In response to the proposed adoption of a principles-based approach to U.S. standard setting, I feel that although this proposal has good intentions it will create more problems than it will fix. The change to a principles-based approach is not the answer to improving the quality and transparency of U.S. financial accounting and reporting. One of the major problems with this possible change is that it requires firms to apply professional judgment in many circumstances. I am afraid, in light of recent events that this will result in more, rather than less, misrepresentation of financial information. Another major point is that this broad application of standards will take away from the comparability and consistency of the statements across the industries. The U.S. has been using rule-based standards all along and in order for this major change to occur the entire profession would have to change their way of thinking and reasoning to adapt to this new principles-based approach. I think this would be a very rough transition and I don’t think the advantages of the new approach will pay off in the end.

One of the arguments to support the implementation of a principles-based approach is that as a result of people relying so heavily on rules, CPAs have abdicated their professional judgment. I think this is a major misconception. Despite the detailed rules, CPAs are still expected to use their professional judgment when preparing financial statements. To say that all accountants are hiding behind the rules and taking no responsibility for how they are reporting their information is wrong. In some cases this may be true, but it is not a valid argument to change the approach used for financial accounting and reporting. The accounting abuse that has taken place within the last 12 months has placed a big emphasis on reporting that will provide an accurate look at the company’s financial standing to the investors. We have seen several different tactics employed in order to mislead investors. A principles-based approach would only give firms more leeway to mislead investors and make it much harder to identify the wrongdoings without having strict rules to be broken. If a principles-based approach was
implemented several rules and exceptions would still need to be included along with the broad principles. This would be necessary to give financial statement users a sense of comparability and allow regulators a way to enforce the standards. Therefore, if a principles-based approach was employed many decisions would have to be made as to which specific rules need to remain as part of GAAP and which we can afford to exclude.

One of the objectives of financial reporting is to provide information that is useful to those making investment and credit decisions. The presentation of the financial statements is very important to reaching this objective. Many believe that this new approach will allow more usefulness and transparency but I disagree. This shift may allow the users to understand the information presented more easily. But at the same time if the objective is to be useful in helping with investment and credit decisions, the lack of comparability and consistency that would be brought about through the new principles-based approach would defeat the purpose of the objective.