Before The
Securities and Exchange Commission

Request for Action by Commission
With Respect to Certain Rules
and Pronouncements
Relating to Accounting Principles

Petition of

ARTHUR ANDERSEN & CO.

June 15, 1976

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BEFORE THE
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C.

PETITION OF ARTHUR ANDERSEN & CO.

RE: Request for Action by Commission With Respect to Certain Rules and Pronouncements Relating to Accounting Principles

Petitioner Arthur Andersen & Co. is a general partnership organized and existing under the laws of the State of Illinois, with its principal office located at 69 West Washington Street, Chicago, Illinois 60602. Arthur Andersen & Co. is a firm of independent public accountants. The activities of our firm include the examination of, and reporting on, the financial statements of business enterprises and public bodies.

Many of our clients are subject to the jurisdiction of the Securities and Exchange Commission (the Commission) and are required to include financial statements, together with our auditors' reports thereon, in filings with the Commission under the various Acts administered by the Commission. Such filings would include, but are not limited to, registration statements filed pursuant to the Securities Act of 1933 and annual and periodic reports and proxy statements filed pursuant to the Securities Exchange Act of 1934. (These Acts are referred to herein as the Securities Acts.) Our public accounting practice is vitally affected by regulations, rules, and pronouncements of the Commission relating to accounting principles.

During the last three years, the Commission and its staff have created considerable uncertainty with respect to the accounting standards, principles, and practices to be followed by registrants in their financial accounting and reporting and by independent auditors in giving opinions on the financial statements of registrants.

We respectfully request that certain actions be taken by the Commission to enable our firm to carry out its responsibilities under the Securities Acts.

OPINION TO BE EXPRESSED BY INDEPENDENT AUDITOR

Rule 2-02(c) of Regulation S-X, which is the basic rule relating to the reports of independent auditors on the financial statements of registrants, is as follows:

"(c) *Opinion to be expressed*—The accountant's report shall state clearly: (1) the opinion of the accountant in respect of the financial statements covered by the report and the accounting principles and practices reflected therein; and (2) the opinion of the accountant as to the consistency of the application of the accounting principles, or as to any changes in such principles which have a material effect on the financial statements as required to be set forth in Rule 3-07(a)."

This rule refers to "accounting principles and practices" but does not indicate how or by whom they are to be determined; nor does it set forth any limitations or prerequisites concerning the selection of the accounting principles and practices to be used by registrants.

Accounting Series Releases are incorporated in Rule 1-01(a) of Regulation S-X by general reference.

DETERMINATION AND ESTABLISHMENT OF ACCOUNTING PRINCIPLES

The Commission has certain powers and responsibilities under the Securities Acts to determine and establish accounting principles for registrants and their independent auditors. However, the Commission does not have the power to adopt or prescribe accounting rules without complying with the Administrative Procedure Act, or in circumvention of that Act, or which are arbitrary, capricious, an abuse of discretion, or otherwise contrary to law.

By issuing Accounting Series Release No. 177 (ASR 177), the Commission has attempted to require each independent auditor or auditing firm to make his or its own subjective determination of preferable accounting principles when an accounting change is made. This is the first time that such a responsibility has been imposed upon independent auditors of registrants to determine preferable accounting principles and practices without any determination of the criteria for preferability by the accounting profession or the Commission.

Numerous alternative accounting principles and practices have been adopted or permitted by the accounting profession and the Commission. In requiring independent auditors to express an opinion on preferability in connection with a change in accounting principles, the Commission has failed to recognize the fact that a determination of the preferability of an accounting principle among alternatives cannot be limited to the time that an accounting change occurs. If a particular principle is preferable when a change is made, it is equally preferable even though no change is made.

If the Commission has decided that new steps should be taken to eliminate accounting alternatives, an overall coordinated program is necessary rather than requiring each auditor or each auditing firm to decide which alternatives are preferable in cases where accounting changes are sought. Such determinations raise serious questions of "due process" not only with respect to those seeking a change, but especially with respect to those not seeking a change.

The Commission cannot evade its responsibilities under the Securities Acts either to establish the criteria for preferability among alternative accounting principles or to eliminate such alternatives.

SUMMARY OF REASONS FOR UNCERTAINTY AND INCONSISTENCY

The uncertainty with respect to the Commission's position concerning accounting principles has arisen because the Commission and its staff have adopted incompatible approaches to the selection of accounting principles and practices, whereas no approach is indicated in Rule 2-02(c) of Regulation S-X.

First, the Commission in Accounting Series Release No. 150 (ASR 150), issued in 1973, reaffirmed its rule originally adopted in 1938 that financial statements prepared in accordance with accounting practices for which there is no "substantial authoritative support" are presumed to be misleading even though that term represents a vague and undefined concept. The Commission in ASR 150 also adopted a rule that accounting principles, standards, and practices contrary to those theretofore or thereafter promulgated by the Statements and Interpretations of the Financial Accounting Standards Board (FASB), the Opinions of the Accounting Principles Board (APB), and the Accounting Research Bulletins of the Committee on Accounting Procedure that are still in effect are considered not to have substantial authoritative support and, thus, are presumed to be misleading under the Securities Acts. Any departures in unusual circumstances are to be handled on an *ad hoc* basis which would not have the status or protection of a rule.

ASR 150 = GAAP

> Thus, the Commission by ASR 150 has adopted a rule limiting independent auditors in giving opinions with respect to the financial statements of registrants, as well as registrants in preparing financial statements, to the use of accounting principles and practices that are approved by specific rules of the Commission or the provisions of the promulgations referred to above that have been adopted as rules (some of which authorize and approve alternatives) or, in the absence of those two sources, any other unidentified sources that the Commission believes represent "substantial authoritative support."

Second, the Commission and its members and staff in recent years have emphasized on many occasions the responsibility of independent auditors to use their professional judgment with respect to what "fairly presents" the facts in the financial statements of registrants. Their comments in this regard are along the lines of (1) "present fairly" cannot be defined by simple reference to generally accepted accounting principles; (2) "fairness" is related in some fashion to "truth" that has a meaning beyond generally accepted accounting principles; (3) determining "fairness" of financial statements represents an opportunity to move away from the rigidities of generally accepted accounting principles and other deterrents; and (4) independent auditors can and should make judgments of "fairness." (See Appendixes B and C.)

But fair Trumps

> Thus, this approach apparently leads to the conclusion that "fairness" cannot and should not be limited to the rigid restrictions outlined in the first approach.

