

8 February 2008

Teresa S. Polley
Chief Operating Officer
Financial Accounting Foundation
401 Merritt 7
Norwalk, CT 06856-5116

RE: Proposed Changes to Oversight, Structure, and Operations of the FAF, FASB, and GASB

Dear Ms. Polley:

The CFA Institute Centre for Financial Market Integrity (the CFA Institute Centre)¹ in consultation with its Corporate Disclosure Policy Council (CDPC)² appreciates the opportunity to comment on the Financial Accounting Foundation's (FAF) Proposed Changes to Oversight, Structure, and Operations of the FAF, FASB, and GASB.

The CFA Institute Centre represents the views of investment professionals, including portfolio managers, investment analysts and advisors located in over 130 countries 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 investors³ and other end users remains 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*.

General Comments

We agree with the FAF's decision to undertake a reexamination of the oversight, structure and operations of the FAF, FASB, and GASB (collectively hereafter referred to as the Boards). The last such examination occurred over five years ago and there have been recent developments that need to be reviewed, such as the expanding use of International Financial Reporting Standards (IFRS) resulting from the U.S. Securities and Exchange Commission (SEC) decisions and an ongoing study to allow domestic registrants the choice to use IFRS. Planning for the future role of the FAF and

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 95,300 investment analysts, portfolio managers, investment advisors, and other investment professionals in 133 countries, of whom more than 79,800 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 CDPC comprises individuals who are investment professionals with extensive experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

³ Investors, as noted in this comment letter, are defined in Appendix I.

FASB as the capital markets move toward a single set of global financial reporting standards is a crucial step in ensuring that these organizations obtain maximum efficiency and effectiveness while also maintaining independence and objectivity. Therefore, the FAF's decision to conduct a reexamination is timely and appropriate. Further, we strongly agree with the FAF's statement that, "these recommendations are of **such significance to the capital markets** that they should be exposed for public comment." [Emphasis added.]

Key Principles

Independence is the bedrock to setting standards that are neutral and in turn, produce financial information that reflects the economic substance of a company's operations and financial position. Relevance and reliability are the two primary qualities that make accounting information useful for decision making. To be reliable, information must have representational faithfulness and it must be verifiable and neutral.⁴

In our review and deliberation of the FAF's proposed changes, we evaluated these proposals using the principles below, which we believe are fundamental to the Boards' oversight, structure and processes.⁵

- I. **It is important to protect the independence of the FASB and GASB:** To support the development of the highest quality standards, the FASB and GASB must be able to work in an environment of independence. While an effective standard-setting body must carefully consider all inputs, it must then make what it believes to be the best decision. As such, the independent decisions of the FASB and GASB should determine future standards.
- II. **The needs of investors should be paramount in producing future standards:** Standards should be set with a view towards providing the best information possible for investors. This information should have, to the extent practicable, the essential qualities of financial information, including relevance, reliability, neutrality, transparency, timeliness, and comparability.
- III. **FASB and GASB members should be chosen based on their knowledge and qualifications, as well as their ability to help the FAF complete its mission:** FAF Trustees should select FASB and GASB members with a view towards assembling a membership that, taken as a whole, can best meet the needs of investors by establishing high quality standards.

⁴ Statement of Financial Accounting Concepts No. 2 "*Qualitative Characteristics of Accounting Information*"
Neutrality means that, in formulating or implementing standards, the primary concern should be the relevance and reliability of the information that results, not the effect that the new rule may have on a particular interest. A neutral choice between accounting alternatives is free from bias towards a predetermined result. The objectives of financial reporting serve many different information users who have diverse interests, and no one predetermined result is likely to suit all interests.

⁵ These principles are consistent with IOSCO's principles stated in its 9 February 2004 letter to the IASC Foundation in response to the Foundation's request for comments, "*Identifying Issues for the IASC Foundation Constitution Review- An Invitation to Comment*" and restated in IOSCO's letter dated 16 February 2005.

