designed to provide the foundation for US financial accounting and reporting. I would like to express my comments on the feasibility of adopting the principles-based approach to US financial accounting standards.

Due to the globalization of capital market and the complexity and sophistication of business structures and transactions, moving towards a broader, more principles based accounting standards that followed in other developed countries and IAS also, would facilitate better reporting environment in US. The present standards are based on "rules". The word "rule" implies the existence of rule setting body that doesn't exist in conceptual framework that FASB has designed in developing the present accounting standards. This rule driven accounting standards require to apply the "financial engineering techniques" designed primarily to achieve accounting objectives rather economic objectives. The following is my opinion for Board's decision of adopting "Principles-based approach" to US accounting standards as opposed to current rule-based standards:

To fulfill Board's mission towards the high-quality accounting standards that improve the quality and transparency of financial statements; Board's decision of accepting principles based standards would facilitate high-quality standards in US reporting environment. The primary qualities of decision useful information are relevance and reliability. FASB

statement No.2 though provides the description of these qualitative characteristics but there is really no conceptual guidance provided about how much trade-off between these two you can allow within the financial statements. On the contrary, the word "transparency" has an important implication so far as financial statement information is concerned. Two elements are attached to the word transparency; one is time element and the other is disclosure element. Transparency of financial information can be improved by providing all the information of how the numbers in the financial statements are obtained to the users instead of throwing just the numbers into the statements. It should let the users of the information interpret the numbers and decide for best allocation of their capital resources. Transparency also means the information should not get exploited before it becomes public, which means information should be available to the decision makers before it losses its capacity to make a difference among the various decision making alternatives. But transparency doesn't imply the full disclosure; rather it demands logical explanations behind the numbers in the financial statements so that the numbers make real sense to the users. The efficient market hypothesis states that if the market is efficient with respect to certain information system then the security prices should reflect all the information. So if the financial statements are transparent then according to efficient market hypothesis security prices should reflect all these information. Basically by improving the transparency of financial information it's the way of letting the market take the capital allocation decision. Beginning of this year the "big five" (now its "big four" though) and Deloitte &Touché have petitioned to SEC to provide interpretative guidance on "Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A)" and the firms mentioned three areas that they believe expanded disclosure would improve the transparency of the financial reporting: (1) liquidity and capital resources including off-balance sheet arrangements (2) certain trading activities that include nonexchange trading contracts accounted for at fair value (3) relationships and transactions on terms that would not be available from clearly independent third parties (details on this petition is available on SEC website www.sec.gov/rules/petition). So it is clear that not only the "Board" but also all the participants (company's managements, auditors, prepares in US financial reporting environment) want to ensure that a company's financial reporting is of high quality. Moreover FASB's conceptual framework does not provide guidance for developing disclosure requirements which is an important issue improving the transparency of financial statements. I believe the new principle-based approach would encompass the broader view of recognition; measurement and reporting requirements that improve both the quality and transparency of financial statements information.

In present accounting standards there are many "exceptions" where the principles in the standards don't apply; such as scope exceptions, application exceptions, transaction exceptions. These exceptions by themselves increase the level of detail and complexity in accounting standards because implementation guidance is required to describe and limit the transactions. For example, FASB statement no.133, Accounting for Derivatives and Hedging transactions, there are so many exceptions, rules that interpretative and implementation guidance is needed to describe transactions that some time focus on the form rather then the substance of the transactions. Complexities involving in accounting for derivatives and hedging transactions lead FASB to provide new derivatives guidance issued by their derivative implementation group early this year. As opposed to rule-based approach the "principles-based" approach would apply more broadly thereby providing few, if any, exceptions to the principles would lead to situations where transactions and events can be grouped together thereby enhancing the comparability and reducing the level of detail and complexity arising from exceptions.

