

Recommendations of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission

A Response by the Financial Accounting Foundation and the Financial Accounting Standards Board

August 1, 2009

Introduction

In July 2007, the U.S. Securities and Exchange Commission (SEC or Commission) chartered the Advisory Committee on Improvements to Financial Reporting (Committee). The Committee's final report, issued on August 1, 2008, included a number of recommendations intended to increase the usefulness of financial information to investors, while reducing the complexity of the financial reporting system to investors, preparers, and auditors.

The Financial Accounting Foundation (FAF or Foundation) and the Financial Accounting Standards Board (FASB or the Board) strongly supported the formation of the Committee as an important step in addressing the various institutional, structural, and other issues that add complexity, reduce transparency, and impede the usefulness of financial information reported to investors. Robert Herz, FASB Chairman, was an Official Observer to the Committee. Other FASB members participated as observers to each of the Committee's four subcommittees, and the FASB provided several staff resources to the Committee.

The FAF and the FASB are pleased to provide this response explaining the actions we are taking with respect to each of the Committee's recommendations aimed at improving accounting standard setting. This response contains two parts:

- An Executive Summary that includes our response to key Committee recommendations related to accounting standards.
- An Appendix detailing our response to each of the Committee's recommended improvements to accounting standard setting.

Executive Summary

Over the past year, the SEC, the FASB, and others have been understandably devoting significant time and attention to addressing the issues brought to light by the current economic crisis. One very welcome development arising from that crisis is a broader calling for greater transparency as a necessary ingredient for recovery and the rebuilding of investor and public confidence. Included in this has been the need to improve and strengthen certain accounting and reporting standards. While accounting did not cause the crisis and accounting will not end it, it did reveal a number of areas requiring improvement in standards and overall transparency. Over the past 18 months, the FASB has responded vigorously with a number of new standards and enhanced disclosure requirements relating to securitizations and special-purpose entities, credit default swaps and derivatives, financial guarantee insurance, and fair value measurements and

credit exposures. The International Accounting Standards Board (IASB) has similarly been working vigorously to improve international financial reporting standards (IFRS). Responding to the calls for timely improvement within their respective jurisdictions while also advancing convergence has proved challenging for both the FASB and IASB.

The current financial crisis, in addition to highlighting the need for enhanced communication throughout the financial system, also revealed a need for improved infrastructure and transparency around markets for complex structured securities and certain derivatives. It is notable that during the past year, many companies and other market participants found it difficult to obtain some of the important information needed to measure the fair value of certain complex financial instruments partly due to limited market infrastructure for such instruments.

Despite the obvious priority of issues arising from the economic crisis, the Board and the Foundation have been acting on the Committee's many important recommended improvements to standard setting. The following is a description of the actions we are taking in response to key Committee recommendations.

Increasing the Usefulness of Information in SEC Reports

The Committee expressed support for the SEC's efforts to data-tag financial reports using eXtensible Business Reporting Language (XBRL) as a way of making it easier for investors to sort and analyze financial information.

In support of those efforts, the FASB initiated a project with XBRL-US in May 2008 to embed *FASB Accounting Standards Codification*TM references into the XBRL taxonomy and display all XBRL elements within the Codification. That project, completed in August, 2009, enables financial statement preparers, auditors, and others to electronically link the XBRL taxonomy to the relevant portions of the Codification.

Enhancing the Accounting Standards-Setting Process

The Committee concluded that the financial reporting system would be best served by recognizing the preeminence of the perspective of investors because they are the primary users of financial reports. The Committee recommended increased investor representation on the FASB and the FAF as the best way to assure that financial reports will be useful to investors.

We agree with those conclusions.

Since 2002, the FAF and the FASB have placed a high priority on continuously improving the quantity, quality, and timeliness of investor input into the standard-setting process and the oversight of it. For example, before 2008, the FASB had formed several standing advisory groups composed solely of investors to provide it with ongoing advice (the User Advisory Council, Investors Technical Advisory Committee, and Investor Task Force), changed the composition of the Emerging Issues Task Force to include investors, and added individuals with a background in professional investing to its staff. The FAF embarked on a multi-year process to

increase investor participation on the Financial Accounting Standards Advisory Council to a level consistent with that of financial statement preparers.

