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Moving toward a principle-based approach to U.S. accounting standard setting: A demand for procedural justice and accounting reform

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ABSTRACT

In the wake of numerous accounting scandals in the early 2000s, the U.S. began considering a move away from a more rule-based approach to accounting standard setting and toward a more principle-based approach to accounting standard setting. Although it is often assumed that this move toward a more principle-based approach is driven by stakeholder preferences, we examine whether this move is driven by demands for procedural justice. Specifically, we analyze one hundred and two comment letters submitted in response to the Financial Accounting Standard Board (FASB) proposal for principle-based standards. We find respondents from different stakeholder groups (preparers, accounting professionals, regulators, users, and academia) do not express a unified preference for rule-based or principle-based standards. We do, however, find that respondents identify benefits and costs of principle-based standards that map into the six elements of fair procedures (representativeness, accuracy, bias suppression, consistency ethicality, correctability). These elements are significantly associated with both the respondent's degree of support for the FASB proposal and the perceived quality of principle-based standards.

1. Introduction

In the U.S., the FASB establishes the accounting standards that are used to report economic activity in a company's financial statements. In the wake of the Enron and WorldCom accounting scandals, critics began to question the process by which these accounting standards were written. Accounting standards, meant to ensure that financial reports fairly present the financial position of a corporation, were perceived as failing to prevent corporations from misleading stakeholders and causing significant losses by investors, creditors, employees, and pension plans (Berkowitz & Rampell, 2002a; Berkowitz & Rampell, 2002b; Burns, 2002). Many critics subsequently argued that the FASB standard setting process was too 'rule-based' resulting in accounting standards that simply provided a means for preparers to structure transactions around bright-line thresholds. In an effort to restore trust in the U.S. accounting standard setting process, FASB issued an exposure draft entitled "Proposal for a Principle-based Approach to U.S. Standard Setting" (FASB, 2002).[1]

This renewed examination of how accounting standards are written spawned a 'rules versus principles' debate which centered on the level of specificity versus the degree of judgment allowed by a standard. The debate often presupposed that different stakeholder groups (preparers, accounting professionals, regulators, users) had incentives to prefer either rule-based or principle-based accounting standards. Preparers, for example, are assumed to prefer principle-based standards so that they can use the latitude in such standards to manage earnings (Berkowitz & Rampell, 2002a; Berkowitz & Rampell, 2002b; Burns, 2002). Conversely, accounting professionals are assumed to prefer rule-based standards so that they can force client compliance while minimizing negative client reaction (Carcello & Palmrose, 1994; Cuccia,

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[1] All accounting standards are based on principles. Accounting standards that have a greater level of specificity are considered rule-based. Prior to the recent FASB Lease Standard Update (Topic 842), lease accounting was thought to be more rule-based than principle-based. That is, although lease accounting is based on the principle that leases should be capitalized if the lease contract transfers substantially all of the rights and benefits of ownership to the leasee, specific "bright line criteria" (i.e., lease transfers ownership, contains a bargain purchase option, has a term equal to or > 75% of the economic life of the leased asset, or the present value of cash flows related to the lease are equal to or > 90% of the fair value of the leased asset) made the previous lease accounting more rule-based. The updated lease standard has moved toward "substance over form" with language that is more open suggesting a more principle-based approach (e.g., instead of a term being " > 75% of the economic life", it is now the "major part of the economic life").

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Hackenbrack, & Nelson, 1995) and limit the ability of regulatory agencies, such as the Securities and Exchange Commission (SEC), to second-guess audit judgment.

Alternatively, we suggest that the 'rule versus principle' debate parallels issues of procedural justice and employs arguments consistent with procedural justice concerns. Perceived justice builds trust and legitimacy in the process, the resulting rules or standards and ultimately the outcomes, which in turn increases commitment to and compliance with those rules and standards. If accounting standards promulgated by the FASB are to be accepted and ultimately complied with, those standards must be perceived as legitimate (Jorissen, Lybaert, Orens, & Van Der Tas, 2012; Richardson & Eberlein, 2011; Tandy & Wilburn, 1992).[2] Accepting accounting standards as legitimate depends on the transparency of and participation in the due process by which those standards are created (Jorissen et al., 2012; Richardson & Eberlein, 2011; Tandy & Wilburn, 1992). In short, the legitimacy of a rule-based or principle-based accounting standard setting process could be better understood by examining the debate through a lens of procedural justice.

Procedural justice focuses on the perceived fairness or legitimacy of the procedures used or steps leading to an outcome or decision (Ambrose, 2002).[3] Prior research has shown that individuals do not focus on procedural justice when outcomes are favorable because they assume that when outcomes meet or exceed expectations, the process producing those outcomes is considered appropriate (Brockner, Ackerman, & Fairchild, 2001). However, when outcomes are perceived unfavorable and unfair, individuals shift their attention away from the outcomes and focus on the fairness of the process used to create those outcomes. When these processes and procedures are not considered fair, any resulting outcomes are also deemed unfair and are not trusted or relied upon. As long as financial information (outcomes) was largely perceived as presenting fair and anticipated results, most people did not question the accounting standards (procedures) used to create that financial information. However, when financial information was no longer perceived as accurate and reliable, then the accounting standards used to create that financial information became suspect.

Prior research has found that perceived lack of procedural justice influences evaluations of market desirability and shapes evaluations of the market allocation procedures (Sondak & Tyler, 2007) as well as influences stakeholder willingness to share information which in turn influences the firm's ability to innovate or allocate resources appropriately (Harrison, Bosse, & Phillips, 2010). In addition, procedural justice concerns play an important role in merger and acquisition participants' willingness to cooperate in organizational change (Melkonian, Soenen, & Ambrose, 2016) and in whether firms realize market position improvements and financial returns following a merger and acquisition (Ellis, Reus, & Lamont, 2009). Finally, perceptions of fairness influence managers' propensity to create budgetary slack (Ozer & Yilmaz, 2011).[4]

In general, responses to a perceived lack of justice can be characterized as withdrawal responses (Howard and Cordes, 2010). In a financial accounting setting, a lack of perceived procedural justice and fairness could lead to lack of trust in the reported financial information, a desire to withdraw investments from the market and reduce participation in standard setting process (Durocher, Fortin, & Cote, 2007). Conversely, increasing perceived procedural justice and fairness and thus the legitimacy of the process strives to create high quality accounting standards that ensure accurate, reliable, and understandable financial information (Richardson and Eberlein, 2010). High quality financial information implies more decision useful information, better decision making and fair treatment of stakeholders.[5]

We believe that by examining the 'rules versus principles' debate from a procedural justice perspective, the accounting community may better understand what concerns any accounting standard system must address to be perceived as delivering accurate and reliable financial information. The U.S. has continued to move toward some form of convergence with International Financial Reporting Standards (IFRS).[6] Since IFRS are often characterized as more principle-based than U.S. standards, using a procedural justice perspective could provide insight into what may occur if stakeholder concerns are not met and provides a means of more closely examining the costs and benefits of adopting a principle-based accounting system (Herz, 2002; Weinberg, 2008).[7]

This study examines whether the preference for and perceived quality of principle-based accounting standards depends on (1) stakeholder group affiliation and/or (2) a demand for the elements of procedural justice. Specifically, we conduct a content analysis of the one hundred and two comment letters to the FASB principle-based accounting standard setting proposal[8] and find that there are no significant differences in the preference for rule-based or principle-based standards between and among stakeholder groups (preparers, accounting professionals, regulators, users, academics). However, we find that respondents identified benefits of a principle-based accounting system that map into the six elements of fair procedures: representativeness, accuracy, bias suppression, consistency, ethicality, and correctability, (Leventhal, 1980). These six elements are significantly associated with the respondent's degree of support for the FASB proposal as well as the perception of quality and transparency of principle-based accounting standards.

