My name is Heather Tomec and I am currently a junior at Providence College taking Intermediate Accounting. As part of my final examination, I am required to write this memo, which is in response to your proposal to develop a principles-based approach to accounting standards setting. The memo will discuss the problems with the current rule-based approach to U.S. standard setting, and will highlight the benefits of moving to a principles-based approach.

Problems With Rule-Based Standards
The current rule-based accounting standards have become increasingly detailed and complex, which has resulted in delays in issuing timely guidance. Since the standards are based on rules instead of broad principles, they are not sufficiently flexible to accommodate future developments in the marketplace. A major problem with the rule-based standards, as stated by former SEC Chairman, Harvey Pitt, is “The development of rule-based accounting standards has resulted in the employment of financial engineering techniques designed solely to achieve accounting objectives rather than to achieve economic objectives.” The recent string of accounting scandals that have been uncovered in which companies eluded rule-specific guidelines to boost their reported earnings and hide debt have been a clear sign that the current standards have not been working well lately. An example of such a rule that has been coming back to haunt regulators is FASB statement No.123, which 10 years ago set the loose standards for stock-based compensation plans that are currently causing so much heated debate. It is obvious that it is time for a change.

Benefits of Principles-Based Approach to U.S. Standards Setting
Much of the detail and complexity of the current rule-based standards discussed above has resulted from (1) exceptions to the principles in the standards and (2) the amount of
interpretive and implementation guidance provided by the FASB and others for applying the standards. A principles-based approach, if adopted, would resolve these problems by applying more broad standards, resulting in very few, if any exceptions to the principles. Also, there would be less interpretive and implementation guidance for applying the standards. This would result in an increased need for professional judgment consistent with the purpose and character of the standards to be applied. Such accounting standards would enhance transparency of financial statements, as well as comparability and usefulness. With few exceptions the level of complexity and detail will be reduced and comparability will be enhanced because transactions will be accounted for similarly. With the reduction of complexity and detail will come more transparent statements that can be easily understood, thereby increasing their usefulness. Finally, a principles-based approach would result in very few differences between U.S. GAAP and International Standards, increasing comparability of financial statements across the world.

Please contact me following the roundtable discussion to update me on any information regarding this issue. I can be reached at Hmt13@aol.com.