Some of the more significant changes made by the FAF and FASB during the last year include the following:

- In August 2008, the Board of Trustees amended the Foundation's By-Laws to include experience in investing as a qualification of individual Board members and for the composition of the Board taken as a whole.
- The amended By-Laws also expand the role of the Chairman of the Board of Trustees. In February 2009, John J. Brennan, chairman of Vanguard Group, Inc., was appointed Chairman. That appointment also increased the number of Trustees with a strong, active investor perspective.
- The amended By-Laws also establish a special committee responsible for the oversight and evaluation of the accounting standard-setting processes of the FASB and the Governmental Accounting Standards Board. Among other things, that committee is to evaluate the efficiency and effectiveness of constituent involvement in standard setting, including investor involvement.
- In October 2008, the Trustees replaced an outgoing FASB member with experience as a professional investor with an individual with a strong professional background that includes experience in both the accounting and investing arenas.
- The FASB made several process changes to improve the timeliness and breadth of investor participation in the standard setting process.

The Committee acknowledged the FASB's extensive process for soliciting feedback from investors and other interested parties but recommended that the process be improved by increasing field work and formalizing post-adoption reviews of new standards. The Committee believed those measures would provide the FASB with better input during and after the standard-setting process, enhancing the effectiveness of the process and making the end product more useful to investors.

The Board agrees that field work is one of several important ways of gathering input about the potential benefits and expected costs of proposed standards. Over the past year, the Board tried several new approaches to field testing its proposals with investors. The Board had to modify a potentially promising approach in response to a number of practical challenges. In coming months, the Board will consider ways to address those challenges.

We agree that the Committee's suggestions for formalizing the post-adoption reviews of new standards have the potential to reduce the complexity of U.S. financial reporting. We are working to develop and implement a post-implementation review process by the end of 2009. We believe, however, that reporting complexity—in particular, that driven by the demand for detailed implementation guidance—would likely be further reduced if the SEC and the Public Company Accounting Oversight Board (PCAOB) developed policy statements on the reasonableness of accounting and auditing judgments, as recommended by the Committee. That is because based on our recent experience with implementation of the more principles-based

standard on fair value measurement, we do not perceive any significant change in the demand for detailed implementation guidance.

The Committee observed that key participants in the financial reporting process need to have a high degree of communication with each other to be responsive to the ever-changing financial landscape. The Committee recommended the creation of a Financial Reporting Forum (FRF) to facilitate that communication.

The FASB agrees that effective and timely communication between the various parties in our financial system is critical. The FASB is committed to creating a forum through which it and the SEC and PCAOB can receive timely input on immediate financial reporting needs and priorities system-wide. Staff representatives of the FASB, SEC, and PCAOB have been working to develop a proposal for such a forum. We hope to see that forum become a reality before the end of 2009.

Improving the Substantive Design of New Accounting Standards

The Committee suggested that taking a different approach to the design of standards in a few important areas could reduce the complexity of existing U.S. generally accepted accounting principles (GAAP).

The Committee supported the objective proposed by the FASB in its project on financial statement presentation that a company divide its individual financial statements into cohesive components. Committee members noted that in a mixed-attribute measurement system, such an approach might help a company portray for investors the various sources of changes in its income. In October 2008, the FASB and the IASB issued a common Discussion Paper proposing that objective and other improvements to the way companies present financial information in the basic financial statements. The Boards began their redeliberations of the proposals in their Discussion Paper in July 2009.

The Committee expressed general opposition to standards that included all-or-nothing bright-lines tests. The FASB shares the Committee's views about the consequences of bright lines on the complexity of U.S. GAAP and is committed to limiting their use in future standards. For example, the Board recently amended guidance on the consolidation of variable interest entities, adopting a principles-based, qualitative approach to making consolidation decisions in replacement of the prior quantitative approach. In its project on leasing, the Board is exploring an approach that would eliminate distinctions between operating and capital leases and the bright lines used to distinguish between them.

The Committee also advocated a move away from industry-specific guidance in authoritative literature—unless justified by strong conceptual arguments. The Board agrees. In several active agenda projects—revenue recognition and its project on financial instruments being two examples—the Board plans to develop principles-based guidance that could be applied across companies and industries. Those projects have the potential to eliminate a significant source of industry-specific guidance in U.S. GAAP.

Delineating Authoritative Interpretive Guidance

Noting that the proliferation of various sources of U.S. GAAP is a source of complexity that could be avoided, the Committee expressed strong support for the FASB's efforts to complete the codification of all U.S. GAAP in one source that clearly delineates authoritative from nonauthoritative literature.