IV. A credible authoritative standard setter needs a transparent and effective due process:

Transparent and participative due process is an essential ingredient in development of standards. High-quality standards are the product of a robust standard setting process where participants – including those who are not members of the standard setting Boards – believe that their views have been heard and considered in the debate.

Discussion of Key Points

Based on our evaluation and assessment of the proposed changes, we highlight the following key areas:

Composition of the Boards

Central to achieving efficient and effective oversight and operations of these boards, is the balance of constituency representation. The composition of the various boards and their committees must reflect the needs of the principal users (i.e., investors), auditors and preparers. Bringing together these perspectives to the standard setting process in a balanced manner will ensure that the financial reporting standards are relevant and useful in decision making.

Currently, investors (as defined in Appendix I) are underrepresented on the FAF and FASB boards. This lack of investor representation is highlighted with the recent FAF trustee appointments and re-appointments effective January 1, 2008. Of the six trustees announced, none were investors. Given three of these appointed trustees begin their first term in 2008 it is unclear how the proposed five-year term, if adopted, will be enacted (i.e., would the new five-year term be effective with appointments commencing in January 2009 or would this term be effective January 1, 2008?).

We strongly recommend that the FAF Trustees form their membership, the committees of the FAF, and the FASB to reflect increased investor representation. Moving toward more balance for this constituency is also consistent with the SEC's Advisory Committee on Improvements to Financial Reporting (CIFiR). On page 37 of its February 11, 2008 draft decision memo, the Standard-Setting Process sub-committee states:

“Investor representation in standards-setting is critical to maintaining an effective system of financial reporting, yet the intricacy of certain accounting matters has sometimes made it difficult to attract meaningful investor participation. Our proposals are intended to underscore the pre-eminence of investor perspectives in developing and administering a well-designed and effective system of financial reporting. The current standards-setting process attempts to balance the views of different stakeholders. However, the financial reporting system would best be served by recognizing that the perspectives of investors should be pre-eminent when competing interests cannot be aligned, because all stakeholders benefit from a system that allocates capital more efficiently.”

The observations and recommendations of the sub-committee on this issue are in keeping with our belief that more investor representation is necessary to bring the ultimate end-user perspective into balance with auditor and preparer representation.

Independent Agenda Setting

The FAF is proposing recommendations to strengthen governance and oversight activities by the Trustees. As stated in the proposal, this initiative would include more active oversight of the standard-setting process, such as due process, agenda setting, solicitation of public comment, consideration of comments, and the retrospective evaluation of the effectiveness and efficiency of standards. The Trustees indicate that they would be careful not to insert itself into the standard setter's substantive deliberations. We believe that oversight by the FAF of the standard setting process should focus on how the FASB operates, and should exclude standard setting and agenda decisions.

In accordance with the FAF's existing by-laws

“In carrying out their authority, functions, powers, and oversight responsibilities under Section 1 and this Section 2 of this Article, the Trustees shall not direct the FASB or GASB to undertake or to omit to undertake any particular project or activity or otherwise affect the exercise by the FASB or GASB of their authority, functions, and powers in respect of financial accounting and reporting and the establishment and improvement of financial accounting and reporting standards, and shall take care not to impair, in fact or perception, the independence and objectivity of the FASB and GASB.”

Furthermore, this is consistent with the role that the International Accounting Standards Committee (IASC) Trustees have regarding their oversight responsibilities of the IASB. The IASC Constitution states:

“In addition to the duties set out in Part A, the Trustees shall:

(c) review annually the strategy of the IASC Foundation and the IASB and its effectiveness, including consideration but not determination, of the IASB's agenda”

Providing the FASB Chair with Authority to Set the Technical Agenda

We do not support the proposal to provide the FASB Chair with unilateral decision making authority to set the technical agenda. The technical agenda is now established upon majority vote of the FASB members, including both additions and deletions. The current system is responsive to an extensive due process, which would be lacking if the Chair had unilateral authority. Input from the FASB's large and diverse constituency for items added or deleted from the technical agenda is vital to the standard setting process.

