



CAQ Alert #2008-11 – February 19, 2008

## DEAR CENTER MEMBERS

### SEC Advisory Committee on Improvements to Financial Reporting Issues Interim Progress Report

In a letter dated February 14, 2008, [Robert Pozen](#), Chair of the Securities and Exchange Commission (SEC) [Advisory Committee on Improvements to Financial Reporting](#) (CIFiR or the Committee), presented an [interim progress report](#) to SEC Chairman Christopher Cox. The Committee overwhelmingly approved the issuance of the interim progress report to the Chairman. The progress report includes the Committee's developed proposals, conceptual approaches, and currently identified matters for future consideration.

CIFiR's progress report contains 12 developed proposals that the Committee believes can be implemented by the SEC, its staff, or other bodies, as appropriate. Conceptual approaches represent CIFiR's initial views, which are based on discussions on a particular subject, but which require additional vetting before finalization into a developed proposal. Matters for future consideration are areas in which deliberations and research have not yet begun.

The Committee published the [interim progress report](#) to **increase the chances** of their **recommendations being implemented**. CIFiR stated in their report that the developed proposals are described with enough detail to enable the SEC and public commentators to **evaluate whether regulatory action is warranted** in the areas noted. CIFiR is hoping to stimulate discussion and debate on the topics discussed under the conceptual approaches so that the Committee can put forward **additional developed proposals later this year**. The Committee's termination date, according to its [charter](#) (Article J), is August 2, 2008.

Mr. Pozen indicated in the letter to Chairman Cox that after the conclusion of the Committee's work later this year, they expect to issue a **final report with written recommendations**.

CIFiR, which is made up of [17-members](#) and chaired by [Robert Pozen](#), held an approximately 45-minute public telephone conference meeting on Monday, February 11, 2008 to vote on issuing the interim progress report to Chairman Cox. The progress report represents the committee's work to date, which included four public meetings where the topics of the report were deliberated by the full committee.

CIFiR's interim progress report was issued on February 14, 2008. To view the February 14, 2008 [Progress Report](#), click on the respective link.

---

## Summary of CIFI<sup>R</sup>'s Interim Progress Report - February 14, 2008

---

The February 14, 2008 111-page report, including appendices, contains CIFI<sup>R</sup>'s developed proposals, conceptual approaches, and currently identified matters for future consideration as defined above.

There are three appendices in the progress report, which consist of a separate statement from [Mr. Peter Wallison](#), examples of substantive complexity and a listing of the committee members, official observers and staff.

Mr. Wallison's statement indicated a dissent from the committee's vote regarding the use of Extensible Business Reporting Language (XBRL) for financial statements (see number 11 below). Mr. Wallison believes that the committee's timetable is (i) based on an erroneous assessment of the potential costs of auditor assurance, (ii) applies restrictions on reporting that will be harmful to XBRL and to users, and (iii) unnecessarily delays the date on which XBRL will be available to investors and analysts.

CIFI<sup>R</sup>'s progress report is organized by the topics considered by each of the four subcommittees that were created:

1. Substantive Complexity
2. Standards-Setting Process
3. Audit Process and Compliance
4. Delivering Financial Information

### *Summary of Developed Proposals in the February 14, 2008 Progress Report:*

The executive overview of the progress report highlights the following key themes that are intended to tie together the chapters of the report.

1. Increasing emphasis on the **investor perspective** in the financial reporting system
2. Consolidating the process of **setting and interpreting** accounting standards
3. Promoting the design of more uniform and **principles-based** accounting standards
4. Creating a disciplined framework for the increased use of **professional judgment**
5. Taking steps to **coordinate** generally accepted accounting principles in the U.S. (**GAAP**) with international financial reporting standards (**IFRS**).

The following summary of CIFIr's developed proposals was taken directly from the executive overview of CIFIr's February 14, 2008 [progress report](#) marked for changes from the February 11, 2007 v1 draft progress report discussed at their public telephone conference meeting. Bold underlined text represents additions; strikethrough text represents deletions.

1. GAAP should be based on business activities, rather than industries. As such, the SEC should recommend that any new projects undertaken jointly or separately by the [Financial Accounting Standards Board](#) (FASB) be scoped on the basis of business activities rather than industries. Any new projects should include the elimination of existing industry-specific guidance in relevant areas as a specific objective of those projects, unless, in rare circumstances, retaining industry guidance can be justified on the basis of cost-benefit considerations (discussed in section II.A of chapter 1).