Third, the Commission issued ASR 177, effective for filings of Form 10-Q for periods beginning after December 25, 1975, which provides that, whenever a registrant makes an accounting change, a letter from the registrant's independent auditors is to be filed indicating whether or not the change is to an alternative accounting principle which in the auditors' judgment is preferable under the circumstances. ASR 177 further states that the Commission believes that professional accounting judgment can be applied to determine whether an alternative accounting principle is preferable, and that management's justification of the proposed change should be sufficiently persuasive to convince an independent professional accounting expert that in his judgment the new principle represents an improved way of measuring business operations. Therefore, the judgments contemplated with respect to preferability of accounting principles are to be made by individual auditors or individual auditing firms, even for matters on which authoritative professional bodies have been unable to reach a consensus as to the preferability of alternatives and on which the Commission has done nothing to carry out the responsibilities it has under the Securities Acts.

The Commission has also stated (see Appendix F) with respect to this rule on "preferability" that the independent accountant must exercise professional judgment in appraising the accounting principles used by his client in reporting economic results (presumably as contrasted to results of operations in conformity with generally accepted accounting principles) and that one of the fundamental professional responsibilities of an independent accountant is to apply his skills and trained judgment in economic measurement to particular factual circumstances to determine whether the circumstances are fairly accounted for in the financial statements. In this regard, the only limitation indicated was that this should be done within the framework of "the accounting model." We do not know what is meant by "the accounting model," which is a term that has never been defined by the Commission or any authoritative professional body. However, ASR 150 presumably is encompassed in some fashion within that ambiguous and undefined term.

> Thus, an analysis of the Commission's attitude (both formal and informal) toward this approach concerning "preferability" raises a serious question about its relationship either to the first approach or to the second approach or to some combination thereof. Also, decisions on preferability among alternative accounting principles cannot be limited only to instances in which accounting changes are made.

Therefore, we conclude that these three approaches, which have been adopted by the Commission, are so incompatible and inconsistent that we as independent auditors are placed in an untenable position. We respectfully suggest that this situation requires clarification and action by the Commission to eliminate the confusion and uncertainty.

QUESTION OF WHAT CONSTITUTES ACCEPTABLE ACCOUNTING PRINCIPLES TO THE COMMISSION

The Commission issued Accounting Series Release No. 4 (ASR 4) in 1938 stating that financial statements prepared in accordance with accounting practices for which there was no "substantial authoritative support" were presumed to be misleading. This same rule was reaffirmed in ASR 150 in 1973, even though Statement No. 4 issued by the Accounting Principles Board in 1970 stated: "No comprehensive authoritative list of detailed accounting principles is presently available."[1]

ASR 150 states that accounting principles, standards, and practices theretofore or thereafter promulgated by Statements and Interpretations of the FASB, the Opinions of the APB, and the Accounting Research Bulletins of the Committee on Accounting Procedure that are still in effect will be considered by the Commission as having "substantial authoritative support" and those contrary to such promulgations will be considered not to have "substantial authoritative support." ASR 150 also indicates that financial statements prepared in accordance with accounting practices for which there is no "substantial authoritative support" are presumed to be misleading. (See Appendix A.)

While "substantial authoritative support" is obviously intended to cover accounting principles, standards, and practices not covered, or beyond those covered, in the promulgations referred to, those promulgations could be construed as a type of "safe harbor" under ASR 150 when followed by registrants and independent auditors. However, it is a vastly different proposition to adopt a rule, as the Commission did in ASR 150, stating that any accounting principles, standards, and practices contrary to those in the designated promulgations are considered not to have substantial authoritative support and, thus, are presumed to be misleading under the Securities Acts. *This latter provision represents the most significant and sweeping rule relating to accounting principles ever issued by the Commission.* // ASR 4

ASR 150 thus incorporated as rules of the Commission approximately 700 pages of pronouncements by two committees of the American Institute of Certified Public Accountants and by the Financial Accounting Standards Board that were issued from 1939 to 1973 (some of which are out of date and obsolete) without the Commission following the rule-making procedures prescribed by the Administrative Procedure Act. In addition, the Commission adopted as a part of ASR 150 the pronouncements issued *and to be issued* by the FASB, which represented only one Statement when ASR 150 was issued, and which now represents twelve Statements and nine Interpretations, with others presently in process. We do not understand how or why the Commission failed to conform with the provisions of the Administrative Procedure Act in this regard or can circumvent the provisions of that Act by automatically adopting as rules, upon issuance, all future pronouncements of the FASB.

When all of those pronouncements were adopted by the Commission as rules, the Commission gave no indication whatsoever that any of the alternative practices permitted thereby were considered to be preferable or that any of the alternatives should be eliminated.

Whatever meaning the undefined term "substantial authoritative support" may have had when ASR 4 was issued in 1938, such meaning would be vastly different today. The

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1. See paragraphs 137-139 and paragraphs 202-206 of Statement No. 4, "Basic Concepts and Accounting Principles," issued by the Accounting Principles Board in 1970. Also, see "Some Thoughts on Substantial Authoritative Support" by Marshall S. Armstrong, *The Journal of Accountancy*, April, 1969, page 44.

Committee on Accounting Procedure, the predecessor to the APB and the FASB, issued its first pronouncement in 1939, and many of the developments relating to accounting principles being followed today have occurred since that time. The rules, pronouncements, actions, and comments of the Commission and its members and staff during the last three years, including the Commission's recent letter of April 30, 1976 (see pages 10-12 and Appendix F), have made the need for a definition of this term particularly urgent.

FAIRNESS OF PRESENTATION OF FINANCIAL STATEMENTS

The Commission and its members and staff have emphasized on numerous occasions that independent auditors, in giving opinions on financial statements, have a responsibility for a fair presentation of the financial position and results of operations that is separate from their responsibilities with respect to conformity with "generally accepted accounting principles." Examples of typical comments in this regard are set forth below:

1. The Commission authorized the Chief Accountant to state in part as follows:

   "We believe that it is apparent from court cases and other sources that 'present fairly' cannot be defined by simple reference to generally accepted accounting principles." (See Appendix B.)

2. The Chief Accountant stated these general conclusions:

   "First, fairness seems to be related in some fashion to 'truth' which has some meaning beyond generally accepted accounting principles. Second, the courts seem to view generally accepted accounting principles as a set of defined rules and conventions and they believe that following these rules does not give complete absolution from the possibility of either civil or criminal liability. Third, the over-all impression left by the financial statements must be considered in appraising fairness and finally, the courts at least seem to view fairness as something that can be interpreted by the layman as well as the sophisticate." (See Appendix B.)