The rest of the paper is organized as follows. Theory and

[2] To this point, Robert Herz (2002), in a presentation to the Financial Executives International Conference, stated that creating a principle-based system is worthwhile only if it yields financial information that is more honest, understandable and trustworthy.

[3] Procedural justice is concerned with the fairness and transparency of the process by which decisions are made. Distributive justice is concerned with the fairness of the distribution of resource (Folger & Cropanzano, 2001). Because we are interested in the accounting standard setting process, we focus exclusively on procedural justice in this paper.

[4] Procedural justice is also directly and indirectly related to a decrease in employee morale and job attitudes as well as their job performance (Parker & Kohlmeyer III, 2005; Shin, Sung, Choi, & Kim, 2015), an increase in employee absenteeism, turnover, and work alienation (Howard and Cordes, 2010; Sweeney & Quirin, 2009); and is an important predictor of trust, job satisfaction, job stress, organizational commitment and sabotage in the workplace (Andrews, Kacmar, & Kacmar, 2015; He, Zhu, & Zheng, 2014; Loi, Lam, & Chan, 2012; Mo & Shi, 2017; Sulu, Ceylan, & Kaynak, 2010).

[5] While fair treatment of all stakeholders may be desired, we recognize that FASB and IASB have stated that their primary focus is on the investor and that stakeholders could have varied and competing definitions of good accounting standards.

[6] Since the Norwalk Agreement in 2002, there has been several directional shifts in the US convergence efforts. In 2007, the SEC removed the requirement for foreign entities that issue stock in the US to include in their financial statements a reconciliation of IFRS to US GAAP. In 2008, FASB and IASB attempted to accelerate convergence efforts by focusing on a few key convergence projects. In 2008, the SEC issued a roadmap and timeline for completion of key convergence projects. In 2009, Mary Shapiro became the SEC Commissioner and stated that the SEC would not be bound by the existing IFRS roadmap. In 2011, the SEC issued two studies comparing US GAAP and IFRS and in 2012, the SEC staff issued its final report concluding that it is not feasible for the US to simply adopt IFRS (Fajardo, 2016; Negash, Holt, & Hathorn, 2017).

[7] The examination of more principle-based standards continues to be relevant with convergence to IFRS (Bradshaw et al., 2010) as well as on the effects on managers' aggressive reporting (Jamal & Tan, 2010), evaluation of auditor judgment and legal liability (Kadous & Mercer, 2016) and auditor expertise (Grenier et al., 2010).

[8] A total of 135 comment letters were received by the FASB. However, 31 of the letters were apparently a part of a class assignment at Providence College. An additional two letters were composed by students that also identify a specific college course. Because these students were required to submit letters, they may not reflect the true views of the students and may bias results. Accordingly, the responses were not included in the analysis presented.

propositions are outlined in Section II. The method is described in Section III and results of the content analysis are reported in Section IV. In Section V, we discuss potential implications of looking at the accounting debate from a procedural justice framework and conclude the paper.

2. Theory

2.1. Stakeholder group preferences

The ‘rule versus principles’ debate often assumes that different stakeholder groups, namely preparers, accounting professionals, regulators and users, have differential preferences for either principle-based or rule-based accounting standards.[9] Prior research on stakeholder group preferences has focused primarily on when and why stakeholders participate in the accounting standard setting process but has generally not addressed the ‘rules versus principle’ debate. Economic theory predicts that stakeholders will participate in the standard setting process if the benefits derived from participation outweigh the costs of participation (Chatham, Larson, & Vietze, 2010; Georgiou, 2010; Huian, 2013; Jorissen et al., 2012; Kwok & Sharp, 2005; Larson, 2007; Tandy & Wilburn, 1992). Prior research generally also indicates that stakeholders tend to participate when there is an increase in perceived uncertainty, as occurred in the post-accounting scandal period, and depends on how valuable the standard's policies are to the constituents (Larson, 2007).

Preparers participate in the standard setting process when proposals impact financial statement values especially net income maximization and income smoothing (Beechy, 1994; Jorissen et al., 2012). Preparers are assumed to prefer principle-based standards (Berkowitz & Rampell, 2002b; Burns, 2002) because principle-based standards provide more latitude for judgment and potentially provide a greater opportunity to manage earnings. Research shows that preparers have incentives to meet or beat analyst forecasts (e.g., Abarbanell & Lehavy, 2003; Burgstahler & Eames, 2003; Kasnik, 1999), avoid losses or earnings decline (Burgstahler & Dichev, 1997, 1998), increase management compensation (e.g., Healy, 1985; Holthausen, Larker, & Sloan, 1995), avoid violating lending agreements (e.g., Defond & Jiambalvo, 1994; Sweeney, 1994), avoid regulatory intervention (e.g., Beatty, Chamberlain, & Magliolo, 1995; Collins, Shackelford, & Wahlen, 1995; Moyer, 1990; Scholes, Wilson, & Wolfson, 1990), and are more likely to engage in earnings management actions when transactions involve judgment (i.e., principle-based) rather than when transactions are structured around accounting rules (i.e., rule-based) (Nelson, Elliott, & Tarpley, 2002).[10] Research on the effect of IFRS-based accounting standard adoption on earnings management however, has been mixed (Hastuti, Ghozali, & Yuyetta, 2016; Merganthaler, 2008; Xu-Dong & Lu, 2014). The prior research hypothesizes that preparers would utilize the latitude in the principle-based standards to engage in more earnings management. Thus, if preparers have incentives to manage earnings and those earnings are managed more often through judgment, then preparers are more likely to prefer principle-based standards, which allow for greater latitude in judgment.

Accounting professionals also participate in the standard setting process when proposals affect reported financial statement values (Jorissen et al., 2012) but they also tend to use persuasion language that emphasize an accountability criteria such as reliability, neutrality and objectivity (Kwok and Sharp (2005). Accounting professionals are presumed to have an incentive to retain clients and avoid litigation (e.g., Carcello & Palmrose, 1994; Cuccia et al., 1995; Hackenbrack & Nelson, 1996; Kadous, Kennedy, & Peecher, 2003; Kennedy, Kleinmuntz, & Peecher, 1997; Nelson & Kinney, 1997). Thus, it is often assumed that accounting professionals prefer rule-based accounting standards (Berkowitz & Rampell, 2002a; Cheney, 2004a, 2004b; Herz, 2002; Shortridge & Myring, 2004) because rules make it “much easier and more diplomatic to accuse someone of breaking a rule than accuse him of telling a lie” (Mano & Mouritsen, 2004). As a result, accounting professionals should prefer rule-based accounting standards that would provide better leverage with clients while minimizing the client's adverse reaction. Rule-based accounting standards also provide better protection from any litigation or regulatory investigation because the accounting professionals have a rule to support their judgment.

Regulators, such as the SEC, are similar to preparers and accounting professionals because they tend to participate in standard setting when proposals affect reported financial values (Jorissen et al., 2012). However, unlike accounting professionals, regulators tend to use persuasive language related to decision usefulness and understandability in their comment letters (Kwok & Sharp, 2005). Popular press articles state that the SEC needs the ability to judge whether the intent of the standard is met not just the letter of the standard (Berkowitz & Rampell, 2002a; Berkowitz & Rampell, 2002b; Dow Jones Newswires, 2002). Regulators are believed to have an incentive to ensure and enforce quality decision useful information. Based on Sarbanes-Oxley act of 2002, the SEC's request for FASB to conduct a study on the adoption of a principle-based accounting system and FASB's proposal for a principle-based approach to accounting standard setting, it would appear that early on regulators prefer principle-based accounting standards. Since that time, the SEC and FASB perspective on convergence with international accounting standards has evolved somewhat and has left uncertainty about regulatory support for adopting IFRS and a more principle-based approach to accounting standards (Yallapragada, Roe, & Toma, 2014). Even so, regulatory sentiment at the time of the exposure draft suggests that regulators preferred principle-based accounting standards.

