CFA INSTITUTE | Centre for Financial Market Integrity

29 January 2008

Mr. Robert Herz
Chair, Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116
USA

Re: IASB-FASB Joint Project on Financial Statement Presentation

Dear Bob:

On behalf of members of the CFA Institute Centre's[1] Corporate Disclosure Policy Council (CDPC),[2] we are writing to express our appreciation for the opportunity to meet and exchange views with you and other FASB members on 16 November 2007. We found our discussions about the Board's project agenda to be very helpful in understanding the direction of, as well as the underlying rationale for, the Board's decisions on current projects and other related financial reporting initiatives.

In particular, we would like to highlight our discussion and strong support for the IASB-FASB joint project on improving financial statement presentation (or "the Project") by reiterating our views in writing. In particular, we highlight the following key aspects the Project:

1. The **matrix format for financial presentation** will provide investors and other users with a richer set of corporate data on which to make their investment decisions. The separation of cash flows from accruals, as well as other non-cash items such as estimates and re-measurements, will highlight the different levels of certainty regarding the timing and amount expected future cash flows. As a result, this disaggregation of data will enable investors and other users to have a better understanding of the underlying economics of a firm's business activities and thereby, improve their ability to evaluate and forecast the firm's performance.

[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 93,700 investment analysts, portfolio managers, investment advisors, and other investment professionals in 131 countries, of whom nearly 80,000 are holders of 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 comprises individuals, who are investment professionals with extensive expertise and experience in the global capital markets, as well as CFA Institute member volunteers. In this capacity, the Council provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures which meet the needs of investors.

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2. The **presentation of data by nature** will further improve an investor and other user's ability to understand the drivers – sources and uses – of a firm's resources and its capacity to generate cash flows. A recent survey of CFA Institute members showed that **97 percent** of 407 respondents indicated that "information about a company's capacity to generate future cash flows is important to their analyses and/or investment decision making process." Of these respondents, **84 percent** also indicated that, "operating cash flows by nature e.g., cash flows received from sales…and cash flows used for [by expense type]," are of high importance.[3]

3. The **cohesive presentation of data** will enable investors and other users to see the connection or interrelationship among the amounts reported on the primary financial statements: balance sheet, income statement and statement of cash flows. Current financial reporting makes it all but impossible to see the interplay of these three financial statements. As a result, users are required to guess and/or try to piece together information from various disclosures at best to obtain a comprehensive and cohesive presentation**.**

4. The **development of interactive computer-readable data** by using XBRL coded tags will increase the utility of this new disaggregated data. Leveraging this technology will allow investors and other users to focus less time on manually extracting and inputting data in their analytic models and therefore, more time on the substantive aspects of valuation and investment decision-making processes.

We believe that implementing the above improvements will benefit markets not only by improving the quality and organization of financial information but facilitating a process for better investment decision making. Similar views have been expressed by other "users" of financial statements, such as the user representatives on the IASB-FASB's advisory working group or JIG.[4]

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[3] The percentage is based on n=361. This number *excludes* those respondents indicating that information was <u>not important</u> to their analysis or had indicated information about capacity to generate cash is important but did not have opinion about operating cash flows by nature. Respondents were asked to rate the level of importance based on a 1 to 5 scale (1=not important to 5=very important): **52%** and **32%** selected **5** and **4,** respectively, to total **84%**. (Only **1%** selected **1** or indicated the information is <u>not important</u>.) Operating cash flows by nature received the most "5=very important" ratings compared to the other listed sources of cash flow information, i.e., EBITA, changes in current assets and liabilities, note disclosures about contractual or future commitments, and cash flows related to investing activities and financing activities.

[4] The Joint International Group (JIG) formed to provide the Boards and their staff with constituents' advice and other commentary in response to the Boards' joint project on financial statement presentation.

The following is an excerpt from the minutes for the JIG's 14 September 2007 meeting, which highlights the users' strong support for the disaggregation and reconciliation using the direct cash flow presentation:

> **The Reconciliation from the Statement of Cash Flows to the Statement of Comprehensive Income and the Statement of Cash Flows**
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> 14. Several "preparer" participants stated that the reconciliation would be difficult to produce and questioned its usefulness. Preparers also stated that they find the direct method cash flow statement the most difficult part of the possible reconciliation schedule. **However, "user" participants said that the reconciliation is the <u>most important</u> part of the financial statement presentation project and that the reconciliation is <u>definitely worth the cost</u>. They stated that analysts <u>spend significant time</u> trying to create a schedule similar to the reconciliation to assess the quality of earnings.** [Emphasis added]

While implementing a new financial reporting format will have some setup cost for financial statement preparers, that cost should be more than offset by the reduced cost to investors and other end users of financial statements. Overall, we believe it should be less costly for a company to prepare data than for thousands of users to attempt to estimate the same data. We also believe that managements will be able to use the new format to improve the Management Discussion and Analysis and to better communicate their financial results to their investors, creditors and other end users.

