Centre for
Financial
Market
Integrity

22 July 2008

Ms. Nancy M. Morris
Federal Advisory Committee Management Officer
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: ***Final Report of the SEC Advisory Committee on Improvements to Financial Reporting***

Dear Ms. Morris:

The CFA Institute Centre for Financial Market Integrity (CFA Institute Centre),[1] in consultation with its Corporate Disclosure Policy Council (CDPC)[2], appreciates the opportunity to comment on the Final Report to be issued by the U.S. Securities and Exchange Commission (SEC or Commission) Advisory Committee on Improvements to Financial Reporting (CIFiR or Committee).

The CFA Institute Centre represents the views of its investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. Central tenets of the CFA Institute Centre mission are to promote fair and transparent global capital markets, and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures provided to investors and other end users is of high quality. The CFA Institute Centre also develops, promulgates, and maintains guidelines encouraging the highest ethical standards for the global investment community through standards such as the *CFA Institute Code of Ethics and Standards of Professional Conduct.*

[1] The CFA Institute Centre for Financial Market Integrity is part of CFA Institute. With headquarters in Charlottesville, VA, and regional offices in New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 96,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 134 countries, of whom nearly 82,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 56 countries and territories.

[2] The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The Council is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the Council provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

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Introduction

We recognize the challenges faced by the Committee as it addressed many areas of complexity in financial reporting today. In our opinion, some of the proposals may have minimal benefit to users, but the report in total offers improvements to all participants in the financial reporting process. As the Committee completes the updates to the draft which were discussed during its 11 July 2008 public meeting, we would like to reinforce some areas of concern expressed in our 31 March 2008 letter related to the Progress Report[3], which continue to be of concern in the most recent draft.

The benefits of the following recommendations accrue to others in the financial reporting process more than for investors:

- Mixed attribute model and fair value
- Determination of materiality
- Error correcting without restatements
- Documentation in applying professional judgment

Several of these areas were discussed in detail during the July meeting. We summarize our views in the remainder of this letter. We look forward to reading the final recommendations of the Committee and trust our comments are helpful in the deliberations.

While the Committee did not put forth any recommendations relating to the adoption of or convergence with international accounting standards, we are encouraged by the Committee's recognition that the timing and priorities of their recommendations could be impacted by future decisions made by the SEC. Another example of SEC actions impacting the committee was the recent "21st Century Disclosure" initiative. The Committee made several recommendations concerning updating SEC requirements and building cohesive disclosure frameworks. This new initiative will embrace these recommendations and CFA Institute is willing to participate as this project moves forward as well.

General Comments

Mixed Attribute Model and Fair Value

In our March comment letter, we expressed our concerns over the negative language the report used in describing fair value reporting. Unfortunately, the tone of Chapter 1 did not improve with the release of the initial draft of the Committee's final report. While the intent of the Committee may have been to call for measured and practical advancement of the use of fair value, the words used in the report could easily be interpreted as an impediment to issuing any standards expanding the use of fair value in the near-term.

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[3] This comment letter is available on the CFA Institute website:
http://www.cfainstitute.org/centre/topics/comment/2008/pdf/cifir_progress_report.pdf

We have advocated increased use of fair value reporting for many years. As we noted in our March comments, our membership survey results support our advocacy in this area. Our March 2008 CEO Newsletter Question of the Month asked several questions related to the impact of fair value.[4] Of the 2,006 CFA Institute members who responded:

- 79 percent indicated fair value improved the transparency and investor understanding of financial institutions (Question 1);
- 74 percent stated that it improved market integrity (Question 3).

While these results support the expanded use of fair value reporting, the respondents also recognized there may be unintended consequences as 55 percent agreed that fair value requirements were aggravating the global credit crisis (Question 2), perhaps reflecting the views widely reported in the media. Varying views are consistent across the debate on the use of fair value measurements, but we continue to support the near-term advancement of fair value as the appropriate measurement attribute for financial instruments with the longer-term goal of a balance sheet fully based on fair value.

We understand there are various causes of complexity in the mixed attribute model and believe the Committee could have focused on areas other than fair value. The Committee could have easily tied recommendation 1.1 to recommendation 1.7 which called for the review and reduction of alternative accounting policies. The examples the Committee provide of SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities,* and SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* allow for alternative treatments for similar financial instruments. Instead of calling for the standard setters to be cautious in making changes as it related to the advancement of fair value reporting, we believe the Committee could have supported the use of fair value measurement for financial instruments in the near-term by citing its own call to eliminate the accounting options. This would reduce the significant complexity inherent in the mixed attribute model for these instruments and still allow for the development of a measurement framework before advancing fair value to nonfinancial assets and liabilities.