3. A Commissioner made the following statement:

   "The increased concern with the fairness of financial statements poses an opportunity to move away from the rigidities of generally accepted accounting principles and other deterrents to meaningful financial disclosure."

   Later in the same address, he said:

   ". . . I would suggest that auditors are not as inexperienced in making judgments of fairness as some of their opposition to this responsibility might suggest." (See Appendix C.)

The advocacy by our firm of "fairness" with respect to financial statements has been well known in the accounting profession and the business community for many years. This position has been advocated in numerous publications issued by our firm and in many addresses by partners of our firm. Our firm is not, and never has been, opposed to the idea of "fairness."

As an illustration, our firm published a booklet on "fairness" in 1960. The theme of that booklet is that ". . . the one basic accounting postulate underlying accounting principles may be stated as that of fairness—fairness to all segments of the business community (management, labor, stockholders, creditors, customers and the public), determined and measured in the light of the economic and political environment and the modes of thought and customs of all such segments—to the end that the accounting principles based upon this postulate shall produce financial accounting for the lawfully established economic rights and interests that is fair to all segments."

While "fairness" is not a new idea, it is only recently that the Commission and its staff have been advocating it frequently and forcefully. However, an important distinction exists between "fairness" as advocated by our firm and as advocated by the Commission. Our firm has viewed "fairness" as a base point for the determination of sound and uniform standards and principles to be applied in an objective manner. On the other hand, the Commission views "fairness" as something to be applied by each independent auditor on each engagement in a subjective manner without any criteria. If the Commission's version of "fairness" is its official position, as now appears to be the case, the Commission should address itself to the level of responsibility it has for achieving "fairness" in financial statements under the Securities Acts, including the oversight responsibility to see that the proper objectives are accomplished. The question in this regard is how a coordinated and consistent approach can be developed.

STATUS OF NEW COMMISSION RULES CONCERNING PREFERABILITY OF ACCOUNTING PRINCIPLES

Amended Instruction H(f) of Form 10-Q

The Commission, in ASR 177 dated September 10, 1975, adopted a rule amending Instruction H(f) of Form 10-Q, effective for reports covering periods beginning after December 25, 1975. (All report forms and instructions thereto are "rules and regulations" of the Commission.) This Instruction also adopted APB Opinion No. 28, "Interim Financial Reporting," as a rule, including *any amendments to be adopted by the FASB in the future.* (The amended Instruction H(f) is set forth herein in Appendix D.)

The Commission, in issuing this rule, added a new dimension to the process of establishing accounting principles when it stated that with respect to an accounting change "a letter from the registrant's independent accountants shall be filed as an exhibit indicating whether or not the change is to an alternative principle which in his judgment is preferable under the circumstances. . . ." ASR 177 states that the Commission "believes that professional accounting judgment can be applied to determine whether an alternative accounting principle is preferable" and that the justification should be "sufficiently persuasive to convince an independent professional accounting expert that in his judgment the new method represents an improved method of measuring business operations. . . ."[2] Thus, judgments with respect to preferability of accounting principles (including concepts, standards, practices, and methods), which are binding on their clients, are to be made by individual auditors or individual auditing firms and such judgments could be completely different from those of other auditors and auditing firms. These judgments are to be made even for matters on which authoritative professional bodies have been unable, over many years, to reach a consensus as to the preferable principles from among alternatives.

Our firm, with thousands of clients, has a grave responsibility to be fair to all of our clients. Whenever our firm, which has played an active role in the determination and formulation of accounting principles and in advocating improvements, states publicly that an accounting principle or practice is preferable, we are also indicating that any alternative principles or practices to that one are not preferable. A letter from our firm stating that a particular principle is preferable for one client could adversely affect many other clients not participating in such a decision and could adversely affect the reputation and credibility not only of such clients but also of our firm in giving reports on the financial statements of those other clients, whether or not they ever make accounting changes, and thus open our clients and our firm to potential costly litigation.

A determination of the preferability of an accounting principle among alternatives cannot be limited to the time that an accounting change occurs. If a particular principle is preferable when a change is made, it is equally preferable even though no change is made or contemplated. Both the independent auditor and his client are placed in a difficult position if a less preferable alternative is continued in use after the auditor has expressed his view on preferability at the time another client has elected to change an accounting principle.

The Commission and the Chief Accountant have indicated that preferability can be related to circumstances in individual cases. While this may be true in some cases, we submit that, in many important areas of accounting, alternative principles and practices cannot be justified by differences in circumstances. This is the reason the Accounting Principles Board and the Financial Accounting Standards Board have had many significant and complex problems with which to deal. It is in these areas that a stated preference by our firm could, in practice, adversely affect many clients—from the standpoint of the quality and credibility of their accounting and financial reporting as well as their ability to make accounting changes which they consider desirable—without such clients even knowing that they were being affected at the time.

Both the Commission and its staff have selected the FIFO and LIFO methods of inventory costing as an example of alternative practices where each auditing firm would

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2. See the paragraph in ASR 177 with respect to the adoption of Instruction H(f) of Form 10-Q, which is included herein as Appendix D. An excerpt from Staff Accounting Bulletin No. 6 dated March 1, 1976, which further interprets the revised Instruction H(f) of Form 10-Q, is also included herein as Appendix E.

be expected to select one of the two methods as being preferable for registrants which are its clients. (See Appendixes E and F.) Such a selection with respect to FIFO and LIFO on any meaningful basis is not feasible at the present time for the following reasons:

1. Some auditing firms would select one method as preferable and some auditing firms would select the other method since there is no consensus as to preferability with respect to FIFO or LIFO.

2. The Commission apparently has concluded that the LIFO method is preferable, although there is no published record of research and rationale in sufficient depth to warrant such a conclusion. The Commission gives as one reason that we are "in a world which emphasizes the income statement." (See Appendix F.) Such an assertion is subject to serious question in several respects and ignores the lesson learned in recent years by many investors and creditors that entirely too much emphasis has been placed on the income statement as compared to the balance sheet.

3. If there is any belief that preferability for FIFO or LIFO can be sorted out among thousands of registrants on the basis of the circumstances in each case, such a belief is unrealistic and not supported by any facts.

4. Staff Accounting Bulletin No. 6 places an unwarranted burden on a registrant to explain and support apparently inconsistent positions (such as between FIFO and LIFO) taken by its auditors in the case of other registrants.