It should also be noted that, in its full committee deliberations on January 11, 2008, the SEC CIFI Committee decided not to endorse the FAF proposal giving the FASB Chair decision-making authority.

Reduction in Size of the FASB Board

We do not support reducing the number of FASB members to five from seven. Since its inception in 1973, the FASB has had a seven member board in an effort to engage a large constituency and to broaden the debate regarding financial accounting standards. We believe that a reduction in the size of the FASB is likely to compromise the outreach to its constituency, since there will be fewer members shouldering an ever increasing workload.

Comments on Specific Proposals

Proposed action: Expand the breadth of individuals and organizations that are invited to submit nominations for the FAF Board of Trustees with the understanding that final authority for all appointments rests solely with the Board of Trustees.

We agree with the FAF that the independence, quality and diversity of its membership would be better served by expanding the nominating process to access a broader population of qualified nominees. However, the investor constituency is currently underrepresented. We suggest that the Financial Nominating Organizations (FNO) be expanded to include other organizations such as the Council of Institutional Investors and the Investors Technical Advisory Committee (ITAC). Expanding the nominating organizations, combined with re-aligning the composition to better balance the investor constituency will greatly enhance the standard setting process.

We also believe the current system under which FNO nominees are virtually guaranteed to be selected as trustees should be replaced by one under which selection is made among a number of nominees that exceeds the number of available openings. Such a change would reduce the excessive influence of the FNOs and produce a more independent FAF board.

Of additional concern is the investor representation on the Trustees' Appointments and Evaluations Committee of the FAF. Provided the Trustees balance the composition of the members with more investor representation, then this committee should also be rebalanced to better represent this constituent interest.

Proposed action: Change the term of service for Trustees from two three-year terms to one five year term.

We agree with the Trustees that the term of service should be changed to one five year term. Not only will this provide the opportunity for a larger number of qualified Trustees to bring their skills and perspectives to the FAF, but it allows for more continuity among its members. The 5 year term will also assist new Trustees with the learning curve as they become involved in the new position.

Proposed action: Change the size of the Board of Trustees from sixteen members to a range of fourteen to eighteen members.

We agree that the size of the Board of Trustees should be changed from sixteen members to a range of fourteen to eighteen members. This will allow the Trustees to better balance the expertise of the board members in reaction to changes in the standard setting environment. We stress however, that the make up of the Foundation and its committees must be more balanced and urge a strengthening of investor representation on its board and established committees (i.e., Appointments and Evaluations).

Proposed action: Strengthen and enhance the governance and oversight activities of the Trustees as to the efficiency and effectiveness of the standard-setting process.

We agree that the FAF should strengthen and enhance the governance and oversight of the Trustees but disagree that they should take an active role in due process and agenda setting. The role of the FAF is to ensure that the FASB and GASB membership is structured to be representative of its constituents, that these organizations are adequately funded and staffed, and that it is independent from the direct influence of special interests. There is a system in place at the FASB and GASB to ensure integrity, independence, and objectivity in the standards setting process through open due process. This due process provides a number of channels for participation and collaboration which should remain independent of the oversight role of the FAF. Giving the Trustees the opportunity to influence the due process and the agenda setting of the FASB and GASB will undermine its role, both in fact and in perception.

Section 2. Oversight of the FAF by-laws provides extensive guidance for the Trustees in connection with the exercise of their authority, functions, powers, and oversight responsibilities. Continued thorough and transparent execution of these duties establishes a means for monitoring the efficiency and effectiveness of the FASB and GASB.

Proposed action: Reduce the size of the FASB from seven members to five.

We do not support reducing the size of the FASB from seven members to five. We believe that the seven member board allows a more thorough debate and broader input of constituencies necessary to achieve the full complement of input. These viewpoints will be vital as the global convergence of the accounting standards continues to take form and with the emergence of increasingly complex accounting and reporting issues.

