October 3, 2007

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number: 265-24 – Discussion Paper for Consideration by the SEC Advisory Committee on Improvements to Financial Reporting (Discussion Paper)

Dear Ms. Morris:

The Financial Reporting Committee ("the FRC") of the Institute of Management Accountants ("IMA") appreciates the opportunity to provide its views on the "*Discussion Paper for Consideration by the SEC Advisory Committee on Improvements to Financial Reporting*"" (the "Discussion Paper"). The FRC is the financial reporting technical committee of the Institute of Management Accountants. The FRC is comprised of representatives from preparers of financial statements from some of the largest companies in the world, the largest accounting firms in the world, valuation experts, accounting consultants as well as academics. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations.

As a starting point we commend the Securities and Exchange Commission ("SEC") for under taking this important initiative. In addition, we agree and support the *SEC advisory Committee on Improvements to Financial Reporting's* (the "Committee") mandate of

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looking for ways to reduce unnecessary financial reporting complexity and making information more useful and understandable for investors.

We have reviewed the Discussion Paper and agree with the basic approach being adopted by the Committee in that the Committee is focusing on the major areas and we like the idea of identifying within one year, a few ideas that can be made operational. Additionally, we believe the major topics being addressed by the various sub-committees appear appropriate. We have limited our comments in this letter to topics where the FRC has the most expertise, namely financial reporting complexity and the accounting standard setting process. Specifically, in the balance of this letter we describe what the FRC views as some of the underlying causes of financial reporting complexity (including the role of the accounting standard setters in financial reporting complexity) and some preliminary thoughts on what can be done to reduce financial reporting complexity. Going forward we will closely monitor the progress of the Committee's work and may have additional comments and observation which we may wish to share with you as well.

Causes of Financial Reporting Complexity

In attempting to discern some of the causes of financial reporting complexity we believe the Committee may hear different perspective from different constituencies. In particular, we have found that each of the stakeholders in the financial reporting process views the issues in this area in terms of what they observe directly through the roles they play. Our sense of the perspectives of financial statement preparers, auditors and users of financial statements as it relates to the causes of financial reporting complexity is set forth below.

1. **Financial Statement Preparers**. Preparers of financial statements believe that financial reporting complexity results from:

- An unforgiving regulatory and legal environment that makes a financial statement preparer reluctant to exercise good faith professional judgment;

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- Operational complexity as a result of complex standards or accounting terms that are difficult to apply (i.e. how should one calculate expected losses in accordance with FIN 46 *Consolidation of Variable Interest Entities*).

- Standards wherein the resulting accounting is inconsistent with management's views of the underlying economics of a transaction. For example, under an FASB accounting standard on accounting for non-controlling interests (which is close to being finalized) a company would be required to record gains or losses upon purchasing a controlling interest in a business for which it previously held a minority interest. It seems unusual to record a gain or loss upon consummation of a purchase transaction for a business the company continues to own.

- The sheer volume of guidance in standards and the proliferation of interpretations from multiple sources (FASB Staff, SEC Staff, Accounting firms) and in many forms (formal rules, informal interpretations, speeches). Additionally, certain of the accounting standards have become so complex that they can only be understood by a relatively small group of experts residing in the National Office of major accounting firms.

- The existence of standards based on inconsistent concepts and principles.

More specifically, we believe complexity is caused by some of the following factors:

- The current legal and regulatory environment creates complexity due to the financial and reputational risks that exist, even when good-faith efforts are made to comply with the rules. We believe that complexity can be mitigated by having principle based standards but only if there is a change in the current regulatory environment (such changes are discussed later in this letter).

- On occasion companies are asked to restate their financial statements for matters in which there is no clear accounting rules but because someone on the SEC staff would have reached a different judgment. Such actions result in the development of informal interpretations of accounting requirements that are not widely understood by financial statement preparers and undermine confidence in financial reporting.

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Moreover, such actions result in preparers wanting detailed accounting guidance on fairly narrow scope issues which exacerbates financial reporting complexity.

