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February 25, 2014

Mr. Hans Hoogervorst
Chair
International Accounting Standards Board
30 Cannon Street
London
United Kingdom

Re: Comment Letter on Conceptual Framework Discussion Paper: Measurement

Dear Mr. Hoogervorst,

The CFA Institute[1], in consultation with its Corporate Disclosure Policy Council ("CDPC")[2], appreciates the opportunity to comment on the International Accounting Standards Board's ("IASB" or the "Board") Discussion Paper, *A Review of the Conceptual Framework for Financial Reporting* ("Conceptual Framework DP"). As we note in our overview letter regarding the Conceptual Framework DP, we are responding to those aspects of the discussion paper where we think investor input may be most needed and where we believe improvements in the Conceptual Framework may have the most direct and immediate impact on financial reporting from an investor perspective. To increase the accessibility of our response to our membership, we have provided separate comment letters on the four topic areas of focus, which are as follows:

- Definition of Equity & Distinctions Between Liability & Equity
- Measurement
- Presentation & Disclosure
- Other Comprehensive Income

We have also provided comments related to Other Issues in Section 9 of the Conceptual Framework DP in our overview comment letter.

CFA Institute is comprised of more than 100,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to

[1] With offices in Charlottesville, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 116,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 137 countries, of whom nearly 108,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 138 member societies in 60 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 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.

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.

SUMMARY OF VIEWS

Measurement: An Important Element of the Conceptual Framework

CFA Institute agrees that there is a need to establish a sound conceptual framework governing the measurement bases for assets and liabilities. We firmly agree with the Board that if financial information is to be considered useful that it must be ***relevant*** and must ***faithfully represent*** what it purports to represent.

Fair Value: The Most Relevant Measurement Basis

CFA Institute has consistently illustrated that investors strongly favor fair value based measurements because they are the measurement basis that most faithfully represents the economics of transactions. Based upon this relevance, we have advocated for the use of fair value measurements for decades.

While we have advocated for the use of fair value measurement for decades, we first formally memorialized our views in the 1993 publication, *Financial Reporting in the 1990s and Beyond* ("Financial Reporting in the 1990s"). We updated and expanded our conceptual framework for financial reporting in CFA Institute's seminal publication *A Comprehensive Business Reporting Model: Financial Reporting for Investors (July 2007)* ("CBRM"). We refer you to this publication for a more complete discussion of the conceptual basis for our belief that fair value is the most relevant measure. The following quote from the CBRM is worth highlighting:

> *Fair value measures reflect the most current and complete estimations of the value of the asset or obligation, including the amounts, timing, and riskiness of the future cash flows attributable to the asset or obligation. Such expectations lie at the heart of all asset exchanges.*

In addition in Financial Reporting in the 1990s, CFA Institute observed:

> *It is axiomatic that it is better to know what something is worth now than what it was worth at some moment in the past . . . Historic cost itself is in reality historic market value, the amount of a past transaction engaged in by the firm. . . . Historic cost data are never comparable on a firm-to-firm basis because the costs were incurred at different dates by different firms (or even within a single firm).* ***There is no financial analyst who would not want to know the market value of individual assets and liabilities***.[3]

In 2010, in conjunction with our response to the FASB's Exposure Draft: *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* ("FASB FI ED"), we published not only our response to the FASB FI ED, in which we articulated our support for fair value but we also issued two additional documents. These documents provide: 1) the basis for our support of fair value measurements and 2) a refutation of the arguments against fair value measurements. These supplemental documents are included by way of the links below:

- Fair Value as the Measurement Basis for Financial Instruments
- Consideration of the Arguments Against Fair Value as the Measurement Basis for Financial Instruments

[3] *Financial Reporting in the 1990s and Beyond*, (Charlottesville, VA: AIMR, 1993), p. 39.

We articulate in our 2010 comment letter on the FASB FI ED that we support fair value for two very basic reasons:

1) *Fair Value Reflects How Transactions Are Executed* – Transactions take place at fair value. Financial institutions only lend against fair value. Investors find this information equally valuable in making their decision on whether to invest in the securities of a financial institution or other enterprise.
2) *Fair Value Reflects Economic Reality* – Fair values reflect the most current and complete expectation and estimation of the value of assets or obligations, including the amounts, timing, and riskiness of the future cash flows attributable to assets or obligations.