We are pleased to report that on July 1, 2009, the FASB reached a significant milestone in reducing the complexity of U.S. GAAP through the launch of the *FASB Accounting Standards Codification*[™] as the single source of authoritative nongovernmental U.S. GAAP. The Codification reorganizes the thousands of U.S. GAAP pronouncements into roughly 90 accounting topics displayed using a consistent structure. Moreover, accounting standards are now easily accessible through a user-friendly, online research system.

The Codification is effective for interim and annual periods ending after September 15, 2009. All existing accounting standards are superseded as described in FASB Statement No. 168, *The FASB Accounting Standards Codification*[™] *and the Hierarchy of Generally Accepted Accounting Principles*. Moreover, Statement 168 makes clear that all other accounting literature not included in the Codification is nonauthoritative.

Clarifying Guidance on Financial Restatements and Accounting Judgments

The Committee recommended that the FASB or the SEC consider the potential benefits that would result from providing additional or improved guidance with respect to materiality and the accounting and reporting of error corrections. Representatives of the FASB and the SEC's Office of the Chief Accountant carefully evaluated those recommendations and agreed that those recommendations would be most effectively addressed by the SEC.

In Closing

We strongly support the goal of reducing complexity and improving financial reporting by increasing the overall understandability, transparency, and usefulness of financial reporting. We appreciate the Committee's efforts to identify important changes to our financial reporting system that would contribute to that goal. As discussed in this Summary and the related Appendix, we have taken many actions to do our part. Achieving the goal of improved and less complex reporting will require continued concerted and coordinated action by the SEC, the FASB and the Foundation, the PCAOB, and many other key parties in our reporting system. Given the many institutional, cultural, and behavioral forces that foster complexity, the effort will not be easy and will take time. We are committed to continuing to do our part to improve the quality and usefulness of financial reports and reduce the complexity of financial reporting.

Compendium of Responses to the Recommendations of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission

The final report of the Committee made a number of important recommendations to the FASB, the FAF, and others. This Appendix discusses in detail how the FASB and the FAF have responded (or plan to respond) to each recommendation directed to them, organized according to the various chapters in the report. Each Committee recommendation is presented in bold-faced type. (Footnotes included in the Committee report are not included here.)

Chapter 1—Substantive Complexity

Recommendation 1.1: Avoidable complexity caused by the mixed attribute model should be reduced in the following respects:

- **Measurement framework – The SEC should recommend that the FASB be judicious in issuing new standards and interpretations that expand the use of fair value in areas where it is not already required until:**
 - **The FASB completes a measurement framework to systematically assign measurement attributes to different types of business activities**
 - **The SEC, the FASB, and other regulators and standards-setters develop and implement a plan to strengthen the infrastructure that supports fair value reporting.**
- **Financial statement presentation – The SEC should recommend that the FASB consider the merits of:**
 - **Assigning a single measurement attribute within each business activity to the maximum extent feasible, which is consistent across the financial statements**
 - **Aggregating financial statements by meaningful categories of business activities, such as the operating, investing, and financing sections**
 - **Developing a practical means for reconciling the statements of income and cash flows by major classes of measurement attributes.**

We agree that the use of multiple different measurement attributes contributes to the complexity of U.S. financial reporting, particularly when the same or similar items are measured in multiple different ways. The Committee's recommendations are broadly consistent with the FASB's current and planned activities, as discussed below.

The FASB and the IASB are working together on a joint project to improve and converge their respective conceptual frameworks. Neither the IASB nor the FASB framework provides conceptual guidance on measurement, and closing that gap is a critically important element of the project. The Boards are developing a proposed framework that they plan to seek comment on by issuing a Discussion Paper in late 2009. The issues the Boards will likely seek views on include:

- How measurement is related to the objective of financial reporting
- The available measures that might be used in financial reporting

- Factors to consider in deciding how a company should measure a particular item, including whether and how the activity it is used in influences how it is measured.

The FAF is in the early stages of a strategic planning exercise that may include evaluating the role of the FAF and the FASB in accounting education and training. We have decided to defer consideration of our role in strengthening the infrastructure supporting fair value pending completion of the strategic plan later this year.

The FASB and the IASB are also working together on a project to develop standards for presentation of information in the basic financial statements (the financial statement presentation project). In October 2008, the FASB and the IASB issued a common Discussion Paper describing their preliminary views on how to improve the presentation of financial information. The Board proposed that companies provide financial statements that presented information that was aggregated in meaningful categories and provide a reconciliation of income and cash flows, as suggested by the Committee. The comment period ended in April 2009; the Boards and their staff have been carefully reading and evaluating comment letters and field work results. The Boards began redeliberations in July 2009 with the goal of issuing an Exposure Draft in the first half of 2010.