Finally, financial statement users such as investors, employee groups and creditors normally participate in the standard setting process when it concerns disclosure issues (Jorissen et al., 2012), cash flow projections, performance evaluation and contract compliance (Beechy, 1994). In general, users do not want to be fooled by earnings management actions. Whether users are fooled by earnings management or not, many skeptics assume that preparers will manage earnings by whatever mechanism they have available to them by either structuring transactions under rule-based accounting standards or through judgment under principle-based standards (Berkowitz & Rampell, 2002a; Berkowitz & Rampell, 2002b; Burns, 2002).[11] Overall, however, if users do not trust management, they may prefer rules because it reduces the amount of judgment available to preparers. In addition, users may perceive that earnings management through structuring transactions is

[9] We have chosen to examine these four stakeholder groups plus academia to be consistent with prior research on stakeholder participation in accounting standard development. We acknowledge that large accounting firms and multinational organizations may have unique perspectives on this debate, adding those stakeholder groups would have been additional classification not found in prior studies (Georgiou, 2010; Huian, 2013; Richardson & Eberlein, 2011). We do, however, address these perspectives with robustness tests in the data analysis.

[10] Typically, earnings management is found when there is both an incentive and opportunity to manage earnings. Principle-based standards may provide an opportunity for earnings management by providing more latitude through judgment while rule-based standards may provide opportunity for earnings management through structuring transactions.

[11] Prior research is mixed on whether users are fooled by earnings management where some studies support users seeing through earnings management actions (e.g., Beaver, Eger, & Engel, 1996; Beaver, Eger, & McNichols, 2001; Beaver, Eger, Ryan, & Wolfson, 1989; Hand, 1992; Liu & Ryan, 1995; Pertroni, 1992; Wahlen, 1994) and other studies do not support users seeing through earnings management actions (e.g., Benish, 1997; Dechow, Sloan, & Sweeney, 1996; Foster, 1979; Hirst & Hopkins, 1998; Teoh, Welch, & Wong, 1998a, 1998b; Teoh, Wong, & Rao, 1998).

more difficult to accomplish than earnings management through judgment.

Taken together, preparers, accounting professionals, regulators and users may have incentives to prefer either rule-based or principle-based accounting standards. Therefore, our first proposition is as follows[12]:

P1. The preference for principle-based accounting standards depends on the stakeholder group affiliation.

2.2. Procedural justice and the demand for accounting reform

Justice is important because it signals the present or future attainment of a benefit, while injustice signals the absence of such valued benefits (Folger & Cropanzano, 2001). While procedural justice is concerned with the fairness and transparency of the process by which decisions are made, distributive justice is concerned with the fairness of the distribution of resource (Folger & Cropanzano, 2001). Both procedural justice and distributive justice perceptions are based on individuals' expectations about outcomes (Cropanzano & Ambrose, 2001 and Hauenstein, McGonidle, & Flinder, 2001). Procedural justice, however, focuses on the ability of the process or procedures to deliver an expected outcome (Cropanzano & Ambrose, 2001). The presence of fair procedures, in the long run, helps ensure the most favorable outcomes (Folger & Cropanzano, 2001). Procedural justice and legitimacy concerns exist in the accounting standard setting process as well. If processes are perceived to be fair and just, trust is built which leads to legitimacy of the process and the rules or standards the process develops. Legitimate processes increase public compliance and commitment to these rules or standards. Thus, procedural legitimacy focuses on the process by which standards are created to ensure high quality standards that are widely accepted and relied upon (Tandy & Wilburn, 1992).

Unfavorable outcomes often force individuals to make sense of such outcomes by leading those individuals to focus on the procedures associated with the outcomes they receive. As a result, the degree of process unfairness is more closely tied to negative reactions when an outcome is unfavorable (Folger & Cropanzano, 2001). When outcomes are favorable, individuals do not focus as much on procedures and may assume that if expectations are met, procedures must be working as well (Brockner et al., 2001). Individuals are remarkably willing to accept procedures at face value and will believe that procedures function as designed until there is overwhelming social or factual support to the contrary (Lind & Tyler, 1998).

Procedures or processes that are deemed failures are often due to rule overload. An organization may try so hard to adhere to every principle of procedural fairness that it is left with a bureaucracy of rules, regulations and policies, which often produce a sense of injustice. As a result, the procedures stop serving the larger objectives (Cropanzano & Ambrose, 2001). This process failure occurs over time. Initial procedures attempt to solve a legitimate fairness problem. Early versions of policies may be broad in nature and address the most common events or more frequently occurring situations. Later refinements of the policy are more likely to deal with special cases, exceptions, appeals systems or new situations that were not originally covered. It is this attempt to handle every single exception to the rule that contributes to the growth cycle and renders policies too complex to implement effectively (Cropanzano & Byrne, 2001).

Concepts of procedural justice are important in the context of financial accounting standards. Financial accounting standards are critical to sound financial reporting and key to the health and vitality of our capital markets (Herz, 2002). Accounting standard setting bodies rely of concepts of procedural justice for legitimacy of the standards issued, subsequent accounting practice and the confidence of users (Burlaud & Colasse, 2011). Further, when users view the standard setting process as procedurally legitimate, they tend to participate more often (Durocher et al., 2007). Accounting standards are valuable because they act as a means for individuals to obtain specific outcomes (i.e., decision useful information that is relevant and reliable, SFAS Concept Statement 1–6).[13] In the long run, high quality accounting standards will help ensure favorable economic outcomes.

Prior to the Enron and WorldCom accounting scandals, U.S. accounting standards were generally thought to be superior to international accounting standards (Berton, 1999; Garten, 1999; Imhoff, 1999; MacDonald, 1999; McNamee, 2000). Although there were concerns regarding auditor independence and earnings management, there was not a general outcry for accounting standard reform. In 2002, post Enron and WorldCom, investor confidence in financial information declined and U.S. accounting standards came under attack (Rapoport & Whitman, 2002). It appears that when the outcomes were good, users assumed that accounting standards were operating as intended. Once the outcomes became unfavorable, however, users questioned the legitimacy of the accounting standards as evidenced by FASB's, 2002 exposure draft on the need to examine principle-based accounting standards.

Given the potential for process failure from rule overload, it is not surprising that the financial accounting standards came under scrutiny. Many critics suggested that the accounting standards were replete with too many complex rules and too many exceptions (Burlaud & Colasse, 2011; Rapoport & Whitman, 2002) and that firms could take advantage of the rules by structuring transactions around the rules (Burns, 2002). Thus, accounting standards may have experienced a process failure where the procedures stopped serving the larger objective. Similar to the build up of organizational policies, accounting standards are based on principles and originate because of genuine issues that grow over time with exceptions, special cases and emergence of new situations that were not originally covered. As a result, the buildup of complex accounting standards and/or corporate failures generated increased scrutiny on accounting standards and initiated a call to reform the accounting standard setting system (Dow Jones Newswires, 2002).

To continue to draw the parallel, if financial accounting standards are similar to procedures and processes that need reform, then the questions is what elements are necessary for standards or procedures to be deemed fair? Leventhal (1980) proposes that there are six elements that make a procedure fair: (1) representativeness, (2) accuracy, (3) bias suppression, (4) consistency, (5) ethicality, and (6) correctability.[14] Each of these elements is relevant to what we expect accounting standards and the financial reporting process to accomplish. In fact, standard setters often rely on the qualitative characteristics listed in the FASB conceptual framework to develop and propose new accounting standards. Accordingly, we expect that the characteristics of relevance, faithful representation, completeness, neutrality, comparability, verifiability, timeliness, and understandability to be a part of a procedurally fair standard setting process.