Determination of Materiality

While the Committee modified the language and discussion in Chapter 3 regarding the impact of qualitative factors in determining the materiality of an error, we remain concerned about the notion that a quantitatively large error can be deemed immaterial. We believe in the concept of allowing equal consideration of both qualitative and quantitative factors in determining materiality of all items and continue to support the implementation guidance included in SAB Topic 1M. The Committee's discussion of this topic in the July meeting was encouraging,

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[4] The full results and related comments are available on the CFA Institute website: http://www.cfainstitute.org/memresources/monthlyquestion/2008/march.html . Respondents provided several hundred comments on this topic which were sorted based on their responses and are available on the CFA Institute website: http://www.cfainstitute.org/memresources/monthlyquestion/pdf/comments_mar08.pdf

especially given the unified front by those the SEC identified as "Users"[5] against this recommendation. We are hopeful this issue will be reconsidered in the final report.

We are also concerned with the discussion on using current investment models as a basis for qualitative factors. There are numerous valuation models used for making investment decisions and an error that may not impact one investor's model may have serious impacts on others. For this criterion to be operational, someone would have to decide which models to consider.

Similarly, the information needs for current and prospective investors differ, as current investors maintain a historical database of company information. The prospective investor uses the historical filings to begin their analysis. The following proposal on correcting errors will transfer the cost of restating information for evaluating performance trends from the company to the investor, who remain reliant upon full and complete disclosures by the company about errors that are corrected.

Error Correcting Without Restatements

The Committee addressed the concern of allowing sizeable errors to go unchanged when determined immaterial, by requiring their immediate correction with recommendation 3.2. Since this likely requires standard setters to modify their standards on correcting errors, we also ask the Committee to recommend specific requirements associated with the disclosure of the correction. We believe a new disclosure note specifically attributed to this topic will ensure investors can easily find the details of such corrections. Without this requirement, corrections could be included throughout the disclosure notes, potentially making it difficult to judge the full impact of the correction.

We envision the note to contain both tabular and narrative descriptions of the corrections. The table would indentify the reporting periods, statement line items and amount of the corrections. The narrative section would elaborate on (1) the nature of the error, (2) how it was discovered and (3) the steps taken by management to prevent future errors. Additional guidance on the requirements of the note should be taken from the Committee's recommended enhanced disclosures for restatements. The ultimate goal is to ensure that investors and other financial statement users can understand why the error occurred, why it did not require a restatement and how it will be prevented in the future.

Documentation in Applying Professional Judgment

We are supportive of recommendation 3.5 and the call for the SEC and PCAOB to clarify their processes and considerations in determining the reasonableness of judgment decisions. This

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[5] The following organizations were classified as "Users" in the SEC's overview filing: Users: AFL-CIO (Feb 10, 2008), AFL-CIO (Jun 23, 2008), CalPERS (Mar 13, 2008), The Capital Group Companies (Mar 13, 2008), CFA Institute (Mar 31, 2008), Council of Institutional Investors (Mar 31, 2008), Consumer Federation of America (Jan 16, 2008), Consumer Federation of America (Apr 14, 2008), Investors Technical Advisory Committee (Dec 13, 2007); This report is available on the SEC website: http://www.sec.gov/about/offices/oca/acifr/acifrcomments063008.pdf

practical approach better aligns the companies and the regulators in executing necessary decision making processes. However, the request for contemporaneous documentation does not include any discussion of providing this information to investors. As accounting standards become more principles-based, investors need a clear understanding of the basis for management's decisions on how standards are applied and the inputs used in calculating a particular outcome. Given that investors make their decision based on this information, additional disclosures and discussions become important in developing appropriate company performance forecasts.

In the discussion of this recommendation, the Committee identified that current accounting standards do not always require the use of the most preferred method as accounting options are often allowed. While the Committee is supportive of regulators adopting qualitative standards that better reflect the economic substance of a transaction, the Committee did not believe such a change could be achieved in the near- or intermediate-term. We would have preferred the Committee take a stronger stance when it comes to requiring accounting standards to reflect the economic substance of activity. By simply stating it is outside the purview of the Committee, this discussion seems to distance itself from the chapter 1 recommendations of eliminating bright lines and alternative accounting treatment. The Committee should reiterate its earlier recommendations and thus strengthen its encouragement of regulators to move in this direction.

Conclusion

We support the Committee's efforts to improve financial reporting. We hope the final Committee recommendations meet its objective of enhancing financial reporting for the benefit of investors.

We appreciate the opportunity to provide comments to the Commission, its staff, and CIFiR members regarding the Progress Report. If any party should have questions or seek further elaboration of our views, please contact Glenn Doggett, CFA, by phone at 434.951.5278 or by e-mail at glenn.doggett@cfainstitute.org.

Sincerely,

/s/Kurt N. Schacht

Kurt N. Schacht, CFA
Managing Director

/s/ Gerald I. White

Gerald I. White, CFA
Chair, Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council
Jeffrey D. Diermeier, CFA, President and CEO, CFA Institute
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