Existing standards of accounting for financial instruments are an often-cited example of the complexity in U.S. GAAP that results from using multiple different measurement bases. In December 2008, the Board added a project to its agenda to comprehensively and expeditiously improve the recognition and measurement requirements for financial instruments in ways that simplify the accounting requirements and the financial information that results from them. As of July 2009, the FASB had made significant progress toward an Exposure Draft it expects to issue for public comment by the end of this year or early 2010. The IASB has a similar project on its agenda; in July 2009, it issued an Exposure Draft of proposed improvements to the way companies would measure financial instruments under international financial reporting standards. The FASB and the IASB are using their best efforts to develop common, high quality standards in this area.

Recommendation 1.2: The SEC and the FASB should work together to develop a disclosure framework to:

- **Integrate existing SEC and FASB disclosure requirements into a cohesive whole to ensure meaningful communication and logical presentation of disclosures, based on consistent objectives and principles. This would eliminate redundancies and provide a single source of disclosure guidance across all financial reporting standards.**
- **Require disclosure of the principal assumptions, estimates, and sensitivity analyses that may impact a company's business, as well as a qualitative discussion of the key risks and uncertainties that could significantly change these amounts over time. This would encompass transactions recognized and measured in the financial statements, as well as events and uncertainties that are not recorded.**

The FASB agrees that clear and robust disclosures are essential to informative and transparent financial reporting—a critical component in maintaining investor confidence in the markets—and that better integrating the existing disclosures could help decrease the complexity of financial reporting.

Thus, in response to recommendations of the Committee, the FASB's Investors Technical Advisory Committee, and others, the FASB added a disclosure framework project to its agenda in July 2009. The Board plans to develop a principles-based framework that would strengthen disclosure quality, rationalize U.S. GAAP and SEC requirements, and improve the consistency and organization of existing and future financial statement disclosures to make them more meaningful for investors.

The Committee's final report contains many thoughtful recommendations about the elements of an effective disclosure framework, and the Board will carefully consider them as it develops a proposal. The FASB plans to seek comment on a proposed framework by issuing a Discussion Paper in the first half of 2010.

Recommendation 1.3: The SEC and FASB should also establish a process of coordination for the Commission and the FASB to regularly assess the continued relevance of disclosure guidance in both bodies of literature, particularly as new FASB standards are issued. Existing guidance should be updated or removed, as appropriate.

Including redundant or irrelevant disclosures in financial reports contributes to their length and complexity. The Board agrees that it and others should strive to minimize that avoidable complexity by periodically assessing the continued relevance of existing disclosure requirements. In that regard:

- As described above, an objective of the Board's disclosure framework project is to rationalize existing U.S. GAAP requirements, removing redundant disclosures and those that do not provide users with relevant information.
- In response to another Committee recommendation, the FASB is planning to formalize and strengthen its post-implementation reviews of standards. In developing that process, the Board will consider the need for a process to periodically reevaluate and update disclosure requirements.

Recommendation 1.4: Recognition guidance in U.S. GAAP should be based on a presumption that bright lines should not exist. As such, the SEC should recommend that the recognition guidance in new projects undertaken jointly or separately by the FASB avoid the use of bright lines, in favor of proportionate recognition. Where proportionate recognition is not feasible or applicable, the FASB should provide qualitative factors in its recognition guidance. Finally, enhanced disclosure should be used as a supplement or alternative to the two approaches above.

The FASB shares the Committee's views about the consequences of bright lines on the complexity of U.S. GAAP and is committed to limiting their use in future standards. For example, the Board recently amended guidance on the consolidation of variable interest entities, adopting a principles-based, qualitative approach to making consolidation decisions in replacement of the prior quantitative approach. In its project on leasing, the Board is exploring an approach that would eliminate the distinctly different operating and capital lease accounting models and the bright lines used to distinguish between them.

Although the Board is committed to eliminating or reducing the use of bright lines and exceptions, we do not perceive any significant change in the demand for such guidance, suggesting a possible need for further changes to the institutional, legal, and cultural factors driving that demand.

Recommendation 1.5: Constituents should be better trained to consider the economic substance and business purpose of transactions in determining the appropriate accounting, rather than relying on mechanical compliance with rules. As such, the SEC should undertake efforts to, and also recommend that the FASB, academics, and professional organizations, better educate students, investors, preparers, auditors, and regulators in this respect.