5. If a registrant changes from FIFO to LIFO for Federal income tax purposes in a proper manner, with the legal requirement that LIFO be reflected in the financial statements, it is unlikely that the registrant's auditors can effectively stop this change. Likewise, if a registrant changes from LIFO to FIFO, with FIFO still being followed by more business enterprises than LIFO, and with FIFO being supported by many knowledgeable accountants as having a better theoretical basis under present accounting principles, it is unlikely that the registrant's auditors can effectively stop this change. This example merely illustrates the fact that, unless the Commission or the FASB goes through proper procedures to eliminate FIFO or LIFO, there is no basis for the Commission to evade its own responsibility by attempting to prevent registrants from adopting either method under the guise of a Commission rule placing a responsibility for preferability on individual auditors and auditing firms.

For independent auditors to comply ostensibly with the Commission's requirement by obtuse wording of their opinions on preferable accounting principles and by taking evasive positions in such opinions, as has been suggested by some who do not want to face the real issues, would only lead to a loss of credibility of the audit function and severe criticism in the future. Our firm desires to deal with the important subject of preferable accounting principles in a forthright and straightforward manner.

Request for Reconsideration by AICPA and Reply by Commission

As a result of a request from the Chairman of the Auditing Standards Executive Committee of the American Institute of Certified Public Accountants, the Commission agreed to have a public meeting with representatives of that Committee on April 23, 1976, to discuss the Committee's request to "institute new rulemaking proceedings ~~on this issue~~ and suspend the effectiveness of the rule during such proceedings." The rule referred to was Instruction H(f) of Form 10-Q.

Subsequent to this meeting, the Secretary of the Commission sent a letter, dated April 30, 1976, to the Chairman of the Auditing Standards Executive Committee on behalf of the Commission stating in part that ". . . the Commission sees no reason to change its conclusion and it therefore has determined neither to amend nor suspend the effectiveness of Instruction H(f) of Form 10-Q." That letter (see Appendix F) includes the following two paragraphs:

> "The most significant argument presented is that an independent accountant cannot properly reach a professional opinion concerning the preferability of an accounting principle where more than one alternative is acceptable and no criteria exist for that determination. This argument suggests that it is not possible for a professional accountant to reach a judgment as to how economic phenomena should be measured without a rule book which prescribes specific criteria for such measurement. The Commission does not agree. The basic training of a professional accountant is designed to provide him with skill and judgment in the techniques of measurement. *One of the fundamental professional responsibilities of an independent accountant is to apply his skills and trained judgment in economic measurement to particular factual circumstances to determine whether the circumstances are fairly accounted for within the framework of the accounting model.*
>
> *"The Commission believes that the independent accountant must exercise professional judgment in appraising the accounting principles used by his client in reporting economic results.* In effect, he must share the responsibility for assuring that operations are described in a fashion which will be meaningful to investors for purposes of their decision making, *subject to the limitations of the basic accounting model.* The Commission believes that the concept of 'fair presentation' embodies this responsibility." (Italics added.)

The letter referred to above places emphasis on the responsibilities of the independent auditor to "exercise professional judgment in appraising the accounting principles used by his client in reporting economic results" and "to apply his skills and trained judgment in economic measurement to particular factual circumstances to determine whether the circumstances are fairly accounted for." These responsibilities, as set forth in the above letter, are certainly as applicable for companies that do not make an accounting change as they are for companies that make an accounting change.

The letter indicates that the only limitation in accomplishing the stated objectives is "the accounting model." We do not know what is meant by "the accounting model." There is no common understanding of its meaning, and it has not been defined by the Commission or any authoritative professional body. If this term is to be the primary limiting factor in the use of our professional judgment with respect to "preferability," it is crucial that we and others be informed of what the Commission has in mind in this regard. The only indications we have of what the Commission might have in mind with respect to "the accounting model" are in the comments of the Chief Accountant of the Commission in an address. (See Appendix B.) Those comments, in our opinion, represent a completely inadequate description of "the accounting model" (as it would relate either to any one or to all registrants) for the purposes of registrants or independent auditors in carrying out their responsibilities under the Securities Acts. Also, ~~we do not understand~~ the significance of the Chief Accountant's reference in this regard to "divine revelation." If the notion of "the accounting model" is to play a significant role in "preferability" determinations, it is incumbent on the Commission to prescribe the specific parameters and elements of this model.

The Commission in its letter of April 30, 1976, not only adds a new undefined limitation that was not included in ASR 177 but also sets forth the responsibilities of independent auditors in a way that could not possibly be obtained from the wording of ASR 177. That letter has not been published by the Commission for the benefit of all independent auditors, and yet it represents a significant amendment to the rule adopted by ASR 177 without compliance with the Administrative Procedure Act.

APB Opinion No. 20

The Commission in its letter of April 30, 1976, also refers to APB Opinion No. 20, "Accounting Changes" (1971), which has been adopted as a rule of the Commission, but we submit improperly so. We presume that the reference is to the following sentence in that Opinion:

> "The presumption that an entity should not change an accounting principle may be overcome only if *the enterprise* justifies the use of an alternative acceptable accounting principle on the basis that it is preferable." (Italics added.)

A partner of our firm was a member of the Accounting Principles Board and participated in the discussions and voting of the APB on Opinion No. 20. In his opinion, the APB did not intend that provision to be interpreted in the manner that the Commission and its staff are now interpreting it. We believe that the "legislative intent" of the APB should not be ignored by the Commission.

Statement on Auditing Standards No. 1 (SAS 1) was adopted unanimously in 1973 by the twenty-one members of the Committee on Auditing Procedure (currently the Auditing

Standards Executive Committee of the AICPA) in accordance with formal procedures adopted by the AICPA. SAS 1, with reference to the quotation from APB Opinion No. 20 referred to above, states as follows in section 546.04:

> "The auditor should evaluate a change in accounting principle to satisfy himself that (a) the newly adopted accounting principle is a generally accepted accounting principle, (b) the method of accounting for the effect of the change is in conformity with generally accepted accounting principles, and (c) *management's justification for the change is reasonable. . . .*" (Italics added.)

That Committee correctly interpreted the provision of APB Opinion No. 20 and concluded that the independent auditor would not make a determination of "preferability" of accounting changes as now required by the Commission. The Commission is substituting its judgment for that of twenty-one professional accountants specially selected for this Committee when the Commission with respect to the above wording states: ". . . the Commission believes that the profession has amended an accounting standard in an inappropriate way." (See Appendix F.) In our view, the Commission has attempted to amend both an accounting standard and an auditing standard in an inappropriate way.