The first element of procedural fairness is representativeness. Representativeness refers to procedures that represent the intent of the underlying goals of the process (Leventhal, 1980). The conceptual framework requires accounting standards to be understandable and to

[12] While counter arguments could be made for each stakeholder group, we have attempted to capture the expectations put forth in the popular press. At the same time, we are not proposing specific preferences but rather differences.

[13] SFAS Concept Statement No. 8 has replaced FASB Concept Statements 1 and 2. Faithful representation replaced reliability but the underlying quality characteristics have remained the same.

[14] Sama and Shoaf (2005) examine rule-based versus principle-based corporate governance and propose that the rule-based corporate governance required by the Sarbanes-Oxley Act of 2002 maps into principles or “hypernorms” of more principle-based corporate structures. The hypernorms listed were impartiality (no conflict of interest), transparency/disclosure, accountability/responsibility, truthfulness/honesty, and respect for rights/do no harm.

faithfully represent the underlying economic events. Accuracy refers to procedures that maximize the amount and accuracy of information reaching the decision maker as a means of reducing uncertainty of the decision (Leventhal, 1980; Lind & Tyler, 1998; Thibaut & Walker, 1975). Accounting standards are often designed to reduce variability of accounting choices and increase the accuracy of financial reporting. Bias suppression refers to procedures that reduce the likelihood that factors not relevant to the decision at hand are introduced into the decision making process (Leventhal, 1980; Lind & Tyler, 1998). Accounting standards are often propagated for the purpose of reducing the opportunity for unrelated factors to influence the reporting process. Producing timely and comparable financial statements reduces bias.

Consistency which refers to procedures that facilitate the consistent treatment of people, consistent application of standards, and standards that are developed from a common rule (Cropanzano & Ambrose, 2001; Leventhal, 1980; Lind & Tyler, 1998). Accounting standards facilitate consistent interpretation and application by promulgating standards that can be similarly applied to different situations. Ethicality refers to procedures that reduce the ability of individuals to manipulate the process for personal gain (Leventhal, 1980; Lind & Tyler, 1998). High quality accounting standards provide neutral reporting that does not favor any one party over another. Finally, correctability refers to procedures that allow for corrective action and appeals (Cropanzano & Ambrose, 2001; Leventhal, 1980). The financial reporting process is a corrective process that includes audits, reviews from regulatory bodies and legal action if necessary.

Examining the 'rules versus principles' debate within a procedural justice context allows us to draw similarities and think about standard setting issues in a larger context. The six elements of fair procedures seem to apply to many aspects and expectations of a high quality financial reporting system. If the call for accounting standard reform and subsequent debate is fundamentally a debate over procedural justice, then we would expect that the concepts expressed in that debate should map into the elements of fair procedures. Further, the presence of the elements of procedural fairness should be related to the preference for principle-based standards. It is unclear, however, whether all six elements of procedural fairness will be significant and/or positively related to a preference for principle-based standards. As a result, we do not make directional predictions related to elements of procedural justice and preference for principle-based standards and state our second proposition as follows:

P2. The preference for principle-based accounting standards depends on the concern for elements of procedural justice.

3. Method

3.1. Research approach

To conduct our research, we adopted a five-step process modeled after Durocher et al. (2007).[15] First, we used the existing accounting literature to develop a list of benefits and costs for a principle-based approach to accounting standard setting (see data coding section below). Second, we reviewed theories for accounting standard setting and procedural justice literature to better understand the stakeholder and procedural justice preferences as they relate to rule-based versus principle-based accounting standards (see theory section above). Third, we developed a framework of six elements of procedural justice to be used as the basis for a factor analysis using the comment letters (see results section below). Fourth, we obtained the comment letters (see sample section below). Fifth and finally, we completed a content analysis of the comment letters (see data coding section below) to be used in the statistical analysis of Proposition 1 and Proposition 2 (see results section below).

3.2. Sample

One hundred and thirty-five (135) individuals or groups responded to the FASB request for comment on a principle-based approach to U.S. accounting standards setting. We obtained all 135 of the comment letters from FASB. Included in these FASB comment letters were 31 letters from students of Providence College who completed the letters as a part of a class assignment. Two additional letters were also identified as part of accounting courses at different colleges. Because these student responses could be biased toward course requirements, they were eliminated leaving 102 responses for analysis. However, as a robustness test, these letters were later included as a separate group. The statistical results are inferential identical to those presented below.

As reported in Table 1, a total of 102 comment letters were analyzed. Thirty-eight (37.2%) of the comment letters were written by individual respondents while the remaining 64 comment letters (62.8%) were written by representatives of various groups and organizations. Using the FASB constituent groups identified in the request for comment (i.e., preparers, auditors, SEC, investors, creditors, users) along with the stakeholder categorization used by Tandy and Wilburn (1992), Kwok and Sharp (2005), Larson (2007), Georgiou (2010), Richardson and Eberlein (2011), Jorissen et al., 2012 and Huian (2013), we created five stakeholder categories: Preparers, Accounting Professionals, Regulators, Users and Academics.

Preparers include individual businesses, business trade organizations, corporations, actuaries, non-financial service corporations (including insurance), cooperatives, and associations of preparers. Accounting professionals include CPAs, public accounting firms, AICPA, other accounting organizations, associations of accountants and auditors. Regulators include accounting standard setters, stock exchange regulators, and other government entities. Users include financial services corporations, analyst organizations, banking trade associations, investors, financial analysts, consumer organizations and other users. Academia includes faculty, students and academic associations.[16] Overall, respondents represented this array of different stakeholder interests including preparers (29.4%), accounting professionals (30.4%), regulators (1.0%), users (25.5%) and academia (13.7%).

3.3. Dependent and independent measures

The FASB request for comments on a principle-based approach to U.S. accounting standard setting specifically asked respondents to comment on six questions, some of which had multiple parts (see Appendix A). For this study, we focused on the responses to questions 1a, "Do you support the Board's proposal for a principle-based approach to U.S. standard setting?", 1b "Will that approach improve the quality and transparency of U.S. financial accounting and reporting?," and 5a "What are the benefits and costs of adopting a principle-based approach to U.S. standard setting?." We use the responses to questions 1a and 1b as the dependent measures Support and Quality, respectively. These dependent measures were determined on a scale of 1 (definitely no) to 5

[15] The process we used is similar to the process used by Durocher et al. (2007) who (1) reviewed accounting literature to identify relevant categories, (2) reviewed frameworks and theories from other disciplines that could aid in understanding the phenomenon under study, (3) developed a framework for interviews, (4) conducted interviews and (5) conducted a content analysis of interviews to identify themes.

[16] These categories were tested for robustness. For example, the larger CPA firms such as KPMG were analyzed separately, banks were included as preparers rather than users, and some accounting professionals were included as preparers instead of accounting professionals. None of these groups were significant and the statistical results were inferentially similar to those presented.

Table 1
Descriptive statistics.

	Number	Percent
Individual respondents		
Preparer	4	3.9%
Accounting professional	12	11.8%
Regulator	0	0.0%
User	10	9.8%
Academia	12	11.7%
	38	37.2%
Group respondents		
Preparer	26	25.5%
Accounting professional	19	18.6%
Regulator	1	1.0%
User	16	15.7%
Academia	2	2.0%
	64	62.8%
All respondents		
Preparer	30	29.4%
Accounting professional	31	30.4%
Regulator	1	1.0%
User	26	25.5%
Academia	14	13.7%
	102	100.0%

(absolutely yes).[17] We use the responses to question 5a (benefits and costs) as independent measures to proxy for the elements of procedural justice (Representativeness, Accuracy, Bias Suppression, Consistency, Ethicality, and Corrective).