Our conceptual framework in support of fair value is well documented in the aforementioned documents where we reference empirical research to support our position.

We recognize that the Board has heard this position from CFA Institute previously; however, we are compelled to reiterate the relevance of fair value measurements at a time when the Board is seeking to incorporate measurement as a foundational concept in the conceptual framework. Further, we believe incorporating a measurement basis for financial reporting into the conceptual framework requires a comprehensive understanding, analysis, evaluation, and justification as to why cost/amortized cost or other measurements are less economically superior and less decision-useful to investors than fair value.

Our Concern with the Proposed Approach: Justifies Current Practice &
The Most Important Measurement Basis to Investors: Cash Flows & Fair Value

We reiterate our support for fair value above, but we also express our concern with the Board's measurement basis as expressed in Section 6. We believe Section 6 is written to justify the existing approaches taken by the IASB rather than explain the conceptual foundation for the measurement categories they have developed.

We do not agree with cost/amortized cost measurements since they do not provide value relevant information and they are not comparable measurements within or among entities, but we are most concerned with the "Other Cash Flow Based Measurements" category proposed in Paragraphs 6.51 to 6.54 and 6.110 to 6.130 as its provides the Board with a smorgasbord of measurement options. Reference to the variety of different measurement basis in the existing standards illustrates only the lack of consistency among standards and the lack of conceptual foundation for these measurement variants.

This discussion of measurement examples in the Conceptual Framework DP vividly illustrates the problems investors encounter when trying to understand and adjust such accounting (i.e. non-economic) measurements to the measurements which are (1) consistently used in exchanges and transactions, and (2) economically meaningful to investors: cash and fair value. The variety of measurements used by the IASB are swept up into the caption without sufficient basis or justification for differences. Overall, we find this "Other Cash Flow Based Measurements" category a catch-all category which will allow the Board to develop unique measurements as standards are developed based upon the political negotiations which result from the accounting standard-setting process. The discussion in Paragraph 6.110, as excerpted below, rightly points out that this caption has the capacity to decrease the usefulness of measurements to investors and other users of financial statements. We do not believe it is appropriate to have custom designed measurements as discussed in Paragraph 6.110 as they reduce comparability within the financial statements.

> *Because cash-flow-based measurements can be custom-designed to fit a particular asset or liability, it might be possible to create new measurements in each new Standard. In addition, a custom designed measurement may result in the most relevant information about a particular asset or liability. However, when deciding whether to use a custom-designed measurement, the IASB would need to consider whether it will be understandable for users of financial statements.*

Overall, we are concerned that the proposed approach to measurement categories justifies current practice rather than conceptually supporting the measurement basis selected. Further, we are concerned that a wide variety of measurements and measurement techniques – especially without detailed disclosures explaining the measurements – will require that investors make even more adjustments to arrive at the most relevant measurement basis for the analysis and investment decision-making. Such requirements add to investor costs, and are likely to make financial markets less efficient, raising the cost of capital in all financial markets including securities issuers.

Business Model Approach:
Disagree with Business Model as the Method for Identifying Appropriate Measurement Basis
The Board's proposed approach to ascertaining the measurement basis is grounded in an entity-based business model. ***The business model approach is nothing more than measurement based upon management intent***.

Management intent can (and, in practice, often does) change over time and with changes in management. Most important, the value of an entity's assets and liabilities, along with the overall value of the organization, is neither based upon nor affected by management's intent. Accordingly, we do not support classification and measurement of assets and liabilities based upon management intent as its only effect is to obscure comparability.

Investment decisions and other transaction-relevant decisions are made by comparing valuations of entities and their component assets and liabilities with reference to market conditions, not management intent-based, entity-specific valuations. In Paragraph 9.31 of the Conceptual Framework DP the IASB offers compelling reasons as to why a business model concept is wrong for investors and other types of transactions. These reasons include lack of comparability, lack of neutrality and an inability of the approach to be defined or applied consistently. A business model approach could result in industry sector specific accounting practices that makes comparisons across industry sectors difficult (or even impossible) which is undesirable for investors who want to consider and compare as broad an investment opportunity set as possible. On pages 6 through 10 of the aforementioned document: Consideration of the Arguments Against Fair Value as the Measurement Basis for Financial Instruments; we refute the argument that business model is a better measurement basis for assets and liabilities than is fair value.