The SEC should also recommend that, in conjunction with its current [codification project](#), the FASB add a project to its agenda to remove or minimize existing industry-specific guidance that conflicts with generalized GAAP, taking into account the pace of convergence efforts. (Chapter 1 – developed proposal 1.1)

2. GAAP should be based on a presumption that formally promulgated alternative accounting policies should not exist. The SEC should recommend that any new projects undertaken jointly or separately by the FASB not provide additional optionality, unless, in rare circumstances, it can be justified. Any new projects should include the elimination of existing alternative accounting policies in relevant areas as a specific objective of those projects, unless, in rare circumstances, the optionality can be justified. (Chapter 1 – developed proposal 1.2)
3. Additional investor representation on standards-setting bodies is central to improving financial reporting. Only if investor perspectives are properly considered by all parties will the output of the financial reporting process meet the needs of those for whom it is primarily intended to serve. Therefore, the perspectives of investors should have pre-eminence. To achieve that pre-eminence in standards-setting, the SEC should encourage the following improvements:
  - Add investors to the Financial Accounting Foundation (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 who regularly use financial statements to make investment decisions to ensure that standards-setting considers fully the usefulness of the resulting information. (Chapter 2 – developed proposal 2.1)
4. The SEC should assist the FAF with enhancing its governance of the FASB, as follows:
  - By encouraging the FAF to develop performance metrics to assess the FASB's adherence to the goals in its mission statement, objectives and precepts and to improve its efficiency
  - By supporting the FAF's changes outlined in its [Request for Comments on Proposed Changes to Oversight, Structure and Operations of the FAF, FASB and GASB](#), with minor modifications regarding composition of the FAF and the FASB, as proposed in section II of chapter 2, and agenda-setting, as proposed in section IV of chapter 2
  - By encouraging the FAF to amend the FASB's mission statement, stated objectives, and precepts to emphasize that an additional goal should be to minimize avoidable complexity (Chapter 2 – developed proposal 2.2)

5. The SEC should encourage the FASB to further improve its standards-setting process and timeliness, as follows:
- Create a formal Agenda Advisory Group that includes strong representation from investors, the SEC, the PCAOB, and other constituents, **such as preparers or auditors**, to make recommendations for actively managing U.S. standards-setting priorities
  - Refine procedures for issuing new standards by: (1) implementing investor pre-reviews designed to assess perceived benefits to investors, (2) enhancing cost-benefit analyses, and (3) requiring improved field visits and field tests
  - Improve review processes for new standards by conducting post-adoption reviews of every significant new standard, generally within one to two years of its effective date, to address interpretive questions and reduce the diversity of practice in applying the standard, if needed
  - Improve processes to keep existing standards current and to reflect changes in the business environment by conducting periodic assessments of existing standards. (Chapter 2 – developed proposal 2.3)
6. The number of parties that either formally or informally interpret GAAP and the volume of interpretive implementation guidance should continue to be reduced. 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 to the extent possible, or separately re-codified, as necessary.
  - To the extent practical, going forward, there should be a single standards-setter for all authoritative accounting standards and interpretive implementation guidance that are applicable to a particular set of accounting standards, such as GAAP or IFRS. For GAAP, the FASB should continue to serve this function. To that end, the SEC should only issue broadly applicable interpretive implementation guidance in limited situations (see section VI of chapter 2).
  - 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 well-reasoned, documented professional judgments made in good faith. (Chapter 2 – developed proposal 2.4)
7. The **FASB or the SEC, as appropriate**, ~~or its staff~~ should issue guidance reinforcing the following concepts:
- Those who evaluate the materiality of an error should make the decision based upon the perspective of a reasonable investor.
  - Materiality should be judged based on how an error affects the total mix of information available to a reasonable investor.
  - Just as qualitative factors may lead to a conclusion that a quantitatively small error is material, qualitative factors also may lead to a conclusion that a quantitatively large error is not material. The evaluation of errors should be on a “sliding scale.”

The **FASB or the SEC, as appropriate**, should also ~~direct its staff to~~ conduct both education sessions internally and outreach efforts to financial statement preparers and auditors to raise awareness of these issues and to promote more consistent application of the concept of materiality. (Chapter 3 – developed proposal 3.1)

8. The **FASB or the SEC, as appropriate**, ~~or its staff~~ should issue guidance on how to correct an error consistent with the principles outlined below:
  - Prior period financial statements should only be restated for errors that are material to those prior periods.
  - The determination of how to correct a material error should be based on the needs of current investors. For example, a material error that has no relevance to a current investor's assessment of the annual financial statements would not require restatement of the annual financial statements in which the error occurred, but would need to be disclosed in an appropriate document, and, to the extent that the error remains uncorrected in the current period, corrected in the current period.
  - There may be no need for the filing of amendments to previously filed annual or interim reports to reflect restated financial statements, if the next annual or interim report is being filed in the near future and that report will contain all of the relevant information.
  - Restatements of interim periods do not necessarily need to result in a restatement of an annual period.
  - All errors, other than clearly insignificant errors, should be corrected no later than in the financial statements of the period in which the error is discovered. All material errors should be disclosed when they are corrected.
  - The current disclosure during the period in which the restatement is being prepared, about the need for a restatement and about the restatement itself, is not consistently adequate for the needs of investors and should be enhanced. (Chapter 3 – developed proposal 3.2)
9. The **FASB or the SEC, as appropriate**, ~~or its staff~~ should develop and issue guidance on applying materiality to errors identified in prior interim periods and how to correct these errors. This guidance should reflect the following principles:
  - Materiality in interim period financial statements must be assessed based on the perspective of the reasonable investor
  - When there is a material error in an interim period, the guidance on how to correct that error should be consistent with the principles outlined in developed proposal 8 above. (Chapter 3 – developed proposal 3.3)
10. The SEC ~~or its staff~~ should adopt a judgment framework for accounting judgments. The SEC ~~or its staff~~ **PCAOB** should also encourage **adopt** the Public Company Accounting Oversight Board (PCAOB) ~~to consider a similar action~~ **framework** with respect to auditing judgments. Careful consideration should be given in implementing any framework to ensure that the framework does not limit the ability of auditors and regulators to ask appropriate questions regarding judgments and take actions to require correction of unreasonable judgments.

