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> Letter of Comment No: 4\ File Reference: 1125-001 Date Received: 12 (6)

December 5, 2002

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

Re: File Reference No. 1125-001 – Proposal – Principles-Based Approach to U.S. Standard Setting.

Dear Ms. Bielstein:

The Financial Accounting Policy Committee (FAPC) of the Association for Investment Management and Research (AIMR) is pleased to comment on the Financial Accounting Standards Board's (FASB) Proposal, *Principles-Based Approach to U.S. Standard Setting*. The FAPC is a standing committee of AIMR charged both with maintaining liaison with standard setters who develop financial accounting standards and regulate financial statement disclosures and with responding to new regulatory initiatives. The FAPC also maintains contact with professional, academic, and other organizations interested in financial reporting.

General Comments

The FAPC strongly supports the general tenor of this proposal to reconsider the process by which U.S. accounting standards are formulated, their essential characteristics, and the fundamental principles that will inform and shape the standards. Although we have reservations about some aspects of the Proposal, we concur with the Board's observation that the needs of investors and other users for relevant, timely, reliable, and transparent information should supersede other considerations. We also agree that should the Board adopt several of the

¹ With headquarters in Charlottesville, VA, and regional offices in Hong Kong and London, the Association for Investment Management and Research® is a non-profit professional organization of 61,000 financial analysts, portfolio managers, and other investment professionals in 113 countries of which 48,800 are holders of the Chartered Financial Analyst® (CFA®) designation. AIMR's membership also includes 118 affiliated societies and chapters in 29 countries. AIMR is internationally renowned for its rigorous CFA curriculum and examination program, which had more than 100,000 candidates from 143 nations enrolled for the June 2002 exam.

DRAFT: AIMR FAPC Letter to Ms. Suzanne Bielstein Re: Principles-Based Approach to U.S. Standard Setting 5 December 2002 Page 2

primary aspects of the Proposal, the relevance and comparability of reported financial statements and disclosures will be enhanced.

Principles-Based Approach to U.S. Standard Setting

Accounting Standards

Few, if Any, Exceptions to the Principles

The Proposal states on p. 5:

The main differences between accounting standards developed under a principles-based approach and existing accounting standards are (1) the principles would apply more broadly than under existing standards, thereby providing few, if any, exceptions to the principles and (2) there would be less interpretive and implementation guidance...for applying the standards. [Emphasis added]

The FAPC believes that in the setting of accounting standards a balance must be struck between broad principles and the inclusion of sufficient interpretation and implementation guidance. Such guidance is necessary to ensure that the intent and spirit of the principles is clear to those who must apply the principles as well as to those who will use the resulting statements and disclosures. We agree with the observation that the variety of choices permitted in many of the existing standards has led to a proliferation of disclosures explaining the choices made. Such choices, particularly when driven by "bright-line" criteria, lead to the structuring of transactions to achieve desirable accounting outcomes, including volatility reduction and smoothing, rather than faithfully representing economic reality. Moreover, to the extent that companies make use of such choices, comparability and consistency, essential attributes of disclosure, are reduced.

Less Interpretive and Implementation Guidance

If no exceptions are permitted, the remaining guidance could more usefully focus on such matters as definitions, required measurement methods, and required disclosures regarding major measurement assumptions and models used. Because such guidance is critical to achieving the goals of relevance, reliability, comparability, and consistency, we do not believe that it is possible or desirable to eliminate it. Therefore, we would agree with the conclusion that although the volume of such guidance may be reduced, significant amounts of guidance must remain if the statements are to be clear, understandable, and useful.

Principles Developed Using the Conceptual Framework

The Proposal states on p. 6

DRAFT: AIMR FAPC Letter to Ms. Suzanne Bielstein Re: Principles-Based Approach to U.S. Standard Setting 5 December 2002 Page 3

...[The] framework has not provided all the requisite tools for resolving accounting and reporting problems. In part, that is because certain aspects of the conceptual framework are incomplete, internally inconsistent, and ambiguous.

The FAPC agrees and believes that a reconsideration of the set of overarching principles and concepts that guide the development of accounting standards is an essential first stage of this process. We strongly encourage the Board to develop a set of broad *general* principles that would apply to all standards and that could serve as criteria for evaluating the quality of a proposed standard. For example, the principles might include, among others:

- The information needs of investors and other users for clear, relevant, reliable, and comparable information should supersede all other considerations.
- The reporting and disclosure should enable investors and other users to clearly
 understand the risk and reward implications of all of the company's activities
 during a period.
- Accounting standards should permit only a single method of accounting for similar transactions, with no exceptions allowed.
- The single method of accounting for each type of transaction should be that which best reflects economic reality
- Measurement should be based primarily upon observable market fair values, or market-based models incorporating market assumptions; investors and other users base their pricing, investment, and other decisions on fair values, not irrelevant historical costs.
- Sufficient disclosure should be required to enable users to understand and evaluate the measures.
- Disclosure should be based on a principle of full articulation across the balance sheet, income statement, and cash flow statement; that is, investors should be able to trace related elements of cash, accruals, and fair value changes for major financial statement line items in order to understand the company's performance, resources, and obligations.

The FAPC does not support the inclusion of a "true and fair override". If management concludes that rare circumstances would cause the application of the principle to produce misleading information, management may indicate this, fully explaining the circumstances in the notes. However, we believe that the principle of no exceptions should be adhered to in all cases.

Benefits and Costs

The FAPC believes that investors and other users can benefit greatly from a thorough reconsideration and updating of the process by which U.S. accounting standards are formulated, their essential characteristics, and the fundamental principles that will inform and shape the standards. We do not believe that it is feasible or even desirable to attempt to implement a pure principles-based system. However, we agree with the Proposal's conclusion that the benefits of a balanced system of carefully formulated principles, along with sufficient interpretive and

DRAFT: AIMR FAPC Letter to Ms. Suzanne Bielstein Re: Principles-Based Approach to U.S. Standard Setting 5 December 2002 Page 4

implementation guidance to ensure that the intent and spirit of the principles is adhered to and comparability is maintained, will outweigh the costs of moving to such a system. We believe that existing standards would need to be reconsidered, especially in light of the reconsidered principles and concepts.

Concluding Remarks

The Financial Accounting Policy Committee appreciates the opportunity to express its views on the Board's Proposal: *Principles-Based Approach to U.S. Standard Setting.* If the Board or staff have questions or seek amplification of our views, please contact Rebecca McEnally at 1-434-951-5319 or at rebecca.mcenally@aimr.org. We would be pleased to answer any questions or provide additional information you might request.

Respectfully yours,	
/s/ Jane Adams	/s/ Rebecca Todd McEnally
Jane Adams Chair, Financial Accounting Policy Committee	Rebecca McEnally, Ph.D., CFA Vice-President, Advocacy, AIMR

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