3.4. Data coding

Three independent coders, accounting students with sufficient knowledge but who were unaware of the purpose of the study, were asked to read each letter and (1) determine the appropriate stakeholder category, (2) ascertain the dependent measures Support (question 1a) and Quality (question 1b), and (3) classify Benefits and Costs (question 5a) as described below.[18] To answer the questions about whether the letter writer supported the FASB proposal for a principle-based approach (Support) and whether that approach would improve quality and transparency (Quality), the coders were asked to use a scale of 1 (definitely no) to 5 (absolutely yes). Initial interrater reliability for these two dependent measures, as measured by Kappa, was good (> 0.80). Differences between the coders tended to be small differences in rating (i.e., a 4 vs 5) rather than differences in overall intent (i.e., 1 vs 5). These differences were reconciled by one of the authors by using a single coder's ratings as a benchmark so that ratings used were consistent across all letters.

To aid in coding the benefits and costs identified in each comment letter, we developed a list of potential cost and benefits by reviewing the rule-based versus principle-based standards debates in popular press (Berkowitz & Rampell, 2002a; Berkowitz & Rampell, 2002b; Burns, 2002; Dow Jones Newswires, 2002; Rapoport & Whitman, 2002) and prior accounting literature (Cuccia et al., 1995; Grenier, Pomeroy, & Stern, 2010; Hackenbrack & Nelson, 1996; Jamal & Tan, 2010; Mano & Mouritsen, 2004; Nelson et al., 2002; Sama & Shoaf, 2005).[19] Although the coders were given this list of potential benefits and costs as a starting point, they were specifically asked to identify all benefits and costs mentioned in each letter. Because each letter could contain multiple comments, each comment was coded as a separate benefit or cost often resulting several identified benefits and cost for each letter. Each comment was coded in relation to principle-based standards. For example, a respondent could indicate that principle-based standards would reduce management's ability to structure transactions so the coder would identify a “reduced transaction structuring” benefit. Another respondent could indicate that principle-based standards would increase earnings management because of latitude in judgment provided management so the coder would record “earnings management” costs.

Initial interrater reliability, as measured by Kappa, for the benefits and cost was at least moderate (> 0.60) across all coding. Differences between the coders tended to be the use of additional categories added by the coders rather than disagreement about benefits and costs identification. One of the authors combined similar categories together and reconciled any remaining differences. In total, 9 benefit categories and 12 cost categories were identified and used in the factor analysis below.

4. Results

4.1. Factor analysis

Once the comment letters were coded, we conducted a principle-components factor analysis using varimax rotation to identify which benefits and costs loaded together with eigenvalues > 1. Individual benefits and costs that loaded above 0.60 on any given factor and at the same time, did not load above 0.40 on any other factor were selected.[20] These results were then mapped into the six elements of fair procedures. Although we held some a priori beliefs about how the benefits and costs might map into the six elements of procedural justice, we felt it was important to rely on the factor analysis to create the six elements of procedural justice. For example, clear conveyance of economic substance seemed to map directly into representativeness based on the description in the procedural justice literature. However, for other benefits and costs such mappings were less clear and arguments could be made for potential mapping into various elements. For example, we could envision that increased comparability could potentially map into either accuracy or consistency. As a result, we made no a priori predictions of how benefits and costs would map into the six elements of procedural justice.

As reported in Table 2, a total of six factors (three benefits and three costs) emerged from the factor analysis. Three factors accounting for 70.0% of the variation emerged from the list of identified benefits and three factors accounting for 65.1% of the variation emerged from the list of identified costs. Taken together, these six factors accounted for 69.8% of the variation. As discussed below, these six factors were used to map into the procedural justice elements of Representativeness, Accuracy, Bias Suppression, Consistency, Ethicality and Correctability. All remaining benefits and costs that were identified together as Other

[17] We used a scale of 1 to 5 because we found that the degree of support for the FASB proposal was not a simple “Yes, I support the proposal” or “No, I do not support the proposal”. As a result, we used a scale that we felt gave the coders enough of a range in responses.

[18] Initially two upper level undergraduate accounting students were used as coders. A graduate accounting student with more technical knowledge was added as a coder to expand the scope and precision of the coding.

[19] Coders were provided with an initial list of the following benefits: (1) clear conveyance of economic substance, (2) reduced transaction structuring, (3) understandable standards, (4) increased comparability, (5) reduced complexity, and (6) guidance or judgment beyond FASB. The initial list of costs included the following: (1) increased litigation, (2) increased audit costs, (3) increased insurance costs, (4) variation in interpretation, (5) reduced comparability, (6) standards not applied in good faith, and (7) earnings management.

[20] The factor analysis was completed separately for the listed benefits and costs. An additional factor analysis was completed with all benefits and costs together yielded similar results. However, since of the listed benefits and costs were more likely to cross-load with another factor when combined, the factor scores are reported separately for benefits and costs.

Table 2
Principle components factor loading for principle-based benefits and costs.

	Representative	Accuracy	Bias suppression	Consistency	Ethicality	Corrective
Benefits						
Understandable standards	0.885					
Reduced standard complexity	0.854					
Increased accuracy/transparency		0.885				
Conveys economic substance		0.613				
Timely industry specific guidance			0.844			
Increased comparability			0.692			
Costs						
Standards not applied in good faith				0.846		
Variation in interpretation				0.690		
Increased earnings management					0.766	
Reduced comparability					0.718	
Increased audit costs						0.823
Increased litigation costs						0.783

Benefits and Other Costs. In general, the remaining benefits and costs were identified by relatively few letter writers. By combining them together as Other Benefits and Other Costs, these items were more likely to be significant in the statistical analysis of Proposition 1 and Proposition 2.[21]

We analyzed the six factor loadings to determine whether they reasonably map into six elements of procedural justice (Representativeness, Accuracy, Bias Suppression, Consistency, Ethicality and Correctability). The factor analysis for benefits grouped “more understandable accounting standards” and “reduced accounting standard complexity” together. Given that these two benefits refer to the intent of the underlying goals of the process, we label this factor Representativeness.

The factor analysis grouped “increased accuracy and transparency of financial reporting” and “clearly conveys economic substance of the underlying transaction” together. These two benefits of principle-based standards were labeled Accuracy because any procedure that maximizes transparency and credibly conveys the economics substance of the original transaction will improve the accuracy of any resulting financial decisions. That is, more transparent and accurate financial reporting leaves little room for manipulation.

Finally, the factor analysis grouped “increased comparability of financial reports” and “more timely response especially for industry specific guidance” together which we labeled Bias Suppression. Bias Suppression refers to procedures that reduce the likelihood that factors irrelevant to the decision at hand are introduced into the decision making process. The more comparable and timely financial reports are, especially within a given industry, the less likely decision makers are going to seek outside, unsubstantiated (or unaudited) financial information for decision making.

In terms of costs, the factor analysis grouped “increased variation in accounting standard interpretation” and “accounting standards not applied in good faith” together. These two costs of were labeled Consistency. Consistency refers to procedures that facilitate the consistent application of standards from company to company over a period of time. When the same accounting standard can be applied differently over time or from person to person, then consistency is violated.

Ethicality refers to procedures that reduce the ability of individuals to manipulate for personal gain. The factor analysis grouped “increased earnings management” and “reduced comparability of financial report” together. Earnings management is defined as the process of structuring transactions or changing judgments as a mean of influencing financial reporting decisions. In addition, the use of judgment in applying principle-based standards makes it more difficult to compare the financial reports from different companies and the consequently, the ability to identify inappropriate earnings management is diminished. Therefore, we label this Ethicality.

