Comments on Proposal for a Principle-Based Approach to U.S. Accounting Standard Setting

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Dear Sir or Madam:

Recently the Financial Accounting Standards Board (FASB) has taken a significant step to seek public comments on its proposal, which discuss the possibility of principle-based approach (hereafter, new approach) to U.S accounting standard setting. I believe the proposal will stimulate the interest of every person who is concerning the accounting profession and the capital market. As an accounting student, I would like to present following comments on the proposal to address my opinion about the principle-based approach to U.S accounting standard setting. In addition, at the end of my comments I will also address my concern about how to apply the principle-based approach or what should be noticed in applying the new approach.

Current conceptual framework of U.S financial reporting is developed based on a rule-based approach, which provides extremely detailed, arbitrary and complex rules. The complexity of business environment and changing technology increase the complexity of accounting standards. The detailed, arbitrary and complex accounting standards are not easy to be interpreted not only by investors but also by accounting profession, this situation hinders the application of accounting standards in reality, then reduce the quality and transparency of financial reporting. Recent failure of business, such as Enron, Worldcom, exposed the weakness of current accounting system more clearly. The influence of current approach and its standards on regulators, accounting profession, and investors are discussed as below:

- To regulator. FASB's current accounting standard setting process is very
 complicated, which takes years to issue guidance. FASB tends to solve all the
 problems arising from an issue at one time and attempts to contemplate every
 application of a standard. In fact it is impossible due to the continually changing
 business environment. The process prevents FASB from response to current
 events fast enough.
- To accounting profession. Accounting researchers reported that in the early 1980s the volume of pronouncements in accounting had already become too large to be recalled and applied with reliable accuracy. As a result, an accountant cannot be completely prepared for all possible issues that will confront him or her in practice. Accounting profession are suffering from accounting fraud, expanded litigation. In addition, under the complicated accounting system, it is difficult for accounting professionals to stay current and step back and evaluate whether the overall impact is consistent with the objectives of the standard.
- To investors. The objective of financial reporting is providing investors useful
 information for their decision making. The complexity of accounting standard
 makes investors without accounting knowledge or experience impossible to
 interpret the financial reporting. Without fully understanding, achieving high
 quality and transparency in financial reporting is in vain.

Based on above analysis, I believe certain aspects of current system can and should be improved so that the accounting standards can be implemented more quickly, be more responsive to market changes, and provide more transparent information to investors. I think following potential benefits under principle-based approach would be achieved.

- The new approach prevents regulatory overload and technical avoidance. It allows regulators to shift the focus to current and urgent events.
- The new approach will focus on the fundamental principles instead of detailed
 and arbitrary rules. As a result, it will leave more room for accounting profession
 for implementation and judgment. It can be more flexible and copes well with
 detail and complexity. It can help accounting profession to respond appropriately
 to complex situations and new developments in business practice.
- The quality and transparency of the financial accounting and reporting will be improved. The new approach focuses and produces fundamental principles that make financial information possible to reflect the accounting reality, instead of the normative, comparable but not transparent information under current approach. It can facilitate to convey the information effectively to the users of information.
- Principle-based approach, which is similar to that of IASB, will improve the
 comparability between U.S accounting standards and international accounting
 standards. Many other countries, like Europe and U.K, use Principle-Based
 Approach. The harmonization of U.S accounting standard and international
 accounting standards will attract more foreign investors to enter U.S market, then
 improve U.S economy. The effect to global economic environment will also be
 significant.

However, adoption of a new approach would require changes in the process and behaviors of all participants in the U.S financial accounting and reporting process, which have stated in the proposal. Additionally, I think during transition of accounting standard setting approach and adoption of the new approach, FASB or other pertinent constituents should pay sufficient attention on following issues:

- The objective of financial reporting should be strengthened rather than be weakened no matter which approach will be used. Because the objective is the key of accounting conceptual framework, whether the objective can be achieved determines the success of economy.
- Professional judgment. Which is the hallmark of a true profession. However, the
 term of professional judgment is broad and subjective, how to evaluate the quality
 of profession judgment? I believe that personal responsibility for the decision
 forces a diligent search for the best obtainable approximation of accounting truth,
 and that responsibility leaves no room for arbitrariness. Thus, the responsibility of

management, accountants, and auditors should be well addressed, implemented and monitored.

- The relationship of simplicity and comparability should be balanced. Some believe that more principle-based accounting standards would facilitate better reporting and more understandable. Others, however, are concerned that the principle-based accounting standards might reduce the comparability of financial information. Both of simplicity and comparability play important role in achieving the objective of financial information. Under principle-based accounting standard setting approach, FASB should focus on the intents and spirits of general principles instead of the detailed and arbitrary guidance, it does not mean that FASB should not continually issue interpretive and implementation guidance. However, the substance and intention of issuing interpretive and implementation are changing. The characteristic of comparability should be shifted from comparing the detailed accounting method to the substance of economic and financial transaction.
- Because of information asymmetry moral hazard exists, in which management have incentive to manipulate the earning number. Some argue that principle-based approach will leave more room for earning management. However, the incentive of earning management is not caused by the accounting standard setting approach, it should not imply that principle-based approach can provide basis for elimination of the incentive of the earning management. Enforcement of implementation of principle and establishment of a monitoring mechanism would be used to reduce earning management incentive. The FASB should work together with SEC, AICPA, auditors, investors, and other constituents to foster a sound environment of accounting practice.
- Consideration of transition from current approach to principle-based approach is extremely important. Too hasty to success. I have following suggestion:
 - It is not necessary to adopt the new approach nationally at the beginning. FASB would choose some experimented companies or some accounting areas, such as lease, derivatives, to get experiences.
 - Before national adoption of the new approach, FASB should completely analyze current accounting standards to determine how, when, why, what should be modified or revised.
 - 3. Educate public to understand the new approach.
 - Collect feedback from various sources and evaluate the accomplishment of the new approach, continually adjust the action and direction to achieve the objective of accounting standards.

Sincerely

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