POSITION OF OUR FIRM IN FOLLOWING THE COMMISSION'S REQUIREMENTS

Because of the various contradictory and inconsistent positions taken by the Commission and its staff, as set forth in this petition, our firm is placed in an untenable position in trying to carry out our responsibilities under the Securities Acts and under the rules of the Commission.

The Commission has statutory authority to establish appropriate rules and regulations in a prescribed manner with respect to accounting principles and practices. In this regard, the Commission also has a responsibility to adopt rules that are clear and not inconsistent with other rules of the Commission and with pronouncements, comments, and actions of the Commission and its staff.

"Substantial authoritative support," as that term is used in ASR 4 and ASR 150, has not been defined by the Commission or any authoritative professional body. As a result, that term has been used, particularly in recent years, by the Commission and its staff to mean whatever they want it to mean in individual cases. Also, the rules reflected in ASR 150 are being used frequently by the Commission and its staff to severely restrict (in a highly technical manner) independent auditors in the application of their professional judgment.

On the other hand, as indicated in this petition, the Commission and its staff have been attempting to influence the development of the law by means of letters and speeches and, in that process, emphasis has been given to the need for independent auditors to be concerned with fair presentation of the facts and circumstances, the exercise of professional judgment in appraising accounting principles and in reporting economic results and measurements, the determination of proper accounting principles and practices, the need to reflect reality in financial statements, and other similar responsibilities.

We submit that it is not possible to carry out all of these responsibilities properly so long as ASR 150 is effective in its present form.

To make decisions on "fairness" and "preferability" as contemplated by the Commission in major and controversial areas of accounting, our firm cannot wait until a client decides to make an accounting change. Further, such decisions cannot be made by our firm on an ad hoc, isolated, and uncoordinated basis. Also, we cannot make these decisions without considering their effect on all clients.

These decisions can be made only if they are based on our own carefully considered views concerning the objectives of financial statements and an appropriate conceptual framework. We have developed procedures that can be used for making the necessary decisions if we are required to do so by the Commission. A conceptual framework for arriving at "fairness" and "preferability" of accounting standards, principles, and practices does not exist with respect to the current concept of "generally accepted accounting principles."[3] Thus, the decisions the Commission is asking our firm to make cannot possibly be limited to those accounting principles that are being permitted under ASR 150.

Our procedures contemplate the necessity of obtaining the views of our clients and of notifying them of our decisions, just as the FASB or the Commission would do, since our clients would be significantly affected by our decisions in this regard and are entitled to "due process." This would involve the issuance of discussion memoranda on conceptual matters and specific areas of accounting and the exposure of drafts of our conclusions for comments. Our conclusions would be published so that our clients and the users of the financial statements of our clients would know our conclusions and the basis and reasoning for our conclusions.

In cases of differences in views on preferable accounting either between our firm and our clients or between our firm and other auditing firms, the Commission would be required to resolve the differences of viewpoints and make formal decisions on preferable accounting principles and practices if a coordinated and consistent approach is to be achieved.

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3. APB Statement No. 4, issued in 1970, explains conclusively that "generally accepted accounting principles" represent a group of customs that have evolved and does not have a coordinated conceptual framework. (See paragraph 139.) This is evident throughout that Statement. An example is the definition of assets as "economic resources of an enterprise that are recognized and measured in conformity with generally accepted accounting principles" and of liabilities as "economic obligations of an enterprise that are recognized and measured in conformity with generally accepted accounting principles." (See paragraph 132.)

REQUEST FOR ACTION BY COMMISSION

We are requesting action by the Commission for the reasons stated heretofore in this petition and because we believe that the Commission's action in issuing Instruction H(f) of Form 10-Q, as adopted by ASR 177, and as amended by the Commission's letter dated April 30, 1976, was not adopted in conformity with the Administrative Procedure Act in that:

1. Instruction H(f) of Form 10-Q, as adopted by ASR 177, includes as an accounting rule APB Opinion No. 28, which Opinion was neither then nor previously properly adopted by the Commission as an accounting rule in conformity with the Administrative Procedure Act.

2. Instruction H(f) of Form 10-Q, as adopted by ASR 177, improperly delegated to the Financial Accounting Standards Board the right to make future accounting rules, which shall have the status of accounting rules of the Commission, without compliance by the Commission with, and in direct circumvention of, the provisions of the Administrative Procedure Act. Moreover, Congress has specifically prohibited the Commission from delegating its general rule-making authority even to a division of the Commission.

3. The Commission's letter of April 30, 1976, restricted the exercise of the accountant's judgment in complying with Instruction H(f) of Form 10-Q, as adopted by ASR 177, to the limitations of "the accounting model," an undefined and ambiguous term, and such additional rule was adopted without complying with the Administrative Procedure Act.

4. Instruction H(f) of Form 10-Q, as adopted by ASR 177, incorporated ASR 150 by necessity. ASR 150 is a rule of general applicability, incorporating by reference a major segment of professional accounting literature relating to accounting standards, principles, and practices, and presumably is included within the undefined and ambiguous reference to "the accounting model" in the Commission letter of April 30, 1976. ASR 150, and the multitude of bulletins, opinions, and statements incorporated therein by reference, were all adopted as rules of the Commission in direct violation of the Administrative Procedure Act and without even a pretense of compliance. Moreover, in circumvention of the Administrative Procedure Act, ASR 150 incorporates all future Statements and Interpretations of the Financial Accounting Standards Board.

We are also of the view that:

1. Instruction H(f) of Form 10-Q, as adopted by ASR 177, is unreasonable, arbitrary, and capricious, an abuse of discretion, a deprivation of due process, and contrary to law.

2. Instruction H(f) of Form 10-Q, as adopted by ASR 177, creates an impermissible classification of persons subject thereto—persons seeking to change an accounting

principle heretofore followed by them (accounting principle X) to an alternate accounting principle (accounting principle Y) and those following accounting principle X who desire to continue to follow accounting principle X—and compliance with ASR 177 by an independent auditor in respect of persons seeking a change from accounting principle X to accounting principle Y will inevitably result in stigmatizing those continuing to follow accounting principle X since accounting principle X will have been characterized as a nonpreferred principle. Such a process of stigmatizing others, without an opportunity for them to be heard, adversely affects and aggrieves them and this firm, in violation of due process of law.

