

Walter P. Schuetze

August 1, 2007

Christopher Cox, Chairman  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549

Dear Chairman Cox:

USER-FRIENDLY FINANCIAL REPORTING SYSTEM

On June 27, 2007 the Commission established an Advisory Committee “with the goals of reducing unnecessary complexity [in our financial reporting system] and making information more useful and understandable for investors.” SEC Press Release 2007-123. On May 17, 2007, Treasury Secretary Paulsen said “The Treasury Department is supportive of the SEC and the Financial Accounting Standards Board’s efforts to enhance financial reporting transparency ... for investors.” US Treasury Press Release HP-408.

I agree that the financial reporting system should be simplified. Indeed, I wrote an article to that effect, “Keep It Simple,” published in *Accounting Horizons* in June 1991. The question is, How? My answer is simple. Require that all assets and liabilities, not just financial assets and liabilities, be reported in the balance sheet at fair value as defined by the Financial Accounting Standards Board in its Statement 159. This approach is generally called “fair value” reporting.

Fair value reporting for all assets and liabilities has been endorsed and recommended by a major user group, namely, the chartered financial institute in its October 25, 2005 publication entitled *A Comprehensive Business Reporting Model*. The Financial Accounting Standards Board, in its Statement 159, issued in February 2007, permits issuers to elect fair value reporting as to financial assets and liabilities. I suggest that all assets and liabilities be reported at fair value, as recommended by the chartered financial institute.

Why do I suggest fair value reporting for all assets and liabilities? Because the result will be understood by retail and institutional investors and creditors, by boards of directors, by Congress, and by ordinary people on

Main Street, which is not the case today. Financial reports today may be said to be broadly incomprehensible.

Nowadays, it is fashionable to say that accounting standards should be “principle-based.” The SEC’s staff recommended that approach in 2003. SEC Press Release 2003-86. I have been in the accounting and auditing profession for fifty years. (My resume is attached.) I have been involved in setting accounting standards since 1963 when I worked with the AICPA’s Accounting Principles Board. I have seen numerous attempts at “principle-based” standard setting, almost none of which has worked. I will list a few examples of principle-based standards that did not work in practice, and where the FASB has revisited the issue or intends to revisit the issue:

A. In 1957, in *Accounting Research Bulletin No. 48*, the AICPA’s Committee on Accounting Procedure dealt with accounting for business combinations.

B. In 1964, in *APB Opinion No. 5*, the AICPA’s Accounting Principles Board dealt with accounting for leases by lessees.

C. In December 1967, in *APB Opinion No. 11*, the Accounting Principles Board dealt with accounting for income taxes.

The only significant principle-based standard that has worked in practice is the FASB standard that requires that R&D expenditures be charged to expense as incurred. FASB Statement No. 2. But, many people do not agree with that standard on a conceptual basis.

I think that it will be a grave mistake for standard setters or regulators such as the Commission to attempt to set standards based on principle. If standards are not based on fair value, balance sheets inevitably will contain some items that do not have a fair value simply because of the manner in which accounting standards are set, that is, in a political, bargaining process dominated by issuers of financial statements. For example, some would favor deferral as an asset of some R&D expenditure, yet that deferred amount would have a fair value of zero; it cannot be sold. The same for advertising expenditure, for employee-training expenditure, for relocation expenditure... Goodwill, which is a huge amount on some balance sheets, has a fair value of zero; it cannot be sold. Deferred income taxes, as we know them today, are complex beyond compare, cannot be explained to a non-accountant, and have a fair value of zero.

Investors and creditors understand fair value amounts; investors and creditors do not and cannot understand amounts for assets and liabilities that are not fair value.

I would appreciate your distributing this letter to the Advisory Committee that you appointed to study this matter. I would be pleased to meet with that Advisory Committee to discuss this matter.

Yours truly,

/s/wps

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Walter P. Schuetze was the Chief Accountant to the United States Securities and Exchange Commission from January 1992 through March 1995, when he retired. He was appointed Chief Accountant of the Commission's Division of Enforcement in November 1997 and served through mid-February 2000, when he retired again. He was a consultant to the Commission's Division of Enforcement from March 2000 through March 2002 on matters involving accounting and auditing.

Mr. Schuetze is a consultant in litigations as an expert in accounting and auditing. He is a member of the board of directors and chair of the audit committee of CA Inc. (formerly known as Computer Associates International, Inc.).

Mr. Schuetze's book, Mark-to-Market Accounting, published by Routledge in 2004 (ISBN 0-415-2995-1) is a compilation of his published articles, speeches, and letter submissions to regulatory authorities. He was the recipient in November 2004 of the inaugural University of California – Berkeley Haas School of Business Award for Distinguished Contributions to Financial Reporting.

Mr. Schuetze was one of the original seven members of the Financial Accounting Standards Board, serving as a member from April 1973 through mid-1976. He was a member and chair of the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants in the 1980s. He was a member of the Steering Committee of the International Accounting Standards Committee dealing with Intangible Assets, Business Combinations, and Impairment of Assets. He has delivered occasional lectures on accounting at the business schools of St. Mary's University in San Antonio, Texas, the University of Texas – San Antonio, Texas and Austin, Texas, and the University of Southern California in Los Angeles, California.

Mr. Schuetze began his career in accounting in 1957 with the public accounting firm of Eaton & Huddle in San Antonio, Texas, which merged with Peat, Marwick, Mitchell & Co. (now KPMG LLP) in 1958. He was a partner in KPMG from 1965 to 1973 when he was appointed to the Financial Accounting Standards Board and from 1976 to 1992 when he was appointed to the position of Chief Accountant to the Securities and Exchange Commission.

Mr. Schuetze served in the United States Air Force from 1951 to 1955. He received a Bachelor of Business Administration degree, with honors, from The University of Texas in Austin in 1957. He is a certified public accountant. He is a member of the American Accounting Association and the American Institute of Certified Public Accountants and Beta Alpha Psi and Beta Gamma Sigma, honorary societies.

Mr. Schuetze was born on August 2, 1932.

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