Finally, the factor analysis grouped “increased litigation costs” and “increased audit costs” together. These two costs are labeled Correctability. Correctability refers to procedures that allow for corrective action and appeals. Additional audit costs are often necessary to protect from litigation exposure or as a response to litigation filings. Based on the results of the factor analysis and the reasonableness of the benefit and costs groupings, it appears there is a link between the concerns expressed in the current rule-based versus principle-based standards debate and the six elements of fair procedures.[22]

4.2. Proposition 1 and proposition 2

Proposition 1 predicts that the preference for principle-based standards depends on stakeholder group preferences while Proposition 2 predicts that the preference for principle-based standards depends on concern for the six elements of procedural justice. Six procedural justice variables (Representativeness, Accuracy, Bias Reduction, Consistency, Ethicality, Correctability) were created from the six factors emerging from the principle-components analysis. The factor scores for each of the six procedural justice variables were used as independent variables. Three elements are considered benefits (Representativeness, Accuracy, and Bias reduction) and three elements were considered costs (Consistency, Ethicality, and Correctability). As a result, we expect those factors listed as benefits will be positively associated with support for principle-based accounting standards and factors listed as costs will be negatively associated with support for principle-based accounting standards. In addition, we added a dummy variables Other Benefits and Other Costs that each took on a value of 1 if other benefits and costs were identified by respondents and a value of 0 otherwise.

As suggested by Proposition 1, stakeholders may have different incentives, which could result in differing levels of support for the FASB proposal. Accordingly, the stakeholder categories of Preparer, Accounting Professional, Regulator, User and Academic were also entered into the model. In addition, because respondents with an international affiliation are more likely to be familiar with principle-based

[21] Other benefits included reduced structuring, increased confidence and reduced lawsuits. Other costs included guidance outside FASB, increased insurance cost, additional re-education costs, small company burden, increased implementation cost and less transparency.

[22] While it is unlikely that the respondents to the FASB exposure draft were explicitly referring to justice issues in their letters, we posit that their concerns were akin to procedural justice concerns. That is, that respondents were making statements concerning the ability of either rule-based or principle-based accounting standards (fair process) to provide high quality financial information (fair outcome),

accounting standards, we added a dummy variable International that took on a value of 1 if respondents were internationally affiliated and a value of 0 otherwise. Finally, the dummy variable Respondent, which took a value of 1 if the respondent was representing an individual and 0 if the respondent was representing an organization or group, was entered into the model.[23]

We examine Proposition 1 and Proposition 2 using two dependent variables: Support and Quality.[24] As it relates to support for a principle-based approach to accounting standard setting (Support), a regression was performed using the following model:

$$\begin{aligned}\text{Support} = {} & \beta_0 + \beta_1\text{Representativeness} + \beta_2\text{Accuracy} \\ & + \beta_3\text{Bias Suppression} + \beta_4\text{Consistency} + \beta_5\text{Ethicality} \\ & + \beta_6\text{Correctability} + \beta_7\text{Other Benefits} + \beta_8\text{Other Costs} \\ & + \beta_9\text{Respondent} + \beta_{10}\text{Preparer} + \beta_{11}\text{Accounting Professional} \\ & + \beta_{12}\text{Regulator} + \beta_{13}\text{User} + \beta_{14}\text{Academia} + \beta_{15}\text{International}\end{aligned}$$

The dependent variable Support is coded on a scale of 1 (definitely no) to 5 (absolutely yes). The overall mean value for Support of 3.85 (std = 1.30) indicates that most respondents supported the FASB proposal for a principle-based approach to U.S. standard setting. As reported in Table 3, the estimated regression produces an adjusted R^2 of 0.39 indicating the model explains a large portion of the variability in support for the FASB proposal. The coefficients on Representativeness ($t = 3.78$, $p < .01$), Accuracy ($t = 3.62$, $p < .01$) and Bias Suppression ($t = 2.13$, $p = .04$) are significantly positive while Consistency ($t = -2.18$, $p = .03$), Ethicality ($t = -3.61$, $p < .01$), and Correctability ($t = -3.76$, $p < .01$) are significantly negative. Other Costs and Other Benefits are not significant (both $p > .10$). That is, respondents who support a principle-based system mention the benefits of representativeness, accuracy and bias suppression while non-supporters mention the costs of consistency, ethicality and correctability.

While respondents identified procedural justice concepts in supporting or refuting the FASB proposal, international and stakeholder group affiliations for International, Preparer, Accounting Professional, Regulator, User and Academia were not significant (all $p > .10$). Further, ANOVA results (untabulated) indicate no overall significant difference in mean values for Support ($F = 1.52$, $p = .20$) between the stakeholder groups and all Bonferroni post-hoc comparisons among the stakeholder groups are not significant (all $p > .10$). Finally, Respondent is marginally significant ($t = -1.85$, $p = .07$) indicating that groups or organizations were more likely to support the FASB proposal than individuals.

Taken together, these results indicate that respondents rely on procedural justice concepts in supporting or refuting the FASB proposal regardless of stakeholder group affiliation. These results are consistent with Proposition 2 but not with Proposition 1.

The results for the perceived quality of a principle-based standard setting process are similar to the previous results. Again, a regression was performed using the following model:

$$\begin{aligned}\text{Quality} = {} & \beta_0 + \beta_1\text{Representativeness} + \beta_2\text{Accuracy} + \beta_3\text{Bias Suppression} \\ & + \beta_4\text{Consistency} + \beta_5\text{Ethicality} + \beta_6\text{Correctability} \\ & + \beta_7\text{Other Benefits} + \beta_8\text{Other Costs} + \beta_9\text{Respondent} \\ & + \beta_{10}\text{Preparer} + \beta_{11}\text{Accounting Professional} + \beta_{12}\text{Regulator} \\ & + \beta_{13}\text{User} + \beta_{14}\text{Academia} + \beta_{15}\text{International}\end{aligned}$$

The dependent variable Quality is coded on a scale of 1 (definitely no) to 5 (absolutely yes). The overall mean value for Quality of 3.87 (std = 1.34) indicates that most respondents believed a principle-based approach to U.S. standard setting would improve quality and transparency. As reported in Table 4, the estimated regression produces an adjusted R^2 of 0.47 indicating the model explains a large portion of the variability in the perceived quality and transparency of principle-based accounting standards. The coefficients for Representativeness ($t = 4.00$, $p < .01$), Accuracy ($t = 5.38$, $p < .01$) and Bias Suppression ($t = 3.10$, $p < .01$), are significantly positive while Consistency ($t = -1.87$, $p = .07$), Ethicality ($t = -3.76$, $p < .01$), and Correctability ($t = -3.68$, $p < .01$) are significantly negative. Other Costs and Other Benefits are not significant (both $p > .10$). That is, respondents who believe a principle-based system will improve the quality and transparency of financial information mention the benefits of representativeness, accuracy and bias suppression while non-supporters mention the costs of consistency, ethicality and correctability.

While respondents identified procedural justice concepts when assessing the quality and transparency of financial information under the FASB proposal, international and stakeholder group affiliations for International, Preparer, Accounting Professional, Regulator, User and Academia were not significant (all $p > .10$). Further, ANOVA results (untabulated) indicate no overall significant difference in mean values for Support ($F = 1.67$, $p = .16$) between the stakeholder groups and all Bonferroni post-hoc comparisons among the stakeholder groups are not significant (all $p > .10$). Finally, Respondent is significant ($t = -2.43$, $p = .02$) indicating that groups or organizations were more likely to believe a principle-based system would improve the quality and transparency of financial reporting.

Taken together, these results suggest that respondents believed a principle-based system would improve the quality and transparency of financial reporting regardless of stakeholder affiliation. Again, these results are consistent with Proposition 2 but not with Proposition 1.

