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Financial Accounting Standards Board
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We appreciate the opportunity to provide input in the standard setting process in general and to provide our thoughts on the FASB's Proposal for a Principles-based Approach to U.S. Standard Setting ("Proposal"). We are also interested in participating in the public roundtable discussion on December 16, 2002.

There are many strong arguments for and against both a detailed rules-based approach and a principles-based approach. We agree with the elimination of detailed rules that are exceptions to the principles. Although we would favor the retention of the detailed rules-based approach for interpretive and implementation guidance, we recommend that the visibility and documentation of the general principles underlying each accounting standard be greatly improved within each standard.

Our vision contemplates that the first 20 – 40% of an accounting standard would clearly state the general principles and related rationales. The remainder would include the detailed interpretive and implementation rules supporting the principles and include a prominent requirement at the beginning of the detailed rules stating that, "Preparers may not apply a combination of or analogy to the detailed rules that result in an accounting answer that conflicts with the general principle."

The following are our responses to the specific questions in the Proposal.

1. 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 Proposal's elimination of detailed rules associated with exceptions to the principles. We also support a principles-based approach to U.S. standard setting only if such principles are supported by detailed rules for interpretive and implementation guidance. Our overall recommendation in this regard is included above.

We have two concerns regarding a reduction or elimination of detailed interpretive or implementation rules:

- A. As the Proposal correctly points out, lack of detailed interpretive or implementation rules issued by the FASB will require additional professional judgement on the part of the preparer. While the elimination of exceptions to the principles would indeed reduce the need for interpretive and implementation guidance, it is questionable as to how much of a reduction will result. We believe that the remaining need for interpretive and implementation guidance would remain substantial.

We base our conclusion in this regard on the varying degrees of accounting expertise from company to company and within companies as well as the growing complexity of transactions. As an example, at large decentralized multinational companies, the accounting expertise in distant subsidiaries are robust enough to correctly use and apply judgement to detailed rules, but the expertise may not be sufficient in all cases to apply a general principle to a very complex transaction. An example of such a transaction might include the establishment of and transactions with a joint venture whereby equity is exchanged, technology is licensed, and there is contract manufacturing for and outright sales to the joint venture.

Accordingly, detailed rules will need to be developed within each company. Given the growing complexity of transactions, any ten randomly chosen companies, acting fully in good faith, could judgementally arrive at ten different accounting results to complex transactions under a principle-based only model.

As a result, we believe that principle-based standards that are not supported by detailed interpretive and implementation rules decrease the quality and transparency of U.S. financial accounting and reporting. Users of financial statements would be left to wonder how conservatively or aggressively each company interprets the general principles. Even if companies were required to disclose how they applied the general principles, users of financial statements would be left with an inability to compare quantified differences between companies that make different interpretations.

- B. A principles only-based set of accounting standards only remains so if the regulators do not "interpret" the general principles for us. The Proposal acknowledges that behaviors of all members of the capital market system would need to change. But how would that be ensured? Depending upon the style and mandate of future SEC leaders, there would be no guarantee that detailed rules are not issued anyway through Staff Accounting Bulletins or speeches. This could be the worst of all worlds: detailed rules that are not vetted through the current FASB Exposure Draft due process.

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?**

The guidance issues in IAS 1 should be expanded to include those detailed rules necessary to address some portion of the growing complexity of underlying transactions. We do realize however, that no accounting standard will ever be able to maintain pace with the growing permutations of possible transaction. The existence of detailed rules will facilitate improved analogies for those complex transactions that are not covered by the rules as long as there is a requirement to ensure such analogies and applications of rules do not contradict the general principles. A true and fair view override may not be necessary if detailed interpretive and implementation rules are included in standards.

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?**

Interpretive and implementation guidance should be provided in all cases to narrow the potential varying judgements that could be applied to the general principles. The Board should be the primary standard setter responsible for providing that guidance.

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?**

Ultimately, most of these groups can adapt. But is adapting to a model that potentially results in less comparability and less transparency be worthwhile? As mentioned above, future SEC administrations may adapt by issuing its own detailed interpretive and implementation guidelines.

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?**

Preparers: Contrary to popular belief, our opinion is that the cost of using principles-based standards would be higher than using principle-based standards that are supporting by detailed interpretive and implementation guidelines. While learning and wading through complex existing standards such as SFAS 133 and related DIG issues are time-consuming and onerous, the time spent debating the interpretation and implementation of existing principle-based standards is greater. For companies that take pride and work hard at applying general principles to highly complex transactions in a manner that is consistent with the spirit of the accounting standard, the alternative of researching and ultimately locating a

detailed rule that addresses the complex transaction is far less time consuming and promotes comparability, as long as the application of such rule does not contradict the general principle.

Quantifying these costs may be partially achieved by analyzing the time necessary for a group of highly experienced accountants to arrive at the correct accounting for numerous highly complex transactions under broad general principles versus detail rules that address the complex transactions.

Users of financial statements (e.g., analysts, creditors, etc.): The cost of adopting a principles-based approach for users would be far greater than the cost of adopting a principles-based approach that is supported by detailed interpretive and implementation rules. Given the heightened awareness and concern by investors regarding company's accounting practices arising from recent current events, users of financial statements will want to understand whether company A is applying the general principles consistently with company B or C, etc. This will require extensive additional discussions and analysis with company management. Even with robust disclosures that attempt to explain how each company interpreted and implemented a general principle, the quantification of any differences from company to company will be next to impossible. This may result in analyses by users to guess the differences and potentially decrease users confidence in the accounting model.

6. What other factors should the Board consider in assessing the extent to which it would adopt a principles-based approach to U.S. standard setting?

We agree with the Proposal that the FASB should improve the Conceptual Framework.

In summary, we support accounting standards that are fully grounded in general principles. We support the elimination of detailed rules that are exceptions to the principles (thus significantly reducing the size of certain standards such as SFAS 133). We recommend that standards devote additional text to the general principles but continue to include detailed interpretive and implementation rules that support the principles. We support the improvement to the Conceptual Framework. We recognize that our position may somewhat hinder the convergence process with the IASB. We fully support international convergence of accounting standards and encourage the FASB and IASB to meet halfway using an approach outlined above. If you have any questions, please call me at 914-766-0850 or email me at Colistra@us.ibm.com.

Sincerely,

David Colistra