

INTERNATIONAL FINANCIAL REPORTING STANDARDS: RULES BASED APPROACH OR PRINCIPLES BASED APPROACH

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ABSTRACT: *The reason of the study is to evaluate and converse about the good and in depth approach to develop the IFRS. This study covers the importance of the different approaches to develop the IFRS, the effect of rules whether they have some good effects on the development of International Financial Reporting Standards (IFRS) or have weaknesses in this regard. In opposition to the approach of rules these papers covers the explanation about the approach of principles and their complete and in detail effect on the development of IFRS. This research essay covers-a lot of secondary sources which provides many arguments about the IFRSs . In this study we will discuss the importance of some of the necessary factors to develop the IFRS which are very important for almost all the business. The research covers the details in the favor of each approach and also provides the weaknesses of each approach. The different arguments and discussions made by different writers arc-included in this essay that arc written and discusses by them on different occasions. Each writer has his own arguments in the same situation and gives better guidance to make the conclusion about the approach that is better to develop the IFRS.*

KEYWORDS: Approaches, IFRS, Reporting

INTRODUCTION

International financial reporting standards include a number of standards and the complete framework for preparing and presenting reports. These standards are made according to all the financial problems that the organizations are facing in their day to day operations These IFRSs provides the companies all over the world to make their financial records in good and internationally recognized manners. There are different standards which cover almost all the treatments that are necessary and required by the businesses all over the world. The importance if IFRS and the role which they have played in the preparation and presentation of the financial records to their users make it clear that how much importance they have in any business. These are the standards that are presented by the ASBK (board which presents the standards for accounting). IASB is exclusively in charge for issuing new-IASs The IASB declared that the new standards will be called IFRS but the existing standards will continue to be called IASs Normally the term IFRS is used to refer both to the existing IASs presented by the former IASC (the committee-for accounting standards) and to the IFRS r from the IASB. IFRS contains the rules and the regulations with guidance which are made by IASB. These rules and regulations are made by the mutual consent of many large financial institutions. These are the standards which companies are allowed to follow for the compilation of the financial record of their business. The presence and use of the IFRS has allowed the investors and all the stakeholders to compare the financial record with no difficulty as IFRS allow same treatment of an item for everyone in the market and due to these

similarity which they create in the records of different companies have a lot of benefits for the stakeholders. As the rules and principles effect the development of IFRS so the comparison between both of these approaches is discussed below.

IFRS approaches

IFRS has a very important role in preparing and presenting the financial record of the companies and they also provide the platform to the Stakeholders to compare the financial position of the different companies in order to make better decisions regarding their investments in future. There is a lot of debate on the approach of rules of IFRS and the approach of principles of IFRS. These debates cover the importance of both of these approaches. In the discussion about the rules base approach the Nobes (2005) states that there is a lot of political pressure on the standard setters. This pressure can be given by the large companies and their management. The way to the political pressure may be the reason and explanation of opposing the principles. This is the reason due to which the standards setters avoid the approach of principles. There is a lot of good guidance that are provided by the approach of rules. Nelson (2003) clearly describe the issue of approach of rules with the connection of approach of principles/ Furthermore, the approach of rules provide the correct and detailed guidance regarding the disclosure of the financial record. The proper disclosures have a key role and are very important for the stakeholders for making the analysis of financial record. In addition, Nelson has also argued that the approach of rules makes the standards more complex for the use of managers in the companies to prepare the financial record where the principle based approach provide much simpler accounting standards than the approach of rules but in some cases the approach of rules provides the better standards as compare to the approach of principles. In continuing this long debate there were a lot of arguments in the favour of the principle based approach and the approach of rules. In this context the George and al (2006) argue that in the approach of rules the standards provides the audit committee an aggressive approach but the principle based approach never provides much aggressive approach but in this way the approach of rules provides a lot of options for the comparability. This comparability is a very important point for the users of the financial record as they always make the comparison between the financial records of different companies. This is very important point that approach of rules provides and has much emphasis on this approach. There are a lot of such differences between these two approaches and both the approaches have the strengths and weaknesses as well but in some cases the audit committees feel it much beneficial if the approach of rules issued and in some cases the approach of principles.