Therefore, for these and other reasons stated in this petition, we hereby request that the Commission take the following actions:

1. To revoke amended Instruction H(f) of Form 10-Q and the related explanatory paragraph, as adopted and included in ASR 177.
2. To revoke ASR 150.
3. To define, through the rule-making procedures prescribed by the Administrative Procedure Act, the current meaning of the term "substantial authoritative support" as that term is used in ASR 4 and as it relates to the accounting standards, principles, and practices of registrants when independent auditors give opinions on the financial statements of registrants filed with the Commission under the Securities Acts; or, if the Commission prefers not to define that term, to revoke ASR 4.

Respectfully submitted on the 15th day of June, 1976.

ARTHUR ANDERSEN & CO.

By /s/ CHARLES W. BOAND

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APPENDIX A

PARAGRAPH FROM ACCOUNTING SERIES RELEASE NO. 150 (DECEMBER 20, 1973)

"In Accounting Series Release No. 4 (1938) the Commission stated its policy that financial statements prepared in accordance with accounting practices for which there was no substantial authoritative support were presumed to be misleading and that footnote or other disclosure would not avoid this presumption. It is also stated that, where there was a difference of opinion between the Commission and a registrant as to the proper accounting to be followed in a particular case, disclosure would be accepted in lieu of correction of the financial statements themselves only if substantial authoritative support existed for the accounting practices followed by the registrant and the position of the Commission had not been expressed in rules, regulations or other official releases. For purposes of this policy, principles, standards and practices promulgated by the FASB in its Statements and Interpretations[1] will be considered by the Commission as having substantial authoritative support, and those contrary to such FASB promulgations will be considered[2] to have no such support.

"1. Accounting Research Bulletins of the Committee on Accounting Procedure of the American Institute of Certified Public Accountants and effective Opinions of the Accounting Principles Board of the Institute should be considered as continuing in force with the same degree of authority except to the extent altered, amended, supplemented, revoked or superseded by one or more Statements of Financial Accounting Standards issued by the FASB.

"2. It should be noted that Rule 203 of the Rules of Conduct of the Code of Ethics of the AICPA provides that it is necessary to depart from accounting principles promulgated by the body designated by the Council of the AICPA if, due to unusual circumstances, failure to do so would result in misleading financial statements. In such a case, the use of other principles may be accepted or required by the Commission."

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NOTE: The word "misleading" as used in the paragraph quoted above is particularly significant because of the presence of that word in several sections of the Securities Act of 1933 (including Section 11) and in Rule 10b-5 under the Securities Exchange Act of 1934 as well as several other sections of that Act.

APPENDIX B

EXCERPTS FROM ADDRESS BY THE CHIEF ACCOUNTANT OF THE COMMISSION[4]

"Most recently, the Commission's views on fairness were expressed to the accounting profession in responding to an exposure draft on the subject of reports on audited financial statements. This draft proposed to add a sentence that would define fairness in terms of conformity with GAAP. The Commission's response indicated that the Commission was 'deeply troubled' by this sentence and recommended its deletion. The Commission authorized the Chief Accountant to submit the following comments on this sentence:

> We believe that it is apparent from court cases and other sources that *'present fairly' cannot be defined by simple reference to generally accepted accounting principles.* We are concerned by the impression the sentence gives that AudSEC is determined to deal summarily with the problem. We believe that issues such as the objectives of financial statements and the function of independent auditors have an important bearing on the meaning of 'present fairly' when used by auditors in relation to financial statements. This phrase is the focus of rising public expectations. We recognize that AudSEC cannot deal with all of these issues in a Statement on Auditing Standards, and it seems important that they avoid the appearance of having changed their minds on these issues." (Italics added.)

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"In looking at these various cases and statements, it appears that four general conclusions can be drawn. *First, fairness seems to be related in some fashion to 'truth' which has some meaning beyond generally accepted accounting principles. Second, the courts seem to view generally accepted accounting principles as a set of defined rules and conventions and they believe that following these rules does not give complete absolution from the possibility of either civil or criminal liability. Third, the over-all impression left by the financial statements must be considered in appraising fairness and finally, the courts at least seem to view fairness as something that can be interpreted by the layman as well as the sophisticate."* (Italics added.)

* * * * * * *

"There have been many attempts to define 'the accounting model' and it is unlikely that any specific articulation will win universal approval. Nevertheless, since it is a significant element in the determination of fairness, it seems desirable to attempt to present a simplified statement of my view of the accounting model today.

"Five parameters provide a reasonable definition of this model. First, business results are presented in a set of articulated financial statements of which the income statement has primacy. Second, income is measured by an averaging approach (called matching) which is

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4. John C. Burton, an address entitled "Fair Presentation: Another View," The Baruch College of the City University of New York, February 18, 1975.

APPENDIX B
(Continued)

designed to show the long-run average net cash inflow at the current level of activity. Third, the current level of activity is measured by recognizing revenue on the basis of work done and the legitimization of the value of that work by an arms' length transaction with an outside party. Fourth, asset valuations are generally based on historical monetary costs incurred in arms' length transactions. Increases in value are recognized only when a transaction occurs, while decreases are recognized when there is a reduction in the value of assets for the purposes for which they are held. Finally, business substance rather than legal form must predominate in the analysis of transactions and the determination of the accounting to be followed for them.

"This basic model is not static and may change over time based on a changing consensus of business realities, upon a Financial Accounting Standards Board study of the conceptual framework for financial reporting, *or even upon divine revelation,* if that is different from an FASB study.

"Within the framework of this accounting model, fairness seems to me to have three essential elements when applied to the financial reporting process. First, the financial statements taken as a whole must present business results in a fashion such that users who have a general familiarity with the accounting model will be able to understand what happened to the reporting entity in a business sense. A detailed knowledge of accounting should not be required of users to achieve this result, even though general familiarity with the model is necessary. The user should not be required to be familiar with Judge MacMahon's 'esoteric accounting norms comprehensible only to the initiate.' The basic impression given by the financial statements should coincide with the business reality; in other words, the message must be readily receivable.

"In meeting this first test, subjective determinations as to the appropriateness of accounting principles followed in the circumstances are inevitably required. It is not appropriate for the company accountant or the independent auditor to deny the need for such subjective determinations. The independent accountant is a measurer by profession and he should be best able to appraise the desirability of alternative methods in communicating a factual situation to a user of financial statements." (Italics added.)