- The lack of a fully developed conceptual framework leads to inconsistent concepts and principles being applied across accounting standards. For example, the accounting model for recording non-tax contingencies is based on a probable loss notion while tax contingencies are based on a more-likely-than-not notion and guarantees of a contingency are recorded at fair value. And in a business combination, the accounting for contingencies will be different under the new FASB 141(R).
- The accounting standards have different measurement attributes (such as historical cost or fair value) and different accounting treatment alternatives (an investment in an equity security can be marked to fair value in the statement of operations or in the statement of shareholders equity). Many attribute financial statement preparers' reluctance to accept fair value accounting to an aversion to volatility. In our view, while we agree that companies are somewhat concerned over the earnings volatility impact(s) of utilizing fair value measurement attributes, they are more concerned over the relevance and reliability of measuring non-financial assets and liabilities at fair value when those assets and liabilities do not have readily available markets to determine fair value.
- Many view exceptions to standards as contributing to complexity. We do not believe that an exception included in a standard, necessarily increases complexity and at times such exceptions actually reduce complexity. For example, a simple purchase order to buy a fungible product for use in a business would have been considered a derivative instrument under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("FAS 133"). An exception in FAS 133 provided that such contracts were scoped out from such accounting. This is an example where the standard needed to be "scoped back" to avoid an accounting treatment that would be completely inconsistent with the underlying economics and operational aspects of a particular transaction.

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- The FASB's failure to sufficiently field test proposed standards as evidenced by the identification of significant implementation issues after a new standard is issued (e.g., FAS 133, FAS 140, FIN 46R, etc.).
- The standards have become extremely lengthy and difficult to read and understand. For example, FAS 133 has over 800 pages of authoritative guidance and hundreds of pages of implementation and interpretive guidance.
- The scope of some standards contributes to complexity. Even when one can understand the basic principles of an accounting standard, it is unclear when a transaction is in the scope of a standard. Often times, subsequent interpretations of a standard (by either the FASB or SEC staff or accounting firms) will result in the scope being expanded to include unintended or unforeseen transactions.
- The FASB's apparent need to take on new projects that create unintended consequences for which the current accounting is appropriate. For example, the FASB is planning to issue new guidance on the accounting for business combinations and non-controlling interests when the current accounting guidance in these areas is generally working effectively.
- The lack of a holistic disclosure model. Disclosures are many times duplicated in different places throughout a company's annual report to shareholders.

2. **Auditors of Financial Statements**. Auditors have many of the same concerns that preparers of the financial statements have including the sheer volume of accounting guidance and interpretations. Additionally, they are concerned about the ability to objectively evaluate the assumptions and estimates used in applying many of the accounting standards. They are also increasingly concerned about applying professional judgment in approaching judgmental accounting matters for fear of being second-guessed by the PCAOB, SEC or plaintiffs bar.

3. **Financial Statement Users**. When users think about complexity, they tend to focus primarily on the end result: what is communicated in the financial statements. Are the financial statements clear and easy to understand? Is the information reliable, relevant

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and comparable? Do the disclosures give them sufficient visibility into the possible ranges of variability of the reported results?

Investors read the financial statements, not the underlying accounting standards. If the application of an accounting standard (even one with a simple principle) produces financial results that are difficult to follow or fail to reflect the underlying economics, investors are likely to be confused.

Suggestions to Reduce Complexity

In order for there to be a reduction in complexity, significant efforts are needed by various constituencies in the financial reporting process:

- **Regulators**. In many ways, we believe there has been a diminished use of professional judgment caused in part by fears of second-guessing by regulators. Regulators could address this if they were much more tolerant of good faith efforts to comply with accounting rules. A framework should be developed whereby if certain conditions are met, regulators would provide a "safe harbor" for companies and auditors. We have provided within Appendix A of this letter some suggestions of the elements that could be included in a "safe harbor" protocol.