The proposed framework applicable to accounting-related judgments would include the choice and application of accounting principles, as well as the estimates and evaluation of evidence related to the application of an accounting principle. We believe that a framework that is

consistent with the principles outlined in this developed proposal to cover judgments made by auditors based on the application of PCAOB auditing standards would be very important and would be beneficial to investors, preparers, and auditors. Therefore, we propose that the PCAOB develop a professional judgment framework for the application and evaluations of judgments made based on PCAOB auditing standards. (Chapter 3 – developed proposal 3.4)

11. The SEC should, over the long-term, mandate the filing of XBRL-tagged financial statements after the satisfaction of certain preconditions relating to: (1) successful XBRL U.S. GAAP Taxonomy testing, (2) capacity of reporting companies to file XBRL-tagged financial statements using the new XBRL U.S. GAAP Taxonomy on the SEC's EDGAR system, and (3) the ability of the EDGAR system to provide an accurately rendered version of all such tagged information. The SEC should phase-in XBRL-tagged financial statements as follows:
  - The largest 500 domestic public reporting companies based on unaffiliated market capitalization (public float) should be required to furnish to the SEC, as is the case in the voluntary program today, a document prepared separately from the reporting companies' financial statements that are filed as part of their periodic Exchange Act reports. This document would contain the following:
    - XBRL-tagged face of the financial statements
    - Block-tagged footnotes to the financial statements
  - Domestic large accelerated filers (as defined in SEC rules, which would include the initial 500 domestic public reporting companies) should be added to the category of companies, beginning one year after the start of the first phase, required to furnish XBRL-tagged financial statements to the SEC.
  - Once the preconditions noted above have been satisfied and the second phase-in period has been implemented, the SEC should evaluate whether and when to move from furnishing to the SEC to the official filing of XBRL-tagged financial statements with the SEC for the domestic large accelerated filers, as well as the inclusion of all other reporting companies, as part of a company's Exchange Act periodic reports. (Chapter 4 – developed proposal 4.1)
12. The SEC should issue a new comprehensive interpretive release regarding the use of corporate websites for disclosures of corporate information, which addresses issues such as liability for information presented in a summary format, treatment of hyperlinked information from within or outside a company's website, treatment of non-GAAP disclosures and GAAP reconciliations, and clarification of the public availability of information disclosed on a reporting company's website.

Industry participants should coordinate among themselves to develop uniform best practices on uses of corporate websites for delivering corporate information to investors and the market. (Chapter 4 – developed proposal 4.2)

For past CAQ Alerts on this topic, please go to: [CAQ Alert #2008-09](#) and [CAQ Alert #2007-33](#).

[Back to top](#)

## Stay Informed

As a member of the Center, your firm will receive periodic updates on important developments related to the PCAOB and the SEC, as well as the activities of the Center, particularly with respect to the submission of comment letters on PCAOB and SEC proposals. To stay abreast of these and other relevant events in public company audit practice, please visit the Center Web site at [theCAQ.aicpa.org](http://theCAQ.aicpa.org). Also, we welcome any suggestions or questions - please send them by email at [center@theCAQ.org](mailto:center@theCAQ.org).

Sincerely,

Lillian Ceynowa, CPA  
Center for Audit Quality  
Director of Professional Practice & Member Relations  
(212) 596-6084  
[lceynowa@theCAQ.org](mailto:lceynowa@theCAQ.org)

Jeanne Parsons, CPA  
Technical Manager  
Professional Practice &  
Member Relations  
(212) 596-6124  
[jparsons@theCAQ.org](mailto:jparsons@theCAQ.org)

Kellie Sclafani, CPA  
Technical Manager  
Professional Practice &  
Member Relations  
(212) 596-6065  
[ksclafani@theCAQ.org](mailto:ksclafani@theCAQ.org)

Your email address is part of the Center For Audit Quality mailing list. To unsubscribe to future Center For Audit Quality emails, forward this message to [The CAQ\\_remove@email.aicpa.org](mailto:The_CAQ_remove@email.aicpa.org).

If you need an updated address change, please include your old email address, new email address, and AICPA member ID (if applicable) to [center@theCAQ.org](mailto:center@theCAQ.org).

©2007 The American Institute of Certified Public Accountants, [ISO 9001 Certified](#)  
[AICPA Privacy Policy and Copyright Information](#)

AICPA, 1211 Avenue of the Americas, New York, NY 10036

Center for Audit Quality  
601 13th Street NW, Washington, D.C. 20005

