

24 November 2008

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*Re: Remarks to FASB Roundtable on Improving Financial Reporting, 25 November 2008*

The CFA Institute Centre for Financial Market Integrity (CFA Institute Centre),<sup>1</sup> in consultation with its Corporate Disclosure Policy Council (CDPC)<sup>2</sup>, appreciates the opportunity to participate in the FASB's roundtable to discuss how to improve financial reporting and to help enhance investor confidence in financial markets.

CFA Institute 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 the quality of 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*.

The exceptional situation the world's financial markets are now experiencing has triggered a debate about whether financial reporting standards were a cause or catalyst for the current credit crisis. Our key message is that we do not consider current accounting standards, and in particular the application of fair value accounting by financial institutions, to be one of the causes of the global credit crisis. Moreover, we have encouraged regulators in the United States and Europe to focus on the real causes of the credit crisis and to concurrently support an independent and accountable standard-setting process.

### **Areas for Immediate Attention**

We believe the priorities of the FASB and IASB over the short term should be to improve and adopt changes in the following areas:

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<sup>1</sup> The CFA Institute Centre for Financial Market Integrity is part of CFA Institute. With offices in Charlottesville, VA, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of almost 100,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 133 countries, of whom 86,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 136 member societies in 57 countries and territories.

<sup>2</sup> 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 CDPC 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 CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

- Fair value measurement and disclosure,
- Derecognition, and
- Consolidation.

**Accounting standards that permit companies to structure financial arrangements to avoid recognition or disclosure of material risk exposures need to be eliminated.**

We strongly believe that financial reporting standard setters and regulators—of the banking systems and of the capital markets—as well the enforcement arms of all national securities regulators should no longer permit off-balance sheet assets, liabilities, or activities. We also hope that credit rating agencies will significantly increase their vigilance over off-balance sheet assets, liabilities, and activities, and strive harder to improve the ratings process. The only way any entity can engage in or invest in off-balance sheet assets, liabilities, and activities is by using the credit, liquidity, and other financial resources provided by investors or creditors in the entity.

We support the goal of the FASB and the IASB to develop a single standard for the reporting of financial instruments. From an investor perspective, global convergence is desirable if it captures two important dimensions: 1) harmonization that enables comparability and 2) an improved set of standards that better reflect the economics of the underlying business activities.

However, recent pronouncements and several proposals under consideration by the FASB and the IASB related to financial instruments are selective in the promotion of the principle of harmonization and they have lowered or will lower the quality of financial reporting for investors (e.g., elimination of the “other than temporary impairment” model for “available for sale” securities, or permitted flexible reclassification that reduces comparability). We believe there is a real risk of cross jurisdictional, mutually reinforcing deterioration in the quality of standards if these exceptions to the application of fair value reporting continue to be developed.

We have long been disappointed by the level and quality of user representation on the IASB; the IFRIC currently has no user representation. We believe that the FASB and the IASB (to an even greater extent than the FASB) also need user representation on their staff since these are the groups that develop, research, and formulate the position papers and exposure drafts that are the basis of the final reporting standards issued by the boards. Further, we strongly believe that the user surveys conducted by the FASB and IASB staff need to be more carefully structured and reported to be of a more consistent nature than they generally are today. For instance, users may be told that x number of buy-side and y number of sell-side analysts were polled, but it is rarely clear whether the analysts polled follow the industries affected by the transactions under review or whether the sampled analysts use financial statement data to analyze investments. Most importantly, the IASC Foundation urgently needs to increase the number—and strengthen the quality—of user representation on the IASB.

**Medium-term Focus**

Over the medium term we would like to see the completion of the joint IASB/FASB Financial Statement Presentation project, which should be closely coordinated with advancing the application of interactive data (XBRL) for use by those who rely on financial information.

As part of that project, we believe the boards should devote significant consideration to developing a set of cohesive principles for disclosures in the notes to financial statements designed to meet the information needs of investors.

These principles also would provide clearer and more complete information than currently is available, and would present it in a format that makes the information readily accessible to investors.

As we state in the Comprehensive Business Reporting Model<sup>3</sup>:

*Disclosures are essential to an investor's understanding and analysis of the economics underlying the information contained in financial statements. Disclosures must provide all the additional information investors require to understand the items recognized in the financial statements, their measurement properties, and risk exposures.*

*They must have sufficient supplementary disclosures to evaluate the numbers. Such disclosures can include, for example:*

- *Financial reporting methods used;*
- *Models used for estimation and measurement;*
- *Assumptions used;*
- *Sensitivity analyses of point estimates;*
- *Information about risk exposures; and*
- *Information explaining why changes in important items have occurred.*

*In short, financial statements are not interpretable without adequate information. Disclosures should be regarded as equal in importance to the recognition and measurement in the statements.*

Preparers may object to providing expanded disclosures; they frequently argue that additional disclosures cannot be assimilated or are not used. We believe that more accurate and useful information does not result in overload. Moreover, key attributes of any disclosures should be parsimony and transparency. Too many companies provide repetitive mounds of singularly verbose statements rather than succinct and informative disclosures. Entities with sound risk management and financial reporting practices should have much of the relevant information readily available as a part of their routine assessment of risks. Not analyzing risks on a regular basis could prove more costly in the long run, as unforeseen developments adversely affect an entity's financial fundamentals.

We believe that the statement of cash flows has long been neglected by the FASB and the IASB. We strongly believe that the indirect method is not useful, is potentially misleading, and obfuscates rather than augments information provided by the income statement and the balance sheet. With the exception of the recent clarification of the cash flow consequences of discontinued operations by the FASB and discontinuing operations by the IASB, neither board has reviewed the requirements for the statement of cash flows since issuing the basic standards several years ago. In addition, neither the EITF nor the IFRIC has issued any significant pronouncement on reporting problems related to the statement of cash flows. For example, securitization transactions, derivatives, and foreign currency translation, as well as foreign currency transactions, continue to bedevil reported cash flows. As part of the joint financial statement presentation project, we strongly urge the boards to make mandatory the use of the direct method of preparing the cash flow from operations component of the statement.

### **Long-term Focus**

Finally, we would like to see the FASB and the IASB complete the work identified in their "Memorandum of Understanding" before the SEC permits the use of IFRS, as promulgated by the IASB, by U.S. companies for inclusion in their filings with the SEC.

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<sup>3</sup> See the CFA Institute Centre's [Comprehensive Business Reporting Model](#); July 2007, p. 59.

We have offered specific suggestions for changes dealing with each of the aforementioned areas in specific comment letters and in our *Comprehensive Business Reporting Model*. Moreover, on 3 November 2008, CFA Institute provided written evidence to the U.K. Treasury Select Committee on ‘Accounting and the Banking Crisis’ in which our position on fair value reporting and independence of the accounting standard setting process was discussed in depth. All of those recommendations and suggestions may be found in our comment letters at [www.cfainstitute.org/centre/topics/comment/](http://www.cfainstitute.org/centre/topics/comment/).

If you, other board members, or the staff have questions or seek further elaboration of our views, please contact Patrick Finnegan, CFA, by phone at +1(212) 754-8350, or by e-mail at [patrick.finnegan@cfainstitute.org](mailto:patrick.finnegan@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