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From: Dino Verardo

Subject: FASB Proposal to Change Accounting Standard Setting to a Principles-Based Approach

My name is Dino Verardo, and I am a junior accounting major at Providence College in Providence, Rhode Island. I am currently enrolled in an Intermediate Accounting course, which has covered many issues on financial reporting, standard setting, and the qualitative and quantitative characteristics of accounting information. As part of my final exam, I am writing to you in support of the Financial Accounting Standards Board's proposal to alter accounting standards setting to a principles-based approach.

The idea of implementing a principles-based approach to accounting standard setting has become an important issue in the U.S., due to the recent financial reporting blunders and the Sarbanes-Oxley Act. There are also many other reasons why the FASB should look into changing the way financial information is reported. The most important reason for such a move away from rules-based accounting is because the old rules have not worked of late. Most of the recent financial reporting oversights technically do fall within the rules of accounting, including the collapse of Enron. Though the rules provide accountants with a sort of freedom from liability, if the rules technically allow for such corporate "disasters" as Enron and Worldcom, there clearly needs to be a change.

The principles-based approach to accounting standards would provide a more simplistic approach to setting standards, in that it would only contain a few exceptions to the main principle. This will differ greatly from the rule and exception heavy standards we currently follow. With increasingly more complex standards only the most adept accountant or business executive can follow what is truly occurring. Since financial reporting is meant to provide useful information to those making investment and credit decisions that have a general understanding of business and economics, such a simplistic approach is favorable. If rules-based approach is continued, the main objective of financial reporting to enable the normal investor or creditor to make decisions about the quality of a company's earnings will decrease drastically. The implementation of a

principles-based approach will therefore, greatly increase the understandability and usefulness of the information to reasonably informed users of accounting information.

The principles-based approach is also needed in the accounting industry due to the increase in the development of methods to circumvent the specific rule-based standards. The complex rules now in place are being used by accounting companies in a manner that is technically legal, but misleading to investors (Enron's off-balance sheet financing). Such complex rules allow for crafty accountants to work around particular rules and regulations, even though they are known to be unethical practices. Therefore, implementation of a principles-based approach will increase the professional judgment used by accountants to make decisions, while increasing the liability placed on them for their choices.

Some other reasons for developing principle-based approach to accounting standard setting is to line the U.S. up with international standards. The International Accounting Standards Committee (IASC) has developed basic principles and moved away from specific rules for their standards; therefore showing that a principles-based system can work. Many skeptics believe that a principles-based approach would therefore lead to a lowering of U.S. standards. However, there needs to be some sort of convergence between U.S. standards and international standards because most companies are global, and perform operations in more than one country. Through Harvey Pitt's comments that the U.S. and international standards should be near identical by 2005, shows that the SEC is also in favor of such an alignment. Therefore, there should be no difference between the methods a company can report its financial information depending on the nation it lies in. How can the performance of a company in Japan, who uses principles-based accounting standards, be compared to an American company who follows rules-based accounting standards? There needs to some sort of cohesion, and since U.S. standards have been the ones to fail recently, it seems logical that they be the ones altered.

Though the adaptation to principles-based accounting standards will be difficult and complicated, these standards will lead to a higher quality of earnings and greater transparency in U.S. financial reporting. Though comparability and consistency of accounting information may decrease slightly, by putting a greater demand on accountants and auditors, these professionals will be less likely to place their name on

bad documents or try and circumvent the principles. Primarily because of the raising of expectations and greater liability placed on accountants in a principle-based system, there may be less willingness for them to perform illegal financial acts. With such higher expectations comes better quality of earnings and more transparent information because if there is a question about earnings, the accountant will no longer be able to hide under the complex rules.

Therefore, though it may be difficult to change accounting standards, there are many important reasons that there should be a change. If anything, the great amount of corporate mischief that has occurred recently shows that specific rules are failing to work. There needs to be a change in the way things are done in the field of financial reporting or there will continue to be companies who manage their earnings and show non-transparent information in their records. In conclusion, a greater transparency and quality of information will lead to greater confidence in consumers, and the ability to make good, clear decisions about investment and credit decisions, the main objective of financial reporting.