Another issue relating to the current accounting standards is the interpretive and implementation guidance that are needed to ensure the comparability of financial statements. The amount of interpretive and implementation guidance provided has increased recently adding to the complexity of applying the present standards. For example, "accounting for special-purpose entitics" under the FAS no.94, "Consolidation of All Majority -Owned Subsidiaries". Though this statement addresses certain accounting issues relating to special-purpose entities but there are so many controversial issues in identifying and accounting for SPEs such as, definitional issues related to determining what is or what is not a "substantive operating entity", determining controlling interest of SPEs, that FASB started discussing interpretive guidance to identifying and accounting for SPEs early this year. The principles-based approach would demand less interpretive and implementation guidance (because the exception of

principles and other complexities would be phased out), thereby leaving more room for professional judgments for auditors, managers and accountants. An approach based on principles encompasses broad areas in current accounting standards would significantly reduce the need for this guidance because there would be a few, if any, exceptions to the principles.

Although FASB's conceptual framework has been used in developing the current accounting standards but this framework has not provided sufficient guidance in resolving many complex accounting problems. For example FASB concept statement No 5 "Recognition and Measurements in Financial statements in Business Enterprises does not provide the tools for assessing whether items should be measured at fair value, if so, when, at what level of aggregation and how. Conceptual framework was intended to help in solving complex accounting issues by providing precise terminology, a set of common premises as basis for discussion etc but the accountants really get confused to determine the starting point, if any exists at all, in solving the complex accounting issues because "experience" is considered as a frame of reference in solving these complex issues and every one's experience is different and so basically techniques for solving those critical accounting issues remain unresolved. Again to provide the definition of certain elements in financial statements, "FASB concept statement No 6", there is an inconsistency in defining those items, mainly in definitions of asset and liability. Definitions in concept statement 6 lack clarity too. Moreover the revenue recognition guidance provided in concept statement 5 in some respect inconsistent with the guidance provided in other areas, such as, assets and liabilities. Since certain aspects of conceptual framework are incomplete, internally inconsistent Board needs to develop a conceptual framework that is more complete, internally consistent and clear so that the framework would be able to resolve complex accounting issues.

The adoption of Principles-based " approach would definitely demand strong commitments from companies and their auditors to exercise professional judgments consistent with the intent and the spirit of the standards in public interest and also commitments from prepares to faithfully represent the financial statements. To facilitate the main objectives of this reporting system, to provide guidance on issues such as

materiality assessments, going-concern assessment, overall professional judgment Board should consider the need for developing an overall reporting framework as in IAS1 and this framework should also include a true and fair view override.

Under the "Principles-based" approach guidance would be needed only in significant matters thereby increasing the need to apply professional judgments consistent with the intent and spirit of the standards. We can see the effect of "Principles-based" approach on FASB statement No 133 "Accounting for Derivatives and Hedging Activities" where under the new principles paragraphs 3(a) to 3(c) would apply more broadly, requiring more derivatives instruments be recognized and measured at fair value and 3(d) an exception of the principle which would not allow hedge accounting. Issues involved in FASB's statement No 34, "Capitalization of Interest Cost" might be improved if it is developed under the new standards. Capitalization of Interest Cost Whatever it is the resulting standards would require more broad definition of derivatives and much of the detail and complexity in statement 133 might be phased out.

It is a true question whether the auditors, prepares, investors and others users of financial statements will be able to adjust to the new reporting system or not, but the standards that covers such a broad areas in accounting standards and that used by other developed countries such as U.K., then why not the participants in US capital market commit to make this standards to work.

The development of new "Principles-based" standard would certainly impose some costs associated with the professional judgments in applying accounting standards, maintaining comparability in financial statements. Further, the approach discussed in this proposal could lead to abuse, where the principles in accounting standards are not applied in good faith consistent with the intent and spirit of the standards. These types of situations may make it difficult for SEC and other participants in US financial accounting and reporting process to adjust to a "Principles-based" approach. But the accounting standards that apply more broadly than existing standards should be easier to understand and implement. Increased use of professional judgments would make more sense to the transactions. Since there would be a few, if any, exceptions to the principles the

079

principles-based approach would increase the comparability of financial statements. I

believe the benefits of adopting this approach would out-weigh the costs of implementing

the new standards and the results would be high-quality accounting standards that

improve the transparency of financial information essential to the efficient functioning of

the economy.

Hope the proposal of adopting new "Principles-Based" approach to US Financial

Reporting and standards would be accepted and we all will be able to make it a success.

If you have any question on my letter please feel free to contact me at

rashmita basu@hotmail.com.

Thank you very much.

Sincerely,

Rashmita Basu

6