We agree that education and training are an important determinant of the quality of financial reporting, particularly when accounting standards are principles-based and include fewer detailed rules and industry-specific guidance.

The FAF is in the early stages of a strategic planning exercise that may include evaluating the role of the FAF and the FASB in accounting education and training. We have decided to defer consideration of our role in strengthening the education of our constituents pending completion of the strategic plan later this year.

Recommendation 1.6: U.S. GAAP should be presumptively based on business activities, rather than industries. As such, the SEC should recommend that any new projects undertaken jointly or separately by the FASB be scoped on the basis of business activities, except in rare circumstances. Any new projects should include the elimination of existing industry-specific guidance—particularly that which conflicts with generalized U.S. GAAP—in relevant areas as a specific objective of those projects, except in rare circumstances.

Considering the pace of convergence efforts, the SEC should also recommend, that in conjunction with its current codification project, the FASB add a project to its agenda to eliminate existing industry-specific guidance which conflicts with generalized U.S. GAAP, except in rare circumstances.

Recommendation 1.7: U.S. GAAP should be based on a presumption that formally promulgated alternative accounting policies should not exist. As such, the SEC should recommend that any new projects undertaken jointly or separately by the FASB not provide additional optionality, except in rare circumstances. Any new projects should also include the elimination of existing alternative accounting policies in relevant areas as a specific objective of those projects, except in rare circumstances.

Recommendation 1.8: U.S. GAAP should be scoped with sufficient precision to minimize the use of scope exceptions. As such, the SEC should recommend that any new projects undertaken jointly or separately by the FASB be carefully scoped to minimize the use of

exceptions. Any new projects should also seek to refine the scope of existing standards in relevant areas as a specific objective of those projects to minimize existing scope exceptions.

Recommendation 1.9: U.S. GAAP should be based on a presumption that similar activities should be accounted for in a similar manner. As such, the SEC should recommend that any new projects undertaken jointly or separately by the FASB should not create additional competing models, except in rare circumstances. Any new projects should also include the elimination of competing models in relevant areas as a specific objective of those projects, except in rare circumstances.

The Committee noted the complexity that is created by accounting standards that include exceptions to general principles. Because of exceptions, investors and preparers do not speak a uniform language in communicating financial information, and other constituents in the communication process are similarly affected.

Each of the above Committee recommendations is intended to mitigate the complexity arising from one of four different types of exceptions: industry-specific guidance that conflicts with general standards, alternative accounting policies, scope exceptions, and the creation of competing models for economically similar transactions.

The Board agrees that those types of exceptions can be a significant source of reporting complexity. It is mindful of the need to set the scope of future standards in a way that eliminates or minimizes the avoidable complexity that can arise from exceptions. The Board does not perceive any significant change in the demand for such exceptions, however, suggesting a possible need for further changes to the institutional, legal, and cultural factors driving that demand.

We agree that accounting standards should address business activities broadly rather than the accounting by specific industries. Industry-specific accounting standards can and do contribute to the complexity of financial reporting, particularly when they introduce noncomparability by conflicting with generalized U.S. GAAP. The Board intends to issue standards that address accounting for business activities, not specialized industries, with limited exceptions. As evidence of that intent:

- The FASB and the IASB are working together on a joint project to develop a common, high-quality standard of revenue recognition that would include principles-based guidance that could be applied across companies and industries. The FASB believes simplification of U.S. GAAP should result from such a standard; it would eliminate the need for existing industry-specific revenue recognition guidance, one of the single largest sources of industry guidance in U.S. GAAP today.
- In December 2008, the FASB added to its agenda a project on accounting for financial instruments. The goal of this project is to develop principles for the recognition and measurement of financial instruments that would apply across companies and industries, based in part on their business activities.

While the Board agrees with the Committee that eliminating industry-specific guidance that is in conflict with generalized standards would simplify U.S. GAAP, it believes such conflicts are best eliminated in the context of broad projects to improve the generalized standards. The Board also notes that its active project on revenue recognition has the potential to eliminate the single largest source of industry-specific GAAP.

The Board also agrees that, in general, standards that provide companies with the option of reporting the same transaction in different ways increase complexity by reducing comparability. The Board is committed to developing general standards that include optional accounting treatments only when, in the Board's judgment, the expected benefits of the optionality outweigh the potential cost of increased complexity. The Board also understands the need to reconsider existing accounting alternatives when it develops new standards. For example, the Board decided not to move forward with the second phase of its fair value option project. Moreover, in its current project on recognition and measurement of financial instruments, the Board will consider whether it is necessary or appropriate to continue to allow companies the option of measuring a financial instrument at fair value.

