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A plea for generalised accounting standards

We seem to be getting to the point where there must be a detailed accounting rule for everything, no matter how narrow or obscure the issue.

By Dennis Beresford, *Accountancy Age* 26 Apr 2001

The US, of course, is the clear leader in this race toward complexity. As a 'simple' example, the Financial Accounting Standards Board's Emerging Issues Task Force recently developed positions on a dozen or so extremely detailed interpretations on the accounting for employee stock options.

Do corporate finance directors and auditors really need a rule, for example, on whether variable accounting is required for an in-the-money stock option if granted more than six months after the cancellation of an out-of-the money option?

The US regulatory environment may be the major culprit in the current situation. Aggressive discipline of financial reporting practices by the Securities and Exchange Commission, in particular, contributes to the obsession with detail.

All companies selling new stock receive SEC comment letters that often ask numerous questions about their financial statements. Randomly selected annual reports also are reviewed by the SEC staff and comments are issued. When satisfactory answers aren't forthcoming, revisions in the financial statements or accompanying footnotes are mandated.

In addition to its active review of GAAP application, the SEC staff develops its own additional 'guidance' on reporting practices. Much of this is in the form of speeches by SEC staffers that give corporations lots of specifics about what they must do in applying certain broader accounting standards. Think about UK companies having to follow all of the positions in Sir David Tweedie's speeches over the past ten years!

Many auditors have long demanded more detailed and explicit accounting rules, presumably to help protect against litigation. Senior corporate executives, on the other hand, commonly call for broad standards. But even those executives often ask for specific answers to very narrow issues when responding to FASB proposals, to protect their companies against SEC challenge or litigation.

So there are good reasons why the US has such detailed and complex rules. Nevertheless, I strongly believe that we have passed the point of diminishing returns. Even the best-intentioned finance directors and auditors now have a nearly impossible time keeping up with - and understanding - new accounting rules. We have an exploding number of specific rules that only very focused technical accountants can interpret. While intended to produce more consistency in application of accounting principles, the detailed rules encourage loophole identification followed by even more rules.

I'm not suggesting throwing out accounting standards and relying solely on management and auditor judgment. Financial reporting loses much of its usefulness if there is not a reasonable amount of comparability in reporting practices, and standards are needed to insure reasonable comparability. The trick, of course, is for standards setters to find the equilibrium point between general principles and detailed rules. But it's definitely time to swing the pendulum back toward more general principles.

The advent of the new International Accounting Standards Board gives the profession a golden opportunity to make a fresh start in this area. The IASB's structure provides for close interaction with standard setters in individual countries, including the US and UK. The FASB and others have supported the IASB and have said they will work toward convergence of national and international standards.

Accountants should encourage the new IASB to emphasise a principles-based approach. Further, as part of the commitment to convergence, it is time for the FASB and SEC to change their behaviour and become more like the rest of the world.

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