In our letter issued on April 17, 2002 in response to a previous Trustee proposal to reduce the board size to five members⁶, we expressed our opinion that we saw no evidence that the FASB's size was delaying the process. It was our opinion then and it continues to be our opinion that a five-member

⁶ Comment letter issued to the Financial Accounting Foundation in response to *Proposed Changes to Streamline the FASB Process*. http://www.cfainstitute.org/centre/issues/comment/2002/02fasb_streamln.html

board is just too small to be considered representative of the view of the majority of the FASB's constituents. The experience of the International Accounting Standards Board (IASB) has been that the number of views being expressed around the table has never materially added to the length of the debate but it has added to the quality and depth of the debate. The diversity of views expressed assures that the concerns of all of the FASB's constituents are brought forward and addressed appropriately.

Also, reducing the FASB size will require the reduced membership to handle more duties in addition to considering and voting on accounting standards. This reduction would likely limit the time allotted to consider and vote on accounting standards, which in turn may reduce the FASB's overall effectiveness. For example, each member currently has one or more liaison responsibilities with membership organizations of the FASB's constituencies. Duties include meetings and speaking engagements. The reduction in the number of members will mean that either other members must pick up the additional workload or that contacts with its constituents will be reduced.

Our discussions with current and former members indicate that there are a number of ways in which to improve efficiency and effectiveness, such as changes in staffing, travel and frequency of meetings. For example, the FASB should consider increasing its meeting frequency and its staffing model. With regard to the staffing model, in addition to determining whether more permanent full-time positions are needed, the FASB should review the composition of the staff. Currently, the staff draws predominately from the audit/preparer industry. This mix could be better balanced to include more investor representation.

Proposed action: Retain the FASB simple majority voting requirement.

We agree that the simple majority voting requirement should be maintained even if the Board is reduced to five members. Provided the Trustees continue to require strong due process and create balance among the constituencies represented, then the simple voting requirement should allow for expediency in the standard setting process required to address the complexity of accounting matters and the global convergence of standards.

Proposed action: Realign the FASB composition.

As expressed above, we do not support the Trustee proposal to reduce the current seven member FASB Board size to five members. We urge a realignment of the existing seven-member composition of the FASB to better serve the wide majority of users by requiring that two positions come from the investor community. This composition will better balance the broad interests and be consistent with the direction of the recommendations of the SEC CIFI Standard Setting Process sub-committee which places greater emphasis on increased investor involvement.

Proposed action: Provide the FASB Chair with decision-making authority to set the FASB technical agenda.

We do not support the proposal to provide the FASB Chair with unilateral decision making authority to set the technical agenda. The technical agenda, including both additions and deletions, is now established upon majority vote of the FASB. Input from the FASB's large and diverse constituency for items added or deleted from the technical agenda is vital to the standard setting process. The evaluation, debate and vote regarding the technical agenda ensures that the represented constituencies are not unduly influenced by the opinion and judgment of one individual.

Furthermore, we do not agree that providing the Chair with this decision-making authority will improve the interface with the IASB. The IASB has a robust due process regarding its technical agenda as well as the priority of those items. These decisions are made by a simple majority vote of the IASB and, consistent with the current FASB due process is responsive to its constituencies.

Proposed action: Secure a stable mandatory funding source for the GASB.

We agree that a mandatory stable funding source for the GASB, similar to a model used by the FASB, is essential in order to maintain financial stability for the GASB to fulfill its mission. Achieving financial sustainability will further contribute to its independence and objectivity.

Proposed action: Retain the current size, term length, and composition of the GASB.

We believe that the GASB should consist of seven full time members (including the full-time chair). We believe that part-time board members do not have sufficient time to engage in thorough open due process, evaluate all comment letters, meet with constituents, and conduct other related business. Often-times the one full-time member, the chairman, assumes much of the workload and thereby can control the outcome. This can be detrimental to a transparent, balanced, and effective standard setting process.

Proposed action: Provide the GASB Chair with decision-making authority to set the GASB technical agenda.

For reasons cited in our discussion of the FASB Chair above, we do not concur with the proposal to grant the GASB Chair the authority to set the GASB technical agenda. There is a robust due process currently in place which provides a level of independence and objectivity necessary for autonomous standard setting.