Chapter 2—Standards-Setting Process

Recommendation 2.1: Investor perspectives are critical to effective standards-setting, as investors are the primary consumers of financial reports. Only when investor perspectives are properly considered by all parties does financial reporting meet the needs of those it is primarily intended to serve. Therefore, investor perspectives should be given pre-eminence by all parties involved in standards-setting. Although it is more challenging to obtain investor perspectives than those of other constituents involved in the standards-setting process, additional investor representation would facilitate increased consideration of investor perspectives in the standards-setting process. Specifically, the SEC should recommend that the FAF and the FASB do the following:

- **Add investors to the FAF to give more weight to the views of different types of investors, both large and small**
- **Give more representation on both the FASB and the FASB staff to experienced investors to improve consideration of the usefulness of financial reports**
- **Re-evaluate the manner, timing, and quality of investor input received throughout standards-setting to determine whether changes would be warranted to make investor involvement more efficient and effective.**

The FASB and the FAF agree that investors are the primary consumers of financial reports. It is critically important that the Board understand investors' perspectives and give them appropriate weight in developing accounting standards.

Since 2002, the FAF and the FASB have placed a high priority on continuously improving the quantity, quality, and timeliness of investor input into the standard-setting process and the oversight of it. For example, before 2008, the FASB had formed several standing advisory groups composed solely of investors to provide it with ongoing advice (the User Advisory Council, Investors Technical Advisory Committee, and Investor Task Force), and changed the composition of the Emerging Issues Task Force to include investors, and added individuals with

a background in professional investing to its staff. The FAF embarked on a multi-year process to increase investor participation on the Financial Accounting Standards Advisory Council to a level consistent with that of financial statement preparers.

Additional changes made during the last year include the following:

- In August 2008, the Foundation changed its By-Laws to include experience in investing as a qualification of individual Board members and for the composition of the Board taken as a whole.
- In February 2009, John J. Brennan, chairman of Vanguard Group, Inc., was appointed as a member and to the recently expanded role of Chairman of the Board of Trustees. That appointment also increased the number of Trustees with a strong, active investor perspective.
- The amended By-Laws also establish a special committee responsible for the oversight and evaluation of the accounting standard-setting processes of the FASB and the Governmental Accounting Standards Board. Among other things, that committee is to evaluate the efficiency and effectiveness of constituent involvement in standard setting, including investor involvement.
- In October 2008, the FAF replaced an outgoing FASB member with experience as a professional investor with an individual whose strong professional background includes experience in both the accounting and professional investing arenas. In addition, FASB Chairman Robert Herz has significant experience as an investor, having held positions involving fiduciary and investment management responsibilities for significant pension plans, endowment funds, and other types of pooled investments. As a result, two of the five FASB members have significant experience in the investing arena.
- In late 2008, a former sell-side analyst and venture capital investor joined the FASB staff, bringing to two the number of FASB staff in the Senior Investor Liaison role.
- In 2009, the FASB launched an internal investor “fellowship” program to broaden the experience of FASB staff with traditional accounting backgrounds. Selected staff will spend a year or more directly supporting the two Senior Investor Liaisons, deepening their understanding of investor perspectives, the types of financial information they find useful and how they use it, and ways to effectively engage investors in the development of standards.
- Beginning in 2007, the FAF began a process of increasing the number of individuals serving on the Financial Accounting Standards Advisory Council that have professional investment experience. The goal is to increase investor participation to a level consistent with that of financial statement preparers over several years.
- Several changes were made to more actively engage investors in the standard-setting process, including:
 1. The Board formalized and expanded its network of users by creating an internal user database.
 2. The FAF acquired a customized mass-email system, enabling efficient, two-way communications with a wide variety of investors

3. The Board initiated periodic road shows to expand and enhance direct communication with investors. Through mid-2009, Board members and staff had met with several dozen investor representatives.

Those actions have enhanced the Board's ability to obtain timely investor input on critical issues. For example, during the two-week comment period for the FASB Staff Positions issued in April 2009 on fair value measurements and impairment accounting, the Board and staff were able to obtain critically important investor insights through meetings with several dozen investors from 13 different buy-side investment firms.

