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Response to file reference 1125-001

To: From: FASB director Frank Walker

Subject:

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Background:

I am a Business and Executive Coach certified by the National Association of Business Coaches. I have over 29 years of management experience. Prior to my business career I earned a degree in The History and Philosophy of Science at the University of Chicago.

And I am also to be the CFO of a new company.

Statement in favor:

I strongly favor principles-based accounting standards (PBAS).

The objective is to report the activities and position of the entity based on economic reality rather than the rules.

The example of the rewrite of FAS 34 only reinforces my beliefs.

I agree with FASB that such standards will require a greater level of sound professional judgment on the part of practitioners.

Such standards will provide positive guidance consistent with the objective of true and useful reporting of financial performance. More important, PBAS will eliminate the ability to use a rule to hide deception.

This is a good outcome as such judgments add value to the profession.

This outcome will accomplish at least two things:

- 1. Accounting will be a more important part of management as judgmental decisions are managerial decisions.
- 2. The profession will attract a higher caliber of people.

In addition I would add that principle-based accounting is more comprehensible to the users of financial statements

As a CFO I have to personally sign for the statements under the new law. I personally would like to understand what I am signing to without having to take a class in arcane rules that have nothing to do with my business.

Philosophy/Core Beliefs:

Superior financial management can provide a competitive advantage.

Finance is the engine that powers a company. The more efficient and effective the financing, the better the company's engine.

Superior financial reporting is essential to the use of responsible finance as part of creating a competitive advantage.

Management deserves the best analysis of financial information they can get.

Management works for the owners and creditors of the company. They deserve the same information as management.

My experience suggests that internal reporting is principle-based and external reporting is rule based and they are never the same!

Principle-based standards can serve to eliminate the famous "For internal use only" reports.

Problem with rules:

The blind application of rules can lead to an absurdity. (reducto ad absurdum)

1. In the mid seventies I had to create an alternative consolidated set of financial statements for an international company. Currency markets for that year were volatile. The President of the International Division, after our best year ever, got a report that indicated his division lost money. Why? The formulas indicated we had lost money after conversion to US currency. And the fact was we were sitting on a ton of cash.

2. FASB 133:

A client of mine was advised that all forward contracts were derivatives. One particular contract was the issue. My client was asked to fair value a 25 year international treaty.

I argued that this was not a derivative contract because there is no underlying market for international treaties. When you get to the point that the application of a rule forces you to conclude that an international treaty is a derivative, you have passed absurdity.

The challenge with principle-based accounting:

The new standards require the accounting professionals to get out of the green eye shade business and become part of management decision making.

It requires practitioners to take risks.

It is long overdue.

Rules give the illusion of certainty. They become a substitute for thought.

Principle-based accountancy is based on guidance.

Guidance is different than rules. Guidance establishes a goal and allows the practitioner the freedom to reach those goals. Guidance is a challenge. Rules prohibit thought. Rules do nothing more than turn the practitioner into a robotic automaton.

The horse is out of the barn:

To be blunt, FASB has already started adopting principle-based standards. FASB 133, Concept 7, FASB 142,143,144 are just some examples.

The goal should be a work product that presents a thoughtful analysis of financial information in a manner that best benefits all stakeholders, especially line management who make the decisions on behalf of the owners and creditors and employees.

Corporate Governance:

Given Enron, Tyco, WorldCom, etc. corporate governance has become a huge issue and rightly so.

Corporations are re-filing and re-stating statements as a result. Were the statements wrong? In many cases they were within the rules, just misleading.

We have ample proof that rules can be followed leading to disasters. We have ample proof that rules can be broken, leading to disasters.

Some look to principle-based standards as a way to partially prevent management misconduct.

I strongly suggest that principle-based standards not get confused with management ethics.

We have ample proof that a lack of management ethics leads to disaster, independent of accounting rules.

Insurance Issues:

Error and Omission and Malpractice insurance is already expensive. Principle-based standards may raise the insurance risk for the practitioner.

Following principles appear to have greater risks. Or do they? Following rules is a common defense in a law suit. However, "Just following orders!" did not save the Nazis on trial for war crimes, nor did it save Anderson.

How will the insurance industry underwriting the profession deal with what amounts to new standards of practice?

I do not have an answer. I do suggest FASB consult with insurance carriers to better define engagement contracts under a principle-based system.

Comments on specific questions;

1. Do you support the Board's proposal for a principles-based approach to U.S. standard setting?

YES

Will that approach improve the quality and transparency of U.S. financial accounting and reporting?

YÉS

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?

YES. It is consistent with guidance as opposed to rules and is needed.

3. Under what circumstances should interpretive and implementation guidance be provided under a principle-based approach to U.S. standard setting?

Great question. This is a new world for many accountants and they will have questions. I suggest an advisory group be created that will try to answer any question from any accountant and respond in a timely manner with their best counsel. For anyone to take on this task, implementation liability must remain with the firm asking the question.

Should the board be the primary standard setter responsible for providing the guidance? There are two choices: 1. Improve the FASB, 2. Create a new entity.

I suggest that an improved FASB is the best idea.

4. Will preparers, auditors, the SEC, investors, creditors, and other users of financial information be able to adjust to principle-based approach to U.S. standard setting? If not, what needs to be done and by whom?

This question assumes that all concerned have already adjusted to the status quo.

Right now most firms have one set of books for internal management use based on what is essentially principle-based guidance, a public set of books based on GAAP and FASB rules and another set of books based on the tax code. If the entity is a public utility and a department of a government, add GASB rules that sometimes conflict with FASB rules

Principle-based standards simplify everything as evidenced by your example of a re-written FASB Statement 34.

5. What are the benefits and costs (including transition costs) of adopting a principle-based approach to the U.S. standard setting? How might those benefits and costs be quantified?

The benefits are:

- A. A representation of the financial condition of the business entity that is more useful to users because it is more consistent with economic realities.
- B. It makes things simpler for those who prepare the statements and those who use them.
- C. A principle-based system must be more cost effective than a rule based system.

The costs of the rule based system are huge. There is no such thing as a free rulel

Why? There is no such thing as a perfect rule. Having recognized an imperfection in the first rule, one creates a new rule to try to cure the imperfections in the old rule. But the new rule is imperfect, creating the need for yet another rule to fix imperfection in the rule that was designed to fix the imperfection in the original rule. This process creates an infinite loop in rule making. This process maximizes micro-management. And costs a lot of money.

Principles are eternal and need not be changed and therefore are more cost effective.

I have no idea how to put real numbers on this concept.

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?

I ask the Board that they understand that accountants are in the business of making sure that management, owners, creditors, employees and other interested parties receive the best possible information that reflect the economic realities of the entity.