The Presumption That Providing Fair Values is More Expensive:
From Whose Perspective?
The discussion of cost constraints in Paragraph 6.30 to 6.34 is an assessment of cost considerations from a preparer, not a user, perspective. Financial reporting is intended for users – the party which ultimately bears the cost of providing financial reporting information. Accordingly, the perspective articulated in the conceptual framework should be that of a user. We are concerned by the Board's presumption in the Conceptual Framework DP that the more subjective a measurement – the more costly it is to provide. This belief misses the point that historic/amortized cost based information may be inexpensive to obtain but ultimately very

costly to users since it provides investors with little to no decision-useful information. Some say: "historical/amortized cost is highly certain, but certainly meaningless." Said differently, there is a cost to the investor (i.e. and to the entity through the cost of capital) to not providing such fair value measurements, which cost is absent from the cost/benefit perspective articulated in the Conceptual Framework DP. The overall tone of this cost/benefit analysis is preparer focused and will likely be used to justify cost based measurements rather than fair value based measurements. All preparers are ultimately paid for by the current and/or prospective owners of the entity (i.e., investors in the firms).

Presentation and Disclosure

We agree with the observation by the IASB in Paragraph 6.48(b) of the Conceptual Framework DP that the IASB needs to consider what disclosures should be provided to ensure that the measurement information is faithfully represented. We believe that the disclosure section of the Conceptual Framework DP should outline the nature of disclosures which are associated with each measurement type. Without disclosures which provide meaningful insight into the measurements – particularly if they are based upon the accounting measurements developed by the Board under the Other Cash Flow Based Measurements category – they will not be relevant or decision-useful to investors. We would note that Section 7 (Presentation & Disclosures) of the Conceptual Framework DP does not provide sufficient detailed guidance on disclosures to support the variety of measurement categories.

Accountants: Sufficient Valuation & Measurement Expertise?

One thing which is has become clear to us – especially as we have evaluated the arguments against fair value over the five years since the financial crisis (e.g., The report, *Measuring and Disclosing the Fair Value of Financial Instruments in Markets That are No Longer Active*, of the IASB sponsored Expert Advisory Panel on Illiquid Securities) and considered the findings of audit inspection findings (e.g. PCAOB) – is that a portion of the resistance to the use of fair value is due to a lack of education and experience in valuation techniques amongst accountants. An educational and cultural shift is necessary to enable accountants to better understand how fair value measurements are derived and their decision-usefulness to investors. Without this shift, it is unlikely that there will be progress on providing investors with more decision-useful information.

As noted in this letter, the Conceptual Framework DP lacks sufficient discussions of the use of discount rates and expected value. These two matters are important concepts in valuation that we believe should receive wider attention in the setting of accounting standards.

This lack of valuation and measurement expertise, even amongst standard-setters, causes us concern with the creation of the Other Cash Flow Based Measurements category since it allows the standard-setters to establish accounting valuation and measurement principles when few have practical experience working with these concepts. Overall, we are concerned that the lack of education and experience in valuation and measurement principles pushes standard-setters to familiar measurements such as cost/amortized cost, or their own accounting conventions, rather than those which are best understood by valuation professionals and investors.

SPECIFIC COMMENTS ON SECTION 6
OF THE CONCEPTUAL FRAMEWORK DP

The summary above reflects our overall views on the concept of measurement within the IASB's Conceptual Framework DP. Below we consider, in broad strokes, aspects of the specific sections in Section 6 (Measurement) of the Conceptual Framework DP.

Objective of Financial Reporting & Qualitative Characteristics Impacting Usefulness of Measurement (Paragraphs 6.6 through 6.36)

Objective, Relevance & Faithful Representation

We agree with the need for an objective of measurement for financial reporting purposes and we also agree, in principle, with the information in Paragraphs 6.6 through 6.9.

