Andrew M. Mintzer Certified Public Accountant

507 Marguerita Avenue Santa Monica, California 90402 Phone: (310) 395-0599 Fax: (310) 395-0699 andy@mintzercpa.com

November 19, 2002

Letter of Comment No: 34 File Reference: 1125-001 Date Received: 12/3/02

Director of Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06856

Re: File Reference 1125-001

Dear Director:

I am happy to provide my comments to your proposal, "Principles-Based Approach to U.S. Standards Setting". Before I get into my comments on the specific issues I want to point out that I agree with the view that the principles-based approach described in the proposal will require a "buy-in" and change in behavior of constituents across-the-board. I do not believe that it is reasonable to conclude that this change in behavior is likely.

I disagree that eliminating or significantly curtailing implementation guidance or rules is an improvement to our accounting model. I find nothing inherently wrong or bad with accounting rules. There may be a lot of rules but they are developed and deliberated by accounting experts without the influence of a particular business' financial statements in mind. It is this due process and public debate in developing accounting rules that result in our high-quality standards. Principles-based standards simply would move the debate and deliberation away from the public forum and into each accounting department where the results would be inconsistent and perhaps unknown.

Issue One.

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?

I do not support the Board's proposal for a principles-based approach to U.S. standard setting. I support the continued improvement in GAAP and I support a heightened emphasis on principles and a move away from the emphasis on rules-oriented standard.

You can't compare apples and oranges. However that is exactly what would happen in a principles-based system if you compared one company's financial statements to those of another company or a group of companies in an industry. Under principles-based standards, each company could determine its own unique way to apply GAAP, and you would have no assurance of consistency. Even with a good-faith effort to fully disclose results, you wouldn't know if the operating results were comparable, because they may have been arrived at using different accounting methods or approaches. Disclosures could only go so far.

I support accounting standards that make plain the principle upon which the standard is based. Implementation and interpretive guidance is demanded by preparers and auditors. I do not believe that there will be the necessary universal commitment from all constituents to a principles-based approach such that this implementation guidance can be stricken from GAAP. Indeed, in my view, this may not be humanly possible.

I believe that GAAP is already principles-based.

Statement of Financial Accounting Standards No. 13 (FAS 13) is a prime example of a rules-oriented accounting standard that is <u>based</u> on a general principle. The general principle in FAS 13 is that assets and liabilities create benefits and risks, and those benefits (assets) and risks (liabilities or obligations) ought to be reported in financial statements; and if an entity has a lease arrangement whereby those risks and rewards are experienced by it then an asset and obligation should be reported.

In the case of FAS 13 there is a clear principle with a sound underpinning. As a result of FAS 13 an identical transaction will be accounted for identically by different preparers and their auditors. However, similar transactions may not be. It is here where FAS 13 drops the ball as an effective and transparent standard. If *Lease A* results in a 90% minimum lease payment to fair value relationship, it will be capitalized if *Lease B* results in an 89% relationship, it won't be capitalized. Its hard to argue that *Lease A* and *Lease B* are so different that the accounting treatment should be like night and day. That's because its probably impossible to intellectually define the exact bright line that will be satisfactory in all cases.

The Proposal proposed a solution whereby the standard would express the principle and the preparers and auditors would use their best judgment to apply the principle to the particular transaction. Another alternative that would move towards principles and away from rule-oriented standard is to write the guidance more broadly. Continuing the example above FAS 13 paragraph 7 d. could have said "generally" equals or execceds 90%. Another alternative would be to qualitatively describe guidance as done in FAS 5.

Wall Street will be compelled to track the different accounting methods employed and track the effects as best they can. It is unreasonable to conclude that the financial markets won't make some attempt to make the financial statements comparable. This is done today, but not nearly to the extent that would be necessary in a principle-based standard world. This will be costly to users.

I do not believe that an all out principles-based approach will be effective. As proposed it would not improve quality and transparency. I believe that the financial statement community continues to crave consistency. Financial statement preparers and auditors who are genuine and faithful still crave guidance. When the guidance (or rules) are deliberated in a public forum (such as at FASB or AcSEC) the resulting guidance (or rules) are not subject to the pressures of a particular transaction or earnings expectation.

Sure, that's a lot of rules, but they are developed and deliberated by accounting experts without the influence of a particular business' financial statements in mind. It is this due process and public debate in developing accounting rules that result in our high-quality standards. Principles-based standards simply would move the debate and deliberation away from the public forum and into each accounting department where the results would be inconsistent and perhaps unknown.

If accounting standards do not answer fundamental implementation issues within the four corners of the standard someone else will. The questions are who and will the answers be sound? When standards don't have answers the major auditing firms develop implementation guides where they discuss their views on what constitutes proper accounting. As a result it becomes known that for a given industry or accounting issue a particular auditing firm will permit or require this accounting treatment but another accounting firm will permit or require this other accounting treatment. Is this improved quality? I think not. Prior to the acceleration of activities of the EITF and AcSEC, implementation guidance on current issues was more easily available to the clients of the large auditing firms than to the rest of the world. And the deliberations were not in a public forum and their deliberations did not result in a applicable answer in the GAAP hierarchy.