Where the approach of rules of the accounting standards has a lot of advantages for the preparation and presentation of financial record, it has some disadvantages as well. Alexanderand and Jermakowicz (2006) indicate that the approach of rules almost avoids any type of professional or personal judgment in the preparation of financial record. Where the judgment based approach is nearly exact but the approach of rules never rely on it. The approach of rules provides much detailed guidance which must be followed. In this way the financial record will provide the exact information that will help the users of the financial record to make better comparisons with the other companies and will also help them to make better decisions for their future investment There is also a problem with the approach of rules as if companies use the approach of rules they will not be in the position to use their own judgment if they feel it necessary in any situation as the approach of rules provides the exact information

and guidance that are must to be followed. In the other studies Satave et al.(2006) state that the approach of rules is very much detailed and provides almost all the information on any disclosure. This also avoid the risk of any misjudgement and any incorrect information that any cause if the professionals and given the authority to make the judgment of their own. As the professionals have much ability to make better decisions in different difficult situations and are registered with the authorized bodies but the approach of rules never allow the professionals to do so because every person have different thinking and approach to the same problem and then the different professionals will also make different judgments in different companies which will create the problems for the users of the financial statement to make the comparisons. This is also a reason due to which the standards of accounting that based on rules are in more detail and provides the disclosures in almost all the situation. This is a good approach to the approach of rules as it never relies on the risk of misjudgement. Due to the detailed rules in the accounting standards the professionals feel much difficulty and will also take much time to understand and to apply on the preparation and presentation of the financial record. The approach of rules in the preparation of IFRS is not flexible. Benston et al. (2006) state that the approach of rules provides the users complete guidance and these guidance must be followed in all the situations. This is the weakness of the approach of rules that it never allow the flexibility and the companies have to followed the rules in any case and this approach will not motivate the professionals to make their own better judgment which can be more better than the guidance provided in the approach of rules. Vincent (2003) claims that the approach of rules can cause the unnecessary complexity just due to the complex rules that they provide for the companies guidance to make the financial record. Due to the complexity of the approach of rules the management may feel it difficult to understand and use. In this way principle based approach supports the development of IFRSs which is discussed in the following part of this discussion.

The approach of principles has a lot of benefits and guidance for the companies to prepare and present the financial record in accordance to the IFRS. Piper and Arthur (2005) have discussed in their study that the principle based approach can be applied to the different situations in different ways. This approach of principles can provide much options and guidance to the professionals to make and present the financial record. This approach not only motivates the professionals to use their own judgment but it also motivate them to make the better decisions in some of the critical situations as they think that they can do better in some of the critical situations. By opposing this argument, Schipper (2003) has made &detailed discussion on this issue a«4says that there will be much difficulty for the users of the financial record to make the comparison in the financial record of different companies. As the purpose of publishing the financial statement to the general public is that they can analyze and make better comparison of the financial position of different companies and can make the better decision about where they should invest their amount in future. So the principle based approach will create problem in making the comparison of financial record. As the principle based approach never restrict the professionals to follow a strict rule and encourage the professionals to make some judgments. Mergenthaler (2008) argues that as the approach of principles provides the professionals the opportunity to use their own judgment in some cases. As this approach rely on the professionals but it strictly requires the professionals to show the professional scepticism in order to make better decisions. This is very important so that the users can rely on the professional's judgment without any hesitation. This approach also requires the professionals to have good professional studies and also a good experience in

their required field. In this way they must be authorized and registered to any professional body which allows them to do so. Talking in the favour of the approach of principles, Tsakumis (2009) provides the explanation about the importance of the approach of rules. Moreover, the approach of principles may provide the real performance and the actual position of the company as compare to the approach of rules. It has the flexibility in the accounting standards and this will also help the professionals to prepare the financial record in more actual way and to show all the affects in the financial statement. There is no doubt that the comparability will also stand here but the professionals have the power to control all of such situations as they have the power to make the better decisions in the complex situations. Due to these benefits this approach seems better to make good reliable decisions in some of the situations. These principles have a great role in the understanding. The rules are difficult to understand as they are in more detail. Tsakumis (2009) states that the approach of principles is very simple and is not in much detail. It is very easy to understand 50 pages instead of the 150 pages. This approach provides the professionals a guiding point on which basis they can easily make the better decision in any of the difficult situation. This simple approach also helps to provide the reliable position of the financial statement. This is very helpful for the users but the comparability problem still stands with the approach of principles.

CONCLUSION

In conclusion, it can be concluded that there are a lot of issues that has been discussed here for the better use of any of one approach from the approach of rules and the approach of principles. In the whole discussion the different writers discussion provide a lot of guidance that relate to each approach. As it can be seen that the approach of rules is exact and never provide any chance to the professionals to make any of their judgment which makes the financial statement be able to compare to the other companies and provides the users of the financial record to make better decisions for their future investments but on the opposite side the principle based approach is much easy to understand and flexible as well. Due to the flexibility of the approaches of rules it allows the professionals to make the better decisions of their own in some of the critical situations. No doubt this is a good approach but there is a lot of risk of incorrect information. This approach also creates the problems for the users of the financial record to make the better comparison of the companies. In these issues the approach of rules has more benefits as compare to the Approach of principles. Due to these issues IFRS should be developed by using the approach of rules. This approach provides the rules that must to be followed and provides good platform for the comparability.

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