5. Conclusion

Measurement instruments have been regulated – standardized – in the public interest since ancient times because the public demands fair measures

-Comment Letter 12

6. Discussion

While this study examined the comment letters from the 2002 FASB exposure draft, FASB continues to grapple with IFRS convergence and continues to move toward a more principle-based standard setting system (e.g., new lease standard). As a result, investors, regulators and practitioners continue to debate the merits of a principle-based approach to U.S. accounting standard setting. While both proponents and critics of the original exposure draft suggested that preparers, accounting professionals, regulators, academics and users would have different incentives and preferences for rules or principles, the analysis of the FASB comment letters suggests otherwise. Stakeholder group interests were not systematically associated with support for or perceived quality of a principle-based approach to standard setting. Instead, respondents across stakeholder groups mentioned procedural justice issues in their comments about moving toward a more principle-based accounting standard setting system.

[23] While we believe the models reported for Support and Quality are the most comprehensive models, we conducted robustness additional tests to ensure that our results were not dependant on our model choice. Thus, several alternative models were tested including entering individual and group respondents separately, entering other benefits and other costs individually, splitting the dependent variable into a yes/no categorical variable, and including the Providence College student responses. Other models produced inferentially similar results to those reported.

[24] All collinearity statistics indicate there are no multicollinearity issues with the data.

Table 3
Regression of support for principle-based standards on procedural justice.

Regression of support for principle-based standards on procedural justice

Support = β_0 + β_1Representativeness + β_2Accuracy + β_3Bias Suppression + β_4Consistency + β_5Ethicality + β_6Correctability + β_7Other Benefits + β_8Other Costs + β_9Respondent + β_{10}Preparer + β_{11}Accounting Professional + β_{12}Regulator + β_{13}User + β_{14}Academia + β_{15}International

Variable	Expected sign	Coefficient	t-Statistic	*p*-Value
Intercept		3.85	37.62	< 0.01
Representativeness[a]	(+)	0.30	3.78	< 0.01***
Accuracy[b]	(+)	0.29	3.62	< 0.01***
Bias suppression[c]	(+)	0.17	2.13	0.04**
Consistency[d]	(−)	−0.17	−2.18	0.03**
Ethicality[e]	(−)	−0.29	−3.61	< 0.01***
Correctability[f]	(−)	−0.30	−3.76	< 0.01***
Other benefits[g]	(+)	0.15	0.17	0.86
Other costs[h]	(−)	−0.04	−0.49	0.63
Respondent[i]		−0.15	−1.85	0.07*
Preparer[j]		0.05	0.58	0.56
Accounting professional[k]		−0.04	−0.49	0.62
Regulator[l]		0.06	0.77	0.44
User[m]		0.05	0.65	0.52
Academia[n]		−0.10	−1.20	0.23
International[o]		−0.01	−0.11	0.91
Adjusted R^2		0.39		

*** Significant at $p < .01$ (two-tailed).
** Significant at $p < .05$ (two-tailed).
* Significant at $p < .10$ (two-tailed).
[a] *Representativeness* is the factor score for "more understandable accounting standards" and "reduced accounting standard complexity."
[b] *Accuracy* is the factor score for "increased accuracy/transparency of financial reporting" and "financial reporting clearly conveys the economic substance of the underlying transactions."
[c] *Bias Suppression* is the factor score for "increased comparability of financial reports" and "more timely response for industry specific guidance."
[d] *Consistency* is the factor score for "increased variation in accounting standard interpretation" and "accounting standards not applied in good faith."
[e] *Ethicality* is the factor score for "increased earnings management" and "reduced comparability of financial reports."
[f] *Correctability* is the factor score for "increased audit fees" or "increased litigation costs."
[g] *Other Benefits* is a dummy variable taking on a value of 1 if the respondent identified any other benefits and a value of 0 otherwise.
[h] *Other Costs* is a dummy variable taking on a value of 1 if the respondent identified any other costs and a value of 0 otherwise.
[i] *Respondent* is a dummy variable taking on a value of 1 if the respondent is an individual or a value of 0 if the respondent represents a group or organization.
[j] *Preparer* is a dummy variable taking on the value of 1 if the respondent represents a sole proprietorship, partnership, corporation, non-financial service organization (including insurance), business trade association and a value of 0 otherwise.
[k] *Accounting Professional* is a dummy variable taking on a value of 1 if the respondent represents is an individual CPA, public accounting firm, or other accounting organization (such as the AICPA) and a value of 0 otherwise.
[l] *Regulator* is a dummy variable taking on a value of 1 if the respondent represents accounting standard setting organizations, stock exchange regulators or other governmental regulatory agencies and a value of 0 otherwise.
[m] *User* is a dummy variable taking on a value of 1 if the respondent represents an individual investor, financial services corporation, analyst associations, bank trade associations, financial analysts, consumer organizations, or employee retirement plans and a value of 0 otherwise.
[n] *Academia* is a dummy variable taking on a value of 1 if the respondent represents a faculty, student, or academic association and a value of 0 otherwise.
[o] *International* is a dummy variable taking on a value of 1 if the respondent represents an international group or individual and a value of 0 otherwise.

Processes or procedures are often labeled "unfair" in the wake of rule overload. In the comment letters one of the respondents noted just that problem:

> *There is no such thing as a perfect rule. Having recognized an imperfection in the first rule, one creates a new rule to try to cure the imperfections in the old rule. But the new rule is imperfect, creating the need for yet another rule to fix imperfection in the rule that was designed to fix the imperfection in the original rule. This process creates an infinite loop in rule making. This process maximizes micro-management. And costs a lot of money.*"
>
> Comment Letter 5

When rule overload occurs, it is not unusual for the process or procedure to come under scrutiny. Critics often rely on the elements of procedural justice (representativeness, accuracy, bias suppression, consistency, ethicality, correctability) to demand reform. The results of this study suggest there is sufficient evidence to support the applicability of a procedural justice framework to the 'rules versus principles' debate. Specifically, stakeholders listed the procedural justice elements of representativeness, bias suppression and accuracy in support for principle-based standards and consistency, ethicality and correctability in rejection of principle-based standards. For example,

> Financial statements would present a move accurate reflection of the economics of the underlying business activity.
>
> Comment Letter 111 (Accuracy)

> *A principle-based standards approach with its resulting decrease in the complexity of the accounting guidance and fewer exceptions should make the financial information provided by companies more understandable and useful for its financial statements readers.*
>
> Comment Letter 22 (Representativeness)

> Broader principle-based standards could lead to situations which professional judgments, made in good faith, result in different interpretations for similar transactions and events decreasing the comparability in financial reporting. Lack of comparability could adversely affect the value of financial reporting to creditors and users of the information.
>
> Comment Letter 16 (Consistency)

The results of this study suggest that standard setters in the U.S. should attend to procedural justice issues. Perceptions of fairness affect an individual's willingness to rely on the process and the

Table 4
Regression of quality of principle-based standards on procedural justice.

Regression of quality of principle-based standards on procedural justice

Quality = β0 + β1Representativeness + β2Accuracy + β3Bias Suppression + β4Consistency + β5Ethicality + β6Correctability + β7 Other Benefits + β8Other Costs + β9Respondent + β10Preparer + β11Accounting Professional + β12Regulator + β13User + β14Academia + β15International

Variable	Expected sign	Coefficient	t-Statistic	*p*-Value
Intercept		4.00	31.92	< 0.01
Representativeness[a]	(+)	0.30	4.00	< 0.01***
Accuracy[b]	(+)	0.41	5.38	< 0.01***
Bias suppression[c]	(+)	0.23	3.10	< 0.01***
Consistency[d]	(−)	−0.14	−1.87	0.07*
Ethicality[e]	(−)	−0.28	−3.76	< 0.01***
Correctability[f]	(−)	−0.28	−3.68	< 0.01***
Other benefits[g]	(+)	0.07	0.91	0.37
Other costs[h]	(−)	−0.10	−1.22	0.23
Respondent[i]		−0.18	−2.43	0.02**
Preparer[j]		0.02	0.27	0.79
Accounting professional[k]		−0.02	−0.31	0.76
Regulator[l]		0.02	0.26	0.79
User[m]		0.04	0.46	0.65
Academia[n]		−0.06	−0.67	0.51
International[o]		0.09	1.18	
Adjusted R^2		0.47		