Issue Two

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?

In my view the most valuable feature of IAS 1 is the ease in which the overall reporting framework is communicated. I agree that an overall reporting framework should be developed by the FASB as an Accounting Standard as opposed to a Concept Statement. I do not believe that it needs to be part of the first priority of projects. The revenue recognition project is considerably more important in my view.

The concept of true and fair is a valuable *concept* but is very judgmental. The notion that the whole set of financial statements should convey valuable information to the reader transcends the application of specific accounting rules. Such a sentiment should be incorporated into US GAAP. The AICPA's Rule 203, in my view, already communicates this overarching objective.

All FASB statements contain the statement "The provisions of this Statement need not be applied to immaterial items". I believe that if accounting standards, even those with significant implementation guidance, clearly disclosed the principle upon which the implementation guidance (i.e. the rules) were based then each FASB statement could also contain the following statement at the end in a box,

The implementation guidance in this Statement should not be followed if the result does not fairly and faithfully reflect the fundamental principles expressed herein.

Issue Three

Under what circumstances should interpretive and implementation guidance be provided under a principle-based approach to U.S. standard setting? Should the Board be the primary standard setter responsible for providing that guidance?

As I described in response to the first issue, I believe that interpretive and implementation guidance is needed in all situations. Financial statement preparers and their auditors, however, should be given a clear understanding of the overarching principle in each standard in order to properly and faithfully apply the implementation guidance.

It is folly to attempt to provide a standard on a principle alone. In all walks of life there are principles and rule (or customs and practices). Every principle will ultimately have to be translated to debits, credits and disclosures by human beings. I cannot imagine a standard being so perfectly written that the debits and credits will be self-evident to all constituents in the financial reporting process. So someone will develop that guidance. Will it be developed by the national firms, for-profit business publication houses, a consensus of current practice? In my view the guidance should be developed by experts within the due-process framework. I do believe that there overarching principles that transcend industries. I do not believe, that meaningful guidance can be developed ignoring the difference between industries. Just look at the want ads. Industry-specific experience and knowledge is demanded by employers of financial personnel. Industry-specific accounting and reporting guidance is also demanded.

What will become of accounting education? Educational courses, college-level and continuing professional education, have to use examples and case studies. How will the "answers" for the case studies be developed in a pure principle-based standard world? Again, someone will develop the examples and the applicable guidance.

The public will be better served by having this guidance developed with due-process, not on an ad-hoc basis. When in comes to industry-specific guidance AcSEC and its industry task forces are in the best position for this.

Issue 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?

No, not to a pure principles-based approach. I believe all professions have customs and practices that are preferred. We can no sooner abandon all accounting rules and guidance than society could abandon all traffic rules and regulations and replace them the simple principle of "drive safely".

I incorporated my response to this question in other portions of this letter.

Issue 5

What are the benefits and costs of adopting a principles-based approach to U.S. standard setting? How might those benefits and costs be quantified?

The prominent benefit that has been identified of a principles-based approach is that accounting standards could be issued more timely. Presumably because there won't be the time and effort in editing and composing the practice and implementation guidance. I am not so sure that this is necessarily good. Although I do believe that significant improvements can be made in the rate in which accounting standards are issued, a rush to issue principles-based standards could be dangerous. I would argue that standard setters need to go through the practice iterations and implementations issues even if they do not end up in the public domain as part of the standard. It seems to me that the only way to validate the principle-based standard is to rigorously test it using a wide range of scenarios. Therefore I question if, in fact, high-quality principle-based standards could be issued as fast as some observers seem to believe.

As stated in your proposal on page nine, "Further, the approach discussed in this proposal could lead to abuse, whereby the principles in accounting standards are not applied in good faith consistent with the intent and spirit of the standards." This is true of existing GAAP. Those people who are intent on bad faith disclosures will always have some outlet for their misbehavior. However, I believe that without implementation guidance even those people who believe they are using good faith may produce measurements and disclosures that are not in keeping with the intent of the standard.

Issue 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 must also add to my other comments my concern for addressing the needs of non-public companies and their auditors. Although the day-to-day life of the non-publicly owned companies fails to make the headlines it affects thousands and thousands of businesses throughout the country. This constituency does not have access to large research departments and other financial accounting resources. The demand for implementation

guidance is even stronger for this group. I do not believe that there will ever be a day where only principle-based accounting and reporting standards will meet the needs of this large constituency.

Concluding Remarks

Making Accounting Standards Work. Effective standards should be based on principles and implemented by reasonable rules. Effective and reasonable rules require active participation of the financial reporting community to evaluate the resulting quality. Real life practice issues should be brought to the attention of the appropriate standards-setting bodies so that they can be incorporated into the standards in a timely and meaningful fashion.

Finally there should be a meaningful relationship between the number of possible outcomes of a rule (its complexity) and the quality of the resulting accounting measurement or disclosure. This way, rules-based standards will provide both the consistency that financial statement users crave and the high-quality financial statements they demand.

Sincerely,

Andy Mintzer

Allitz