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TO: The Financial Accounting Standards Board

FROM: Edmond McGonagle

DATE: 12/12/02

SUBJECT: Response to Proposal on Principle-Based Accounting Standards

As stated above, my name is Edmond McGonagle, and I am an accounting major at Providence College in Providence, Rhode Island. After reading the proposal entitled "Principles-Based Approach to U.S. Standard Setting", I am writing to comment on the possible pros and cons of such a principle-based approach.

The recent corporate-accounting scandals of companies such as Enron, WorldCom, and numerous others has warranted a serious re-evaluation of the system by which accounting standards are used and regulated. As has been made evident by these scandals, many companies have looked for loopholes in existing standards as a means of improving the financials of their company. The current system of accounting regulation consists of a rule-based method, which a company must follow, in the preparation of its financial statements. Even with a rule-based approach, however, much of the deceptive financial reporting of the above-mentioned companies has actually fallen within the established rules.

As a result, I feel that serious consideration must be given to the pros and cons of the concept of a more principle-based standard setting process. As today's companies become more and more complex, so do the accounting rules that are implemented to regulate them. Unfortunately, as the complexity of rules increases, it often times results in other, broader, areas being overlooked. The current method of using rule-based standards also seems to take away the professional judgment of certified public accountants, making the profession almost mechanical.

A new principle-based approach has the potential to remedy the current problems. The International Accounting Standard's Board uses a similar system of principle-based standards, resulting in much fewer accounting scandals than are found in the US. If principle-based accounting standards become the norm, there would be more of a responsibility on the part of CPAs to ensure that all financials are prepared in good faith. It is this very issue that may cause the biggest problem.

As has been made evident by recent events, this good faith is often abandoned in exchange for an increased bottom line. One possible solution to this problem would be to hold CPAs more responsible for the honesty and integrity of their work. By doing so, this would help insure that accountants embrace the spirit of the law when using a principle-based approach.

One possible critique of a principle-based approach would be the comparability of companies. Without specific criteria in place, it would seem as though there is a potential to lose this sense of comparability. Since the proposed approach relies more on judgment by those preparing financial statements, it seems as though it would allow a variety of treatments to similar accounts, thus comparability is lost. Without comparability, investors and creditors will have a much more difficult time in evaluating which companies are truly more efficient.

In closing, I feel that the principle-based approach could be the answer to the current woes of the accounting industry. However, I still believe that there are certain areas of accounting that principles are just not enough. As mentioned in the previous paragraph, comparability may be lost in a move from the rule-based approach. Thus, a middle ground must be met whereby a principle-based approach is used, and comparability is preserved.