* * * * * * *

"The need for subjective judgments in determining fairness seems to me also to emphasize the importance of an independent and unbiased measurer. This may require a rearticulation of the role of the independent public accountant in public financial reporting. Traditionally, the auditor has attested to management's financial statements. This has implied that management should make the basic reporting decisions and the auditor's role was to attest to the fact that the statements fell within acceptable limits. As the subjectivity inherent in fair presentation is recognized, it may be considered inappropriate to put the primary responsibility on management for making financial reporting decisions. At a minimum, it would seem that the independent accountant should take on a joint responsibility with management for fair presentation, so as to avoid the suspicion that management may have some bias in reporting on its own activities.

"Joint responsibility would imply that management and independent accountants would have to agree on the various subjective judgments involved in determining what constitutes the best communication of business results to the investing public. If agreement could not be reached, both parties would have the obligation to report differences in view."

APPENDIX C

EXCERPTS FROM ADDRESS BY COMMISSIONER A. A. SOMMER, JR.[5]

"The increased concern with the fairness of financial statements poses an opportunity to move away from the rigidities of generally accepted accounting principles and other deterrents to meaningful financial disclosure. I well realize the concern that the accounting profession has with respect to the introduction of concepts of 'fairness' into their judgment process. However, I am sure all of you recognize that the courts and the Commission are in effect committing you to this kind of judgment. In *United States* v. *Simon*, a criminal case decided several years ago by the United States Court of Appeals for the Second Circuit, an opinion authored by Judge Henry C. Friendly, in the estimation of many, the most knowledgable and sophisticated federal judge in matters of corporation finance, indicated clearly that in many circumstances an auditor may not stop at a determination that financial statements have been prepared in accordance with generally accepted accounting principles, but that his professional endeavor must also encompass a determination of fairness. The Court of Appeals affirmed the decision of the lower court, including particularly the legal propriety of the trial judge's charge to the jury. In that charge the Judge very clearly indicated that while a determination by an auditor that financial statements have been prepared in accordance with generally accepted accounting principles went a long way toward establishing the propriety of the auditors' conduct, that did not constitute a complete defense and the auditor must of necessity go even further in examining the statements for fairness.

"I do not think the courts or the Commission are calling upon the accounting profession to make fine delineations with respect to fairness. Rather it seems to me that what we are seeking is the sort of determination of fairness that would find among reasonable men little disagreement, although the older I get, the more I realize there are very few propositions that can be put forward that would not encounter disagreement in some quarter. I do not think it should have required elaborate standards to enable auditors to make judgments of fairness about the financial statements of many franchisors, land developers, acquisitive conglomerates, and other phenomena of the recent past, just as I do not think it poses a very harsh burden to expect auditors to make fairness judgments when very significant amounts of ordinary income of a corporation represent gain on the early extinguishment of debt. . . ." (Italics added.)

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". . . Finally, *I would suggest that auditors are not as inexperienced in making judgments of fairness as some of their opposition to this responsibility might suggest.* They, like all of us, are making relatively surefooted judgments of fairness every day. We have highly developed notions of fairness with regard to the conduct of our children, our wives, our business associates, our governments. The transportation of these concepts, which should be more fully developed in the psyche of professionals than elsewhere, into professional life should not be difficult." (Italics added.)

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5. A. A. Sommer, Jr., an address entitled "Keep Your Eye on the Donut," National Association of Accountants, New York City, March 18, 1975.

APPENDIX D

AMENDED INSTRUCTION H(f) OF FORM 10-Q AS ADOPTED BY ASR 177

"(f) The financial statements to be included in this report shall be prepared in conformity with the standards of accounting measurement set forth in Accounting Principles Board Opinion No. 28 and any amendments thereto adopted by the Financial Accounting Standards Board. In addition to meeting the reporting requirements for accounting changes specified therein, the registrant shall state the date of any change and the reasons for making it. In addition, in the first Form 10-Q filed subsequent to the date of an accounting change, a letter from the registrant's independent accountants shall be filed as an exhibit indicating whether or not the change is to an alternative principle which in his judgment is preferable under the circumstances; except that no letter from the accountant need be filed when the change is made in response to a standard adopted by the Financial Accounting Standards Board which requires such change."

PARAGRAPH IN ASR 177 WITH RESPECT TO ADOPTION OF AMENDED INSTRUCTION H(f) OF FORM 10-Q

"In connection with accounting changes, a letter from the registrant's independent public accountant is required to be filed in which the accountant states whether or not the change is to an alternative principle which in his judgment is preferable under the circumstances. A number of accountants objected to this requirement on the grounds that no standards exist for judging preferability among generally accepted accounting principles and that authoritative accounting principles only require that management justify that a change is to a preferable method. The Commission believes that professional accounting judgment can be applied to determine whether an alternative accounting principle is preferable in a particular set of circumstances. Since a substantial burden of proof falls upon management to justify a change, the Commission believes that the burden has not been met unless the justification is sufficiently persuasive to convince an independent professional accounting expert that in his judgment the new method represents an improved method of measuring business operations in the particular circumstances involved. The proposed rule has therefore been adopted as proposed."

APPENDIX E

EXCERPT FROM SEC STAFF ACCOUNTING BULLETIN NO. 6 (MARCH 1, 1976) WHICH INTERPRETS AMENDED INSTRUCTION H(f) OF FORM 10-Q

"f. Reporting Requirements for Accounting Changes

Facts:

Instruction H(f) to Form 10-Q requires that a registrant who changes its method of accounting, shall indicate the date for such changes and the reasons for the changes. The registrant also must include as an exhibit in the 'first Form 10-Q filed subsequent to the date of an accounting change, a letter from the registrant's independent accountants . . . indicating whether or not the change is to an alternative principle which in his judgment is preferable under the circumstances.' A letter from the independent accountant is not required 'when the change is made in response to a standard adopted by the Financial Accounting Standards Board which requires such a change.'

Question 1:

If one client of an independent accounting firm changes its method of accounting and the accountant submits the required letter stating his view of the preferability of the principle in the circumstances, does this mean that all clients of that firm are constrained from making the converse change in accounting (e.g., if one client changes from FIFO to LIFO, can no other client change from LIFO to FIFO)?

Interpretive Response:

Where the factual circumstances surrounding the accounting changes are similar, the staff would not expect an accounting firm to accept accounting changes in both directions by different clients. In unusual cases, however, substantially different factual circumstances may exist in different client situations which would make it possible for the accountant to conclude that switches in opposite directions may each be preferable under all the particular circumstances. Registrants and accountants may expect the staff to request that it be furnished with the details supporting acceptance of apparently inconsistent positions by the accounting firm.