Recommendation 2.2: The SEC should continue to recommend that the FAF enhance governance of the FASB, as follows:

- **Recommend that the FAF amend the FASB's mission statement, stated objectives, and precepts to emphasize that an additional goal should be to minimize avoidable complexity**
- **Recommend that the FAF develop performance metrics to ensure that key aspects of the standards-setting process are effective, efficient, and compliant with the goals in the FASB's mission statement, objectives, and precepts.**

The FASB is updating its Rules of Procedure to reflect changes made necessary by recent amendments to the FAF By-Laws and the release of the Codification. As part of that update, which the Board expects to complete in upcoming months, it will consider whether and how to amend its mission statement, objectives, and precepts.

In August 2008, the Foundation Trustees amended its By-Laws to establish a special committee (the Oversight Committee) responsible for the oversight and evaluation of the accounting standard-setting processes of the FASB and the Governmental Accounting Standards Board (the Boards). Chaired by the Foundation Chairman, the Oversight Committee has the principal responsibility of establishing, implementing, and administering processes for the Trustees' ongoing oversight and evaluation of the adequacy, transparency, independence, efficiency, and efficacy of the standard-setting processes. In particular, the Oversight Committee's responsibilities include:

- Monitoring the Boards' standard-setting processes and evaluates whether they are consistent with their mission statements.
- Monitoring external influences, such as international convergence activities, Congressional activities, and State legislative activities, on the Boards' standard-setting process.
- Evaluating the adequacy of resources available to fulfilling the Boards' mission and conducting their standard-setting activities.
- Evaluating whether the standard-setting process is transparent, timely, effective, and efficient, including through the development and use of performance measures.

Recommendation 2.3: The SEC should recommend that the FAF, the FASB, and other participants in the financial reporting system continue to improve the effectiveness, efficiency, and timeliness of standards-setting, as follows:

- **Create an FRF that includes key constituents from the preparer, auditor, and investor and other user communities, to meet with representatives from the SEC, the FASB, and the PCAOB to discuss pressures in the financial reporting system overall, both immediate and long-term, and how individual constituents are meeting these challenges. This may require the FASB to re-evaluate the roles and composition of its advisory groups or agenda committees.**
- **Enhance the consistency and transparency of key aspects of the FASB's field work, including cost-benefit analyses, field visits, and field tests.**
- **Formalize post-adoption reviews of each significant new standard to address interpretive questions and reduce the diversity of practice in applying the standard, if needed.**
- **Formalize periodic assessments of existing accounting and related disclosure standards to keep them current.**

We agree that timely and effective communication among the various parties in our financial system is critical. The FASB is committed to creating a forum through which it and the SEC and PCAOB can receive timely input on immediate financial reporting needs and priorities system-wide. Staff representatives of the FASB, SEC, and PCAOB worked together to develop a proposal for such a forum. We hope to see that forum become a reality before the end of 2009.

Field work procedures are one of the many ways the Board obtains input on the benefits, costs, and operationality of proposed standards. Over the past year, the Board tried several new approaches to assess the benefits of proposals made in its financial statement presentation project:

- Through the FASB's Financial Accounting Standards Research Initiative, a team of academics surveyed credit analysts about the perceived benefits of certain proposed changes to financial statement presentation. That survey process revealed a number of practical challenges related to survey design and identifying an appropriately wide range of survey participants.
- A number of companies agreed to provide input on the costs and operationality of the proposal by recasting prior-period financial data. The Board had also planned to gather information about the benefits of its proposals by sharing that "before and after" information with a small group of investors, reasoning that using company-prepared financial information would produce more useful and credible survey results. The Board significantly modified that approach in response to a number of practical challenges.

Once those two surveys are completed and the results analyzed, the Board will consider ways it might address the practical challenges of field-testing its proposals with investors.

In addition, the Board plans to consider in the near future how it might enhance other aspects of its field work to make it more consistent and transparent, including:

- Whether field work can be made more cost-effective, efficient, and consistent across projects by developing qualitative criteria to guide decisions about which methods to use.
- Whether to improve transparency by publicly discussing plans for field work at an early stage.
- Whether the Board could enhance its communications about the nature, extent, and evaluation of field work by developing guidelines for preparing the basis for conclusions.

Beginning in early 2009, the Board began to consider how it might improve and formalize its process for evaluating standards after they have been issued and implemented. In July, the FASB discussed a proposal with the FAF's Oversight Committee. That proposal called for a review of major standards after they had been in effect for several years, focused on evaluating the consistency of reporting changes with the objectives of the standard, the reasonableness of the on-going costs of application, and whether changes in regulation, business practice, or other factors require amendments to the guidance. The FASB and the FAF plan to finalize changes to the FASB's post-implementation review process by the end of this year. In doing so, the FASB will consider how it might coordinate its evaluation process with similar activities being undertaken by the IASB.