Concerns with Due Process

We place a high degree of importance on the work of the FASB and the GASB and the oversight provided by the FAF. Changes to the roles for any of these organizations should be accomplished through a due process that is both extensive and transparent. We are concerned that the approach taken here to engage the Boards' constituents falls short of fully satisfying these two criteria, given the significance these changes are expected to have on the capital markets.

The public comment period for this proposal is greatly foreshortened compared to typical FAF/FASB comment periods, and we expect many constituents were not aware that such a review was underway until the public comment period commenced in mid-December. In addition, the proposal as drafted makes it difficult to put into context the impact of the changes without first understanding the current situation and why a change is necessary. Given that the document provides neither a basis for conclusions nor a discussion of the alternatives considered and rejected in favor of what is being proposed, we have not been able to develop that context for the recommendations. We believe this impairs the ability of commentators to respond fully to the recommendations. Also, in doing our research, we found it difficult to find the by-laws of the FAF and operating procedures of the FASB and GASB. These documents are not currently posted on the Boards' website for public view. We urge the Boards to post these documents to make them easily accessible, similar to the Constitution of the International Accounting Standards Committee Foundation and the Due Process Handbook for the IASB.

Soon the FAF will make decisions affecting the key underpinnings of the Boards' governance, composition, and operations. We would encourage additional due process and engagement of the Boards' constituents prior to making these decisions. We believe that the changes should reflect a better balance of investor representation on the boards and committees, independence of agenda setting, outreach to a wide and diverse constituency, and preservation of a strong due process.

The CDPC appreciates the opportunity to express its views on the Financial Accounting Foundation Proposed Changes to Oversight, Structure, and Operations of the FAF, FASB, and GASB. If you, the trustees, or your staff have questions please contact Matthew Waldron, Senior Policy Analyst at matthew.waldron@cfainstitute.org or 434-951-5321. We would be pleased to answer any questions or to provide any additional information you might request.

Sincerely,

/s/ Kurt N. Schacht

Kurt N. Schacht, JD, CFA
Managing Director

/s/ Gerald I. White

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

cc: Robert H. Herz, Chairman-Financial Accounting Standards Board
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Appendix I

Definition of Investor

The mission, by-laws, and amendments currently proposed by the FAF and FASB and GASB make frequent reference to the importance of “users” or “investors” in both their targeted purpose and constituencies.

The “investor” targeted for FAF, FASB and GASB purposes should be an individual who has achieved, through education, examination and experience, a level of professional competency. For example, a candidate could include an investment professional with a decade or more of buy-side or sell-side experience who is the holder of a relevant professional designation (such as a CPA or Chartered Financial Analyst[®] (CFA[®])) and/or who has an MBA with a concentration in accounting or finance. An extremely important aspect to the “investor” definition is the ability to bring to accounting standard setting decisions an emphasis on the usefulness of financial statement data for investment decisions, including the need for comparability, consistency, and transparency. Preparers and auditors of financial statements may not understand how those statements are used, and usually have a preference for flexibility and confidentiality (preparers) and auditability (auditors). In essence, an investor is an individual whose career advancement and compensation are tied directly to their success or failure at making significant investment decisions.

As in any profession, “investors” come in a variety of flavors – frequently starting in assistant analyst support positions, moving up to full analyst responsibilities where their recommendations are actively used in investment decisions, advancing further to management roles (i.e., overseeing the activities of other investment professionals), and finally achieving executive positions within their companies or institutions. It is important for the FAF, FASB and GASB to recognize that as an individual makes that last transition, their role as an “investor” may undergo a significant change. The orientation of the CEO or other management level officer of a mutual fund, bank, or brokerage firm is likely to be much more closely associated with the priorities of preparers, since they are themselves responsible for preparing such public financial statements, and less linked to the needs and desires of analysts who are using these statements. While it is extremely important for the FAF, FASB and GASB to receive input from such individuals, it is likely that financial statement users in non-management ranks and their immediate supervisors (such as directors of research) may provide more representative input as “investors.”