Given the potential benefits to investors and other end users, CFA Institute has initiated several activities to promote this joint project, including:

1. A special session at the 2008 CFA Institute annual conference on 12 May in Vancouver, British Columbia;
2. A dedicated section titled, "Financial Statement Presentation" under the topical area of Financial Reporting, on the CFA Institute Centre's web site; and
3. A series of four articles in the CFA Magazine, starting with the January-February 2008 issue titled, "The Lifeblood of Capital Markets: Improving financial reporting should be a priority" pp. 24-25. [This article is attached to our letter.]

Later on 16 November 2007, the CDPC met with FASB staff to informally discuss additional projects. We would like to take this opportunity to briefly share some of the views that we expressed to staff:

1. **Liabilities and Equity:** We support the "basic ownership" approach as it comports with the narrow view of equity that we expressed in the CBRM.[5] In particular, we concur with Board's stated positions within its PV document as follows[6]:

   Under the basic ownership approach, an instrument would be classified as equity if it (1) is the most subordinated interest in an entity and (2) entitles the holder to a share of the entity's net assets after all higher priority claims have been satisfied. The holders of equity instruments are viewed as the owners of the entity. All other instruments, for example, all forward contracts, options, and convertible debt, would be classified as liabilities or assets. Instruments classified as liabilities or assets that have varying or uncertain settlement amounts would be measured at fair value with changes reported in income. As a result, changes in an issuer's share price would affect income. The underlying principle of the basic ownership approach is that claims against the entity's assets are liabilities (or assets) if they reduce (or enhance) the net assets available to the owners of the entity.

   The Board decided on the basic ownership approach because it classifies only the lowest residual interests in the entity as equity. Additionally, the approach is simpler and easier to apply than the other two approaches the Board considered in detail. Also, the basic ownership approach requires a narrow definition of equity, which provides fewer opportunities than the other approaches to structure instruments and arrangements to achieve a desired accounting treatment.

2. **Contingencies:** We believe that SFAS 5, *Accounting for Contingencies* should be amended to properly measure and recognize obligations arising from contingencies when they meet the definition of a liability. The IASB is addressing contingencies in its amendments to IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, which we issued a comment letter expressing a need for improving this standard.[7]

   As an interim step until the measurement and recognition issues in SFAS 5 are amended, we urge the Board to proceed with its project to improve the disclosures

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[5] CFA Institute Centre's position paper, *A Comprehensive Business Reporting Model: Financial Reporting for Investors* (CBRM), July 2007. The CBRM is available at the following link - http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2007.n6.4818.

[6] FASB's Preliminary Views (PV) – *Financial Instruments with Characteristics of Equity*, comments are requested by May 30, 2008.

[7] Comment letter to the International Accounting Standards Board dated 6 November 2006 - http://www.cfainstitute.org/centre/issues/comment/2006/pdf/iasb_ias37.pdf

about possible and unrecognized claims and obligations. Based upon our discussion with staff members, we support their proposed key features of revised disclosures, as follows:

- *A recharacterization of the threshold (more than remote instead of reasonably possible) for disclosure of loss contingencies,*
- *An assumption of an unfavorable outcome in disclosing a best estimate (even if difficult to estimate) of the possible loss or range of loss,*
- *Disclosure of the expected timing of resolution, the amounts of losses accrued and estimates of recoveries,*
- *A rollforward in tabular format of loss contingencies recognized,*
- *An option to aggregate information by the nature of contingencies, and*
- *An exemption from making certain disclosures of certain quantitative information about a case, but only in the rare circumstance that those disclosures would be prejudicial even when aggregated with disclosures about other loss contingencies.*

3. **Leases:** We have urged the Board to examine this issue as we believe that current lease accounting standards do not properly report the effect of leases on the statement of financial position. We believe that the right-of-use model should be the basis for a new accounting standard. Again, we refer to the CBRM and the discussion about off-balance-sheet obligations.[8]

If you, other Board members and/or your staff have questions, seeking further elaboration of our views, please contact Georgene B. Palacky, by phone at +1.434.951.5326 or by e-mail at georgene.palacky@cfainstitute.org.

Sincerely,

/s/ Gerald I. White	*/s/ Georgene B. Palacky*
Gerald I. White, CFA Chair of the CDPC CFA Institute Centre	Georgene B. Palacky, CPA Director, Financial Reporting Policy CFA Institute Centre

cc: Sir David Tweedie, Chair, International Accounting Standards Board
Corporate Disclosure Policy Council
Ray DeAngelo, Managing Director, Members and Society Division, CFA Institute
Kurt N. Schacht, JD, CFA, Managing Director, CFA Centre

[8] Ibid.