The Board acknowledges that a high volume of authoritative implementation guidance contributes to the complexity of U.S. GAAP. The Board supports the idea of issuing implementation guidance in the early years only in emergency situations and evaluating as part of a post-implementation evaluation whether additional guidance is needed to reduce application diversity or otherwise improve reporting. The Board believes that implementation of that approach would be greatly facilitated were the SEC and the PCAOB to act on the Committee's recommendation that they develop policy statements articulating how they evaluate the reasonableness of accounting and auditing judgments (a judgment framework). That is because based on our recent experience with implementation of the more principles-based standard on fair value measurement, we do not perceive any significant change in the demand for detailed implementation guidance.

Recommendation 2.4: The SEC should coordinate with the FASB to clarify roles and responsibilities regarding the issuance of interpretive implementation guidance, as follows:

- **The FASB Codification, a draft of which was released for verification on January 16, 2008, should be completed in a timely manner. In order to fully realize the benefits of the FASB's codification efforts, the SEC should ensure that the literature it deems to be authoritative is integrated into the FASB Codification by following, to the maximum extent practicable, a format consistent with the one used by the FASB.**
- **All other sources of interpretive implementation guidance should be considered non-authoritative and should not be required to be given more credence than any other non-authoritative sources that are evaluated using reasonable judgments made in good faith that are supportable under U.S. GAAP.**

On July 1, 2009, the FASB launched the *FASB Accounting Standards Codification*TM as the single source of authoritative nongovernmental U.S. GAAP. The release of the Codification is a significant milestone in reducing the complexity of U.S. GAAP. It reorganizes the thousands of U.S. GAAP pronouncements into roughly 90 accounting topics displayed using a consistent structure. Accounting standards are now easily accessible through a user-friendly, online research system that should reduce the time and effort involved in researching accounting issues, mitigate noncompliance risk, and provide accurate information through real-time updates as new standards are released. Each topic within the Codification also includes relevant SEC guidance.

The Codification is effective for interim and annual periods ending after September 15, 2009. All existing accounting standards are superseded as described in FASB Statement No. 168, *The FASB Accounting Standards Codification*TM *and the Hierarchy of Generally Accepted Accounting Principles*. Moreover, Statement 168 makes clear that all other accounting literature not included in the Codification is nonauthoritative.

Recommendation 2.6: The SEC should recommend that the FASB build upon recent improvements made to the design of accounting standards as part of its Understandability initiative – primarily by increasing the use of clearly-stated objectives, outcomes, and principles, and emphasizing the importance in financial reporting of being responsive to investor and other user needs for clarity, transparency, and comparability, while seeking to capture the economic substance of transactions to the extent feasible.

The Board agrees that issuing clearly written, understandable standards contributes to reducing the complexity of U.S. GAAP and improving the quality and consistency of their application. The Board has adopted an approach of including clearly stated objectives and principles, highlighted using bold-faced type. The Board has started including in its standards educational examples that illustrate how the principles would be applied to real-world transactions and events. The recently issued guidance on consolidation of variable interest entities is a good example of this approach.

With the release of the Codification, the Board may consider other ways to further enhance the understandability of new accounting requirements.

Chapter 3—Audit Process and Compliance

Chapter 3 of the Report focuses on financial restatements. The Committee recommended that the FASB or the SEC consider the potential benefits that would result from providing or improving guidance with respect to materiality and the accounting and reporting of error corrections. Representatives of the FASB and the SEC's Office of the Chief Accountant carefully evaluated each of those recommendations and concluded that they related to SEC reporting requirements. Accordingly, the FASB has no plans to act on those recommendations at this time.

Chapter 4—Delivering Financial Information

The Committee expressed support for the SEC's efforts to data-tag financial reports using eXtensible Business Reporting Language (XBRL) as a way of making it easier for investors to sort and analyze financial information.

In support of those efforts, in May 2008, the FASB initiated a project with XBRL-US to embed Codification references into the XBRL taxonomy and display all XBRL elements within the Codification. The project, completed in August 2009, will produce three main benefits:

- Financial statement preparers, auditors, and other taxonomy users will be able to electronically link from an element to the relevant content in the Codification to ascertain the appropriateness of using an element.
- When software vendors integrate the electronic links into analysis tools, financial statement users will be able to link to the associated content in the Codification.
- The Codification will display all XBRL elements linked to a Subtopic and a paragraph.