Certainly investors seek to understand from financial reporting information whether management has effectively and efficiently deployed the resources entrusted to them, but it has been our long-standing view that accounting based upon management intent does not provide a relevant, neutral and faithfully representative basis upon which to make such an assessment of a company's results or management nor to make a comparison between entities. We believe that an entity's financial results should reflect an unbiased, market-based assessment of the results of the company. As such, we cannot support the inclusion of the notion of management intent in the objective of measurement as we believe it introduces unnecessary management bias. We believe such inclusion would allow measurement of assets and liabilities to be changed to reflect the result management wants to communicate. For example, assets held at cost/amortized cost can be used by management to defer losses or time the recognition of gains and losses to best suit the operating performance message management wishes to communicate. We believe Paragraph 6.10 introduces management bias into the reporting of financial results and does not allow investors to make neutral and unbiased comparisons among investment alternatives.

As discussed above, we are concerned that the view of measurement in the Conceptual Framework DP supports an intent (business model) based view of financial reporting. This management intent/business model approach is much of what is discussed in consideration of the concept of relevance in Paragraphs 6.11 through 6.19. It is of concern to us that the notion of relevance in financial reporting is used to support management intent rather than measurement based on market conditions, even though all investment decision-making is relative to existing market opportunities. Investors decide to invest in an organization when they are able to measure that entity's performance relative to other investment choices. Accordingly, measurement methods which are management-focused, intent-based and entity-specific rather than market-referenced are not decision-useful because they do not (1) faithfully represent values, nor (2) result in comparable information among other competing investment opportunities.

It is our belief that financial reporting should assist users of financial statements with assessing the performance of management, but such assessment requires measurement of assets and liabilities that is not distorted by management intent or management's biases in measuring assets and liabilities. Accordingly we cannot support the concepts of relevance as currently articulated in the ED.

As it relates to the discussion of faithful representation, we believe it is important to reiterate that a measurement does not need to be entirely free from error (or the potential for error) to be a faithful representation of the value of the assets and liabilities. We are concerned by the notion that being entirely free from error can justify substantially less relevant amortized cost measurements over fair value measurements. Investors understand the concept of uncertain measurements and, with appropriate disclosures, find such measurements to be highly decision-useful and faithful representations of the assets and liabilities being measured.

We do not disagree with the concept of avoiding "accounting mismatches" as articulated in Paragraph 6.22 – assuming the appropriate measurement of assets and liabilities at fair value. In the current form, however, this notion biases standard-setters to amortized cost measurements and intent-based accounting given the bias for recording liabilities at amortized cost. When all assets and liabilities are recorded at fair value, there are no accounting mismatches. Such mismatches result from the piecemeal measurement approaches contained in current standards. It is our view that this language is more likely to be used to continue this arbitrary approach, which lacks any conceptual basis, rather than eliminate mismatches by establishing a measurement basis that is conceptually grounded in economics.

Enhancing Characteristics (Understandability, Timeliness, Verifiability, Comparability)
We believe it is important to consider enhancing characteristics of measurement. We agree with the perspectives expressed in Paragraphs 6.23 that the number of measurement bases should be kept to a minimum. We believe that initial and subsequent measurements should be the same and we fully agree with the notion that optional changes to measurement can result in earnings management as noted in Paragraph 6.24. The Conceptual Framework DP, however, promotes many different forms of measurement (see discussion below) and measurement based upon management intent (i.e., business model) which will change over time – which is contrary to the beliefs expressed in Paragraph 6.24.

As it relates to the other enhancing characteristics (timeliness, verifiability, and comparability) the Board perceives to be important and discussed in Paragraphs 6.27 through 6.29, we have the following observations:

a. *Timeliness* – If timeliness is an enhancing characteristic, this suggests that historical/amortized cost is not a useful measurement since this information is always outdated. Some stakeholders complain that fair value measurements are not timely when financial statements are issued months after period end, but fail to recognize that historical/amortized cost measurements may be measurements which are years out-of-date.

b. *Verifiability* – We are concerned that the language used in the Conceptual Framework DP will be interpreted as saying that historical/amortized cost is always more verifiable than fair value measurements – other than Level 1 market values – and therefore a better measure. We think that relevance is more important than reliability or verifiability. We do not see the value in data that are verifiable but neither timely nor comparable.

c. *Comparability* – We concur with the notion that the smallest number of measurement options promotes comparability. However, it is important to highlight that historical/amortized cost measurements (both within and between entities) are inherently less comparable than are fair value measurements, despite the perceived subjectivity of fair value measurements, because cost measurements are historical fair value measurements of transactions executed at different times and under different market conditions both within and among entities.