*** Significant at $p < .01$ (two-tailed).
** Significant at $p < .05$ (two-tailed).
* Significant at $p < .10$ (two-tailed).
[a] *Representativeness* is the factor score for "more understandable accounting standards" and "reduced accounting standard complexity."
[b] *Accuracy* is the factor score for "increased accuracy/transparency of financial reporting" and "financial reporting clearly conveys the economic substance of the underlying transactions."
[c] *Bias Suppression* is the factor score for "increased comparability of financial reports" and "more timely response for industry specific guidance."
[d] *Consistency* is the factor score for "increased variation in accounting standard interpretation" and "accounting standards not applied in good faith."
[e] *Ethicality* is the factor score for "increased earnings management" and "reduced comparability of financial reports."
[f] *Correctability* is the factor score for "increased audit fees" or "increased litigation costs."
[g] *Other Benefits* is a dummy variable taking on a value of 1 if the respondent identified any other benefits and a value of 0 otherwise.
[h] *Other Costs* is a dummy variable taking on a value of 1 if the respondent identified any other costs and a value of 0 otherwise.
[i] *Respondent* is a dummy variable taking on a value of 1 if the respondent is an individual or a value of 0 if the respondent represents a group or organization.
[j] *Preparer* is a dummy variable taking on the value of 1 if the respondent represents a sole proprietorship, partnership, corporation, non-financial service organization (including insurance), business trade association and a value of 0 otherwise.
[k] *Accounting Professional* is a dummy variable taking on a value of 1 if the respondent represents is an individual CPA, public accounting firm, or other accounting organization (such as the AICPA) and a value of 0 otherwise.
[l] *Regulator* is a dummy variable taking on a value of 1 if the respondent represents accounting standard setting organizations, stock exchange regulators or other governmental regulatory agencies and a value of 0 otherwise.
[m] *User* is a dummy variable taking on a value of 1 if the respondent represents an individual investor, financial services corporation, analyst associations, bank trade associations, financial analysts, consumer organizations, or employee retirement plans and a value of 0 otherwise.
[n] *Academia* is a dummy variable taking on a value of 1 if the respondent represents a faculty, student, or academic association and a value of 0 otherwise.
[o] *International* is a dummy variable taking on a value of 1 if the respondent represents an international group or individual and a value of 0 otherwise.

outcomes from that process. Research in procedural justice suggests that when procedures are deemed unfair, individuals are likely to feel angry and resentful resulting in diminished trust of both the process and the outcomes (Lind & Tyler, 1998). When a process is deemed unfair, individuals are less likely to rely on the process, express less confidence and willingness to trust the outcomes and are less likely to support or accept conclusions drawn from the outcomes (Brockner et al., 2001; Folger & Cropanzano, 2001; Lind & Tyler, 1998).

While the procedural justice literature has focused on employee responses to perceived injustice, we can see some similarities with financial reporting users. When investor confidence declines, many investors are hesitant to invest in corporate stocks and investors express lack of trust in the financial reporting system (Bailey & Sawers, 2012; Hodge, 2003; Rapoport & Whitman, 2002). Given the decline in investor confidence and trust after the accounting scandals of the early 2000s, it was not surprising that investors were hesitant to invest in corporate stocks. The restoration of that trust might well be rooted in the perceived fairness of the accounting procedures used to create financial information and ultimately, the level of trust in a rule-based or principle-based reporting system could affect the willingness to choose and invest in companies (Bailey & Sawers, 2012).[25]

Our results, however, also suggest that principle-based standards fulfill only half of the justice concerns. We find that principle-based standards seem to be positively linked to three elements of fair procedures (representativeness, accuracy, and bias suppression), but they are also negatively linked to three elements of fair procedures (consistency, ethicality and correctability). These results suggest that principle-based standards do not meet all the requirements for fair procedures. As a result, moving toward more principle-based standards will not eliminate every concern about fairness. In addition, if we experience events similar to the events that led up to the call for standards reform yet again, a procedural justice framework would suggest that we would again question the process that creates financial information, (i.e., the accounting standards).[26] That is, we

[25] While we posit that outcome failure may have caused investors to question the process by which financial information is created (accounting standards), we also posit that once the process is questioned, it leads to continued concern over the outcomes until trust is re-established in both process and outcome.

[26] For example, in September 2008 banking and financial services trade groups lobbied the SEC to suspend the mark-to-market, or fair-value, accounting standard because they claimed that the standard distorted banks'

may find ourselves in this debate once again.

7. Limitations and future research

We examine principle-based versus rule-based standard setting process through the lens of procedural justice. We find that elements of procedural justice are important concerns to address in the standard setting process. What we are unable to do, however, is tease out whether individuals prefer a principle-based system because they perceive it as more fair or because they perceive a rule-based system as less fair. This is an important question for future research. Further, if perceptions of procedural justice are important in the standard setting process, future research should examine ways to enhance those perceptions throughout the process.

We also acknowledge that the non-significant results on stakeholder group may be because this was not an exposure draft on a specific standard where the outcome of the standard might have a greater impact on the different stakeholder groups. As such, our results may not be generalizable to exposure drafts related to specific accounting treatments. For example, a recent study of the IASB exposure draft for impairment of financial assets (ED/2009/12) received 192 comment letters and the results indicated that the stakeholder groups had different levels of agreement with the proposed standards although the study did not test whether the differences were statistically significant (Huian, 2013).

8. Conclusion

Procedural justice provides a unique perspective that is not often used with regard to the accounting standard setting process but can be very useful in bringing new insight into that process. One of the purposes of financial accounting is to provide decision useful information that helps economic agents make economic decisions. Procedural justice is concerned with fair processes that ensure fair outcomes. This study examines the FASB proposal for a principle-based approach to U.S. accounting standard setting within a procedural justice context. The results of this study do not indicate that one type of standard is better than another, but rather that there are several fairness concerns that should be met for a standard to be perceived as fair. Respondents who support principle-based standards indicate that principle-based standards improve representativeness, bias suppression, and accuracy. On the other hand, respondents who do not support principle-based standards indicate that principle-based standards degrade consistency, ethicality and correctability. Ideally, accounting standards should improve all six elements of procedural justice. Looking at accounting standards within a procedural justice context allows us to understand that the accounting profession needs to create standards that meet all of elements of fair procedures.

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Appendix A. FASB proposal request for comment

1. a. Do you support the Board's proposal for a principle-based approach to U.S. Standard setting?
   b. Will that approach improve the quality and transparency of U.S. Financial accounting and reporting?
2. a. Should the Board develop an overall reporting framework as in IAS 1?
   b. Should the framework include a true and fair view override?
3. a. Under what circumstances should interpretive and implementation guidance be provided under a principle-based approach to U.S. standard setting?
   b. Should the board be the primary standard setter responsible for providing that guidance?
4. a. Will preparers, auditors, the SEC, investors, creditors, and other users of financial information be able to adjust to a principle-based approach to U.S. standard setting?
   b. What needs to be done?
5. a. What are the benefits and costs (including transition costs) of adopting a principle-based approach to U.S. standard setting?
   b. How might those benefits and costs be quantified?
6. What other factors should the Board consider in assessing the extent to which it should adopt a principles-based approach to U.S. standard setting?

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(*footnote continued*)
balance sheets and contributed to the market's volatility. In response, Arthur Levitt and Lynn Turner stated that it was the use of accounting sleight of hand that hid the true risk of assets and liabilities that distorted the market and led to investor loss of confidence. In addition, the only way to restore the markets functionality was to restore public trust by improving the quality, accuracy and relevance of financial reporting (Levitt & Turner, 2008).

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