Question 2:

If a registrant changes its accounting to one of two methods specifically approved by the FASB in a Statement of Financial Accounting Standards (such

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(Continued)

as FASB 9) need the independent accountant express his view as to the preferability of the method selected?

Interpretive Response:

If a registrant was formerly using a method of accounting no longer deemed acceptable, a change to either method approved by the FASB may be presumed to be a change to a preferable method and no letter will be required from the independent accountant. If, however, the registrant was formerly using one of the methods approved by the FASB for current use and wishes to change to an alternative approved method, then the registrant must justify its change as being one to a preferable method in the circumstances and the independent accountant must submit a letter stating that in his view the change is to a principle that is preferable in the circumstances."

APPENDIX F

LETTER FROM SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549

April 30, 1976

Mr. Kenneth P. Johnson
Chairman
Auditing Standards Executive
Committee
American Institute of CPAs
1211 Avenue of the Americas
New York, New York 10036

Dear Mr. Johnson:

The Commission has considered the issues raised by the Auditing Standards Executive Committee of the AICPA (AudSEC) in its request that the Commission amend the instruction to Form 10-Q which requires that when a change in accounting principles has occurred the registrant file a letter from its independent public accountant in which the accountant states whether or not the change is to an accounting principle which in the accountant's judgment is preferable under the circumstances.

This instruction was originally published for comment in Securities Act Release No. 5549 on December 19, 1975. Comments were raised on the proposal raising essentially the same issues as those set forth in your letter and in addition the issues were presented at the public hearings held by the Commission on its interim reporting proposals. The Commission gave careful consideration to these issues prior to the adoption of the rules, and it concluded that the objections raised were not a reasonable basis for denying to investors the benefits which would arise from requiring an independent accountant to reach a professional judgment as to the preferability of an accounting method in the registrant's circumstances and reporting such judgment in a filing with the Commission.

The reasoning behind this conclusion was set forth in Accounting Series Release No. 177. Since no new evidence or reasoning has been presented to it, the Commission sees no reason to change its conclusion and it therefore has determined neither to amend nor suspend the effectiveness of Instruction H(f) of Form 10-Q. Because of the concern expressed by AudSEC, however, the Commission does wish to respond in more detail to the arguments presented than was possible in Accounting Series Release No. 177.

The most significant argument presented is that an independent accountant cannot properly reach a professional opinion concerning the preferability of an accounting principle where more than one alternative is acceptable and no criteria exist for that determination.

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(Continued)

This argument suggests that it is not possible for a professional accountant to reach a judgment as to how economic phenomena should be measured without a rule book which prescribes specific criteria for such measurement. The Commission does not agree. The basic training of a professional accountant is designed to provide him with skill and judgment in the techniques of measurement. One of the fundamental professional responsibilities of an independent accountant is to apply his skills and trained judgment in economic measurement to particular factual circumstances to determine whether the circumstances are fairly accounted for within the framework of the accounting model.

The Commission believes that the independent accountant must exercise professional judgment in appraising the accounting principles used by his client in reporting economic results. In effect, he must share the responsibility for assuring that operations are described in a fashion which will be meaningful to investors for purposes of their decision making, subject to the limitations of the basic accounting model. The Commission believes that the concept of "fair presentation" embodies this responsibility.

In this particular case, the accountant is only being asked to reach a judgment and report as to preferability in the situation where the registrant wishes to change accounting principles. This requirement is based on a specific accounting standard (APB Opinion No. 20) adopted by the profession. This standard adopted a presumption that changes in accounting principles should generally not be made, since consistency of reported results from period to period is important to investors. The opinion did permit changes, however, if "the enterprise justifies the use of an alternative accounting principle on the basis that it is preferable." It is clear from the language used that the Accounting Principles Board did not intend that this requirement be met on the basis of an unsubstantiated management opinion.

The accountant's judgments as to preferability should not be based solely upon an abstract preference among principles as was suggested in some of the examples cited in the April 23 meeting with AudSEC, but rather must reflect a professional appraisal of the specific circumstances that exist in the case of a particular registrant. Clearly, for example, the preferability of methods of depreciation will depend on the nature and location of assets and management's plans for their use and not upon a subjective personal preference for "straight-line" or "accelerated" depreciation in every case. In addition, there may be elements of business judgment and business planning which enter into a registrant's determination that an alternative accounting principle is preferable and the accountant is not expected to either ignore such elements or to substitute his judgment with respect to them (within reasonable limits) for that of the registrant. Rather he is expected to apply his professional accounting judgment to a determination as to whether an alternative accounting principle is preferable in the light of all the relevant factors in the particular case. In his letter with respect to the preferability of the change, an accountant may refer to his reliance on the registrant's judgment with respect to such elements.

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(Continued)

The Commission therefore believes that it is only requiring registrants to meet the requirements of generally accepted accounting principles in requiring that registrants provide a justification sufficient to convince their independent accountants that the accounting change is to a preferable method in the circumstances. If the accounting profession has been interpreting the words of SAS 1 to lead to a different conclusion, the Commission believes that the profession has amended an accounting standard in an inappropriate way. If in fact there is no professional basis for concluding that one accounting principle is preferable to another, as AudSEC suggests, then APB Opinion 20 makes it clear that no change can be made which is in conformity with generally accepted accounting principles.

In some of the cases cited by AudSEC, however, the Commission believes that it would be possible for a professional judgment to be reached as to preferability. For example, in a period of rising prices and in a world which emphasizes the income statement, it would not be difficult to reach a professional judgment in most cases that the LIFO system of inventory costing would produce a more meaningful result than FIFO for investors, particularly in the light of the requirement that the current replacement cost of LIFO inventory be disclosed.

In Staff Accounting Bulletin No. 6, the Commission staff expressed its view that accounting firms would not be expected to approve accounting changes in different directions by different clients when factual circumstances are similar, but it also indicated that where factual circumstances differed significantly, different accounting principles may be preferable. This subject has been further discussed above and, in the light of that discussion, the Commission believes that this interpretation is reasonable and that it will encourage firms to make such decisions with care. Such care and study should contribute in the long run to the desirable end of reducing acceptable alternatives, but the Commission recognizes that until alternatives are eliminated by standard-setting bodies, there will be cases where similar facts are differently accounted for. The Commission does not believe that making individual firm changes in accounting more difficult will delay the adoption of improved accounting standards in controversial areas.

For these reasons, the Commission declines to take the action requested in your letter of February 4, 1976.

Sincerely,

/s/ GEORGE A. FITZSIMMONS

George A. Fitzsimmons
Secretary