<u>Cost Constraints</u>
Our perspectives on cost constraints as expressed in Paragraphs 6.30 to 6.34 are noted above.

Measurement Categories (Paragraphs 6.37 through 6.54) &
Cash Flow Measurements Other Than Estimates of Current Prices (Paragraphs 6.110 through 6.130)

<u>Measurement Categories, Including Other Cash Flow Based Measurements</u>
As noted above, we have carefully considered the cost versus fair value debate for decades and we clearly favor fair value. Regarding the Other Cash Flow Based Measurements category, we recognize it sweeps in many of the measurements currently utilized, but we are concerned this category is really a justification for any accounting measurement the Board decides is suitable. We do not believe a substantial conceptual justification has been built for the use of this category and we do not believe justification has been provided for the similarities or differences in measurement. As we note above, we are concerned that such cash flow based measurements raise the potential for any number of combinations of accounting measurements.

Further, we do not believe there is sufficient detail in the presentation or disclosure section of the Conceptual Framework DP to provide or require disclosures which would make such measurements truly understandable for users and provide them with sufficient detail to allow them to adjust the measurements to cash or fair value – the measures they believe are most relevant.

<u>Discount Rate & Own Credit</u>
We do not see a discussion of discount rate in Paragraphs 6.45 – 6.54 or Paragraphs 6.110 – 6.130 – other than to note that discount rates are used in several measurements and to observe that the inclusion of own credit is noted as being controversial. We noted in our review of the Conceptual Framework DP more broadly that there is an acknowledgement of the use of discount rates – to some degree in Section 6 but more frequently in Section 8 on Other Comprehensive Income – but there is no discussion of the conceptual foundation for how discount rates are determined. We think it is essential that the Board establish a conceptual basis for determining discount rates used in accounting measurements. We do not believe a conceptual framework on measurement can be meaningful without a consideration of discount rates.

Further, we are uncertain how simply noting that own credit is controversial resolves whether it should be included in the measurement of liabilities. We think excluding own credit fails to reflect the market's perception of whether liabilities will be repaid. During the financial crisis, the financial statements reflected many liabilities at amortized cost when the fair value footnote more accurately illustrated that the liabilities were likely to be repaid at some lower amount.[4] In this circumstance, useful information was not prominently displayed in the financial statements. We do not find the measurement of liabilities at fair value counterintuitive – the change in measurement reflects the transfer of value between capital providers to the enterprise.

[4] In fact, many enterprises did extinguish liabilities at amounts significantly below their carrying amount, recording realized accounting "gains."

Entity Specific Measurements
We disagree with the notion in Paragraph 6.125 - 6.127 implying that entity specific inputs and measurements are more relevant than market based measurements. This subjects the measurement to management bias and makes comparison between investment alternatives nearly impossible. We strongly disagree with the ideas put forth in these paragraphs.

Identifying an Appropriate Measurement Basis (Paragraphs 6.55 through 6.109)
We agree with the notion that both subsequent and initial measurements need to be considered. Based upon our conceptual framework the measurements should be the same both initially and subsequently. For that reason, we did not consider the differences in approach discussed in these paragraphs of the Conceptual Framework DP.

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Thank you again for the opportunity to comment on the Conceptual Framework DP. If you or your staff have questions or seek further elaboration of our views, please contact either Matthew Waldron by phone at +1.212.705.1733, or by e-mail at matthew.waldron@cfainstitute.org or Sandra J. Peters, CPA, CFA by phone at +1.212.754.8350 or by email at sandra.peters@cfainstitute.org.

Sincerely,

/s/ Sandra J. Peters

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Head, Financial Reporting Policy
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/s/ Ashwinpaul C. Sondhi

Ashwinpaul C. Sondhi
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