  In addition, the SEC should establish a restatement protocol such that all restatements would be reviewed by the Office of the Chief Accountant before the Division of Corporation Finance requests that a registrant restate its financial statements. Further, similar to "Tax Courts" that exist in resolving disputes between taxpayers and the IRS, the Committee may want to look to the establishment of an "Accounting Court" where companies and auditors can seek to resolve disputes they have with the SEC over interpretations of the accounting rules.

- **Congress.** Tort reform is needed to protect companies and auditors from frivolous lawsuits surrounding financial reporting.

- **Standard Setters**. Standard setters need to strive to make accounting standards simpler and clearer and not take on projects that do not improve the accounting for

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transactions or reflect the substance of transactions. Additionally, standard setters should undertake more rigorous field testing of new standards to identify significant implementation issues before a standard is issued and effective.

- **Preparers and Auditors**. Preparers and auditors must elevate behavior and strive to implement not only the letter of accounting standards but the spirit as well. Moreover, preparers must strive to provide more meaningful disclosures in their financial statement in order for users to understand the range of variability in reported results.

We believe that there are significant opportunities to improve financial reporting and make information available to investors more meaningful and we stand ready to assist you in helping to advance this important initiative. We appreciate the opportunity to comment on the Discussion Paper and would be pleased to answer any questions you may have. I can be reached at 212-484-6680.

Sincerely,

/s/ Pascal Desroches

Pascal Desroches
Chair, Financial Reporting Committee

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Appendix A

"Safe Harbor" Protocol

This recommendation represents an attempt to address the diminished use of professional judgment caused in part by fears of second-guessing by regulators and the plaintiffs bar. Accounting standards for public companies vary in nature, ranging from standards containing principles and implementation guidance on broad accounting topics to those containing guidance pertaining to specific business transactions or industry events. Even with the broad spectrum of existing accounting standards, transactions or other business events frequently arise in practice for which there is no explicit guidance. In these situations, public companies and their auditors consider other relevant accounting standards and evaluate whether it would be appropriate to apply the guidance in those standards by analogy. Preparers often find it difficult to make these determinations, particularly in new or emerging areas. Even when accounting guidance is applied by analogy, questions frequently arise as to whether the analogy is appropriate based on a company's particular facts and circumstances.

In general, a safe harbor provision in a law serves to not impose liability if an attempt to comply in good faith can be demonstrated. Safe harbor provisions are used in many areas of the federal securities laws. One well known safe-harbor that may serve as a model for crafting a safe-harbor for accounting transactions is the safe-harbor for forward-looking statements under the Private Securities Litigation Reform Act of 1995 ("PSLRA"). The PSLRA provides a safe harbor from liability in private claims under the Securities Act and Exchange Act to a reporting company, its officers, directors and employees, as well as underwriters, for projections and other forward-looking information that later prove to be inaccurate, if certain conditions are met.

In view of this situation, we are recommending that a "safe-harbor" protocol be developed that would protect well-intentioned preparers from regulatory or legal action or having to restate their financial statements when a prescribed process is appropriately followed and results in an accounting conclusion that has a reasonable basis. In those rare

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situations where the SEC staff believes that a change is warranted in the way a registrant was accounting for a particular matter the “safe-harbor” protocol could provide that such a change be effected as a change in accounting principle pursuant to the guidance in FASB Statement 154 *Accounting Changes and Error Corrections*.

A possible outline for the protocol for the preparer to follow would be as follows:

- The company would identify all relevant facts of the transaction at the time the transaction is entered into.
- The company would determine if there is appropriate “on-point” accounting guidance.
- If no on-point guidance exists, the company would timely document the conceptual basis and accounting for their conclusion.
- Such accounting treatment would be approved by the external auditors of the Company.
- The company would disclose (if material) in the financial statements and in Management’s Discussion & Analysis the nature of the transaction and the rationale for the approach adopted.

We believe that a “safe harbor” approach is appropriate in dealing with the issue of complexity in accounting as it will allow preparer and auditor judgment and will encourage the FASB to issue principle based accounting standards.

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