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Final Exam Essay

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To: Financial Accounting Standards Board  
From: James Trani  
Date: December 11, 2002  
Subject: Proposal to adopt a principles-based approach to accounting standard setting.

My name is James Trani and I am a student in Intermediate Accounting at Providence College. It has come to my attention that to increase the quality and transparency of financial reporting, the Financial Accounting Standards Board (FASB) has proposed the adoption of a broader, principles-based approach to accounting standard setting, similar to the approach of the International Accounting Standards Board (IASB). This would involve a complete modification of the standard setting process and the existing standards, as well as require the cooperation of all those that practice accounting. It is my opinion that adopting this new standard setting approach would be beneficial and should be implemented.

#### Advantages to Principles-Based Approach

In the aftermath of the recent accounting scandals, the actual accounting standards themselves have come under much scrutiny. Many feel that the current method of standard setting is too confusing due to the length the documents and the number of exceptions to the rule, allowing for the discovery of loopholes. A principles-based method for standard setting would provide for a looser interpretation of the rule on a case by case basis. When accountants do not understand how to properly apply these lengthy standards to their current tasks, the information is not reported as transparently and concisely as possible, leaving financial statement users such as potential investors and creditors lost. This new approach would allow the accountant to use his/her professional judgment to apply the standards in a fashion that can be more understood both by him/her and by the readers.

### Disadvantages to Principles-Based Approach

A broader scope to accounting standard setting also includes some possible troubles that the FASB would need to consider. Based on the current status of the profession in the eyes of the public, requiring accountants to utilize their own discretion can be looked upon as an invitation for conflict. To some of the critics, this approach could violate the characteristics of comparability and consistency. One valid question asks, "If opinions on how to treat certain items vary from accountant to accountant, how will companies or the investing public understand the information presented to them or be able to compare the treatment of various items?" Still others fear inappropriate actions on the part of accountants such as using these broader rules that would be left to their interpretation to make somehow biased judgments.

### Recommendations

To deal with the disadvantages listed above, the Board would need to know when to provide interpretive and implementation guidance. I feel that when a new standard under the principles-based approach involves complex issues that can have several valid applications, some loose guidance would be necessary to keep accountants within a reasonable range of each others opinion. Restricting interpretation down to one exact method with several exceptions confuses more than it elucidates. There would also need to be a system of effectively gaining the cooperation of all accountants to act with integrity and honesty in using their professional judgment to interpret principal-based standards. The new Public Accounting Oversight Board would be a fitting candidate to ensure that all accountants are registered in some way to uphold an oath of truthfulness. The oversight board would also administer proper punishment to those who do not comply or deviate from this agreement. By implementing a principles-based standard setting approach in a manner similar to this, I feel the industry would better understand how to apply standards to the financial statements and in turn statement users would better understand the information presented to them.