CFA Institute Perspective on Financial Reporting including Fair Value

Presentation at the MASB Annual Meeting

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CFA Institute

CFA Institute
A global organization

Our Mission ► To lead the investment profession globally by setting the highest standards of ethics, education, and professional excellence.

Our Vision ► Fair and efficient global markets.

Members ► Approximately 106,500 investment professionals in 137 countries; 90% hold the CFA charter

Candidates ► More than 200,000 registrations expected for the three levels of exam in this fiscal year

Offices ► Brussels, Buenos Aires, Hong Kong, London, New York & Charlottesville, VA

CFA Charterholders Are Accomplished

- Studied more than 300 hours per exam and passed 3 exams
- Worked professionally for at least 4 years
- Provided professional references
- Submitted a professional conduct statement
- Been accepted for CFA Institute & local society membership

CFA Institute

CFA Institute is a global, not-for-profit organization comprising the world's largest association of investment professionals.

We offer a range of educational and career resources, including the Chartered Financial Analyst (CFA) and the Certificate in Investment Performance Measurement (CIPM) designations, and are a leading voice on global issues of fairness, market efficiency, and investor protection.

A Matter of Trust

World economies and markets depend on widespread trust. It is this responsibility — the trust bestowed upon investment professionals — that informs the core of our organizational mission: "To lead the investment profession globally by setting the highest standards of ethics, education, and professional excellence."

CFA Institute Guiding Principles

For more than 40 years, CFA Institute has advocated for efficient capital markets that are ethical, transparent, and provide investor protections.

We believe:

- Investors come first. The interests of the investing client must always take precedence over the interests of investment professionals and their employers
- Investment professionals must act ethically and in accordance with the highest professional standards. They must:
  - Act with integrity in all their dealings
  - Maintain independence and objectivity
  - Continuously strive to maintain and improve their professional knowledge and competence

CFA Institute Guiding Principles (cont'd)

We believe (emphasis added below):

- **Investors need complete, accurate, timely and transparent information** from securities issuers
- Financial statements should be reported from the perspective of the shareholder who bears the ultimate risk, and with the shareholder's best interests held paramount
  - **Financial statements should be fully transparent and report the fair values of all assets, liabilities, exchanges, and transactions that could potentially impact the investor**
  - **All assets and liabilities should be included in the balance sheet,** with no hidden assets, hidden debt, or hidden obligations
- **Markets should move toward one set of global, high-quality standards for reporting financial information**
- Self-regulation is generally the preferred method for promoting fair and efficient markets. However, we recognize that some circumstances require additional regulation in order to ensure adequate investor protection

CFA Institute Strategic Objectives

- **Enhance the CFA Program**
- **Create and Source Relevant Lifelong Learning for Members**
- **Connect with Members through Technology**
- **Advocate Effectively for Members and Ethical Markets**
  Refine our structure and process to be an increasingly effective member advocate and proponent of ethical and professional standards for global capital markets.

(The Standards and Financial Market Integrity (SFMI) Division's mission is to promote ethical conduct, professional standards, and integrity in financial markets on behalf of CFA Institute members worldwide. They advocate on behalf of the global investment community for effective, transparent, and fair capital market practices and regulations that uphold investor protections and market integrity.)

- **Solidify and Extend Our Global Capabilities**

Formulating SFMI Positions

- Seek CFA Institute member input (surveys and working groups)
- Consider academic and industry research/writing on the subject
- Develop positions working with the Corporate Disclosure Policy Council (an advisory committee - members include investment professionals with extensive expertise in global capital markets who work with the Financial Reporting Policy Group staff)

- No specific policy position has been developed or issued with respect to intangible assets

Comparison of CFA Institute Comprehensive Business Reporting Model (CBRM) 2007 and IASB/FASB Conceptual Framework for Financial Reporting 2010

CBRM

- The Comprehensive Business Reporting Model is a framework for developing financial reports and disclosures that meet the needs of investors, such as equity investors, creditors, and other providers of capital.

Conceptual Framework

- The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.

CBRM

- Improve the ability of investors and investment professionals to evaluate companies' performance and financial condition, and to make well- informed investment decisions.

Conceptual Framework

- Provide information that is useful in assessing future net cash inflows to the entity. Such information includes information about the economic resources of (assets) and claims against (liabilities and equity) the entity, and about how well the management and governing board have utilized the resources of the entity.

CBRM

- Proposes 12 principles to ensure that financial statements disclosures are relevant, understandable, accurate, and complete.

Conceptual Framework

- Identifies 2 fundamental qualitative characteristics that make financial information useful: relevance and faithful representation (ideally complete, neutral and free from error). Identifies 4 characteristics that enhance the usefulness of relevant and faithfully represented financial information: comparability, verifiability, timeliness, and understandability.

CBRM: 12 Principles (emphasis added)

- The primary financial statements must provide the information needed by equity investors, creditors, and other suppliers of risk capital.
- In financial reporting standard-setting as well as statement preparation, the company must be viewed from the perspective of an investor in the company's common equity.
- Fair value information is the most relevant information for financial decision making.
- **Recognition and disclosure** must be **determined by** the **relevance** of the information to investment decision making and **not based upon measurement reliability alone**.
- **Transactions and events that affect the company's economic position must be recognized as they occur** in the financial statements
- Investors' information requirements must determine the materiality threshold.

CBRM: 12 Principles (emphasis added)

- Financial reporting must be neutral.
- All changes in net assets, including changes in fair values, must be recorded as incurred in a single financial statement, the Statement of Changes in Net Assets Available to Common Shareowners.
- The cash flow statement provides information essential to the analysis of a company and must be prepared using the direct method only.
- Changes affecting each of the financial statements should be reported and explained on a disaggregated basis.
- Individual line items should be reported based upon the nature of the items rather than the function for which they are used.
- **Disclosures must provide all the additional information investors require to understand the items recognized in the financial statements, their measurement properties, and risk exposures**.

September 2010 Position on Fair Value

- Support of fair value premised on member views over a period of at least 20 years
- From November 2009 survey to September 2010 survey, support for fair value as the most appropriate measure for loans increased from 52% to 71%.

Basic Position

- Support a single fair value measurement model for **financial assets and liabilities**
- Do not favour a mixed measurement model
- Do not believe that management's intent should affect the reported measurement
- **Decision-useful information**, such as fair value of financial instruments, should not bypass the basic financial statements

Why Fair Value?

Transparency is provided by fair value measures and these are relevant and decision-useful to investment decision-making

RELEVANCE

- Transactions take place based upon fair value
- Fair value reflects economic reality
- Amortized cost is outdated, lacks comparability, is not relevant
- No compelling argument that amortized cost results in better investment decision-making
- Mixed measurement model is not most decision-useful
- Academic research finds relevancy in fair value measures
- Market prices demonstrate investors adjust book values because they are not true measures of economic value

Why Fair Value? (cont'd)

RELIABILITY

- Reliability as used in submission closely relates to conceptual framework's notion of faithful representation.
- Relevance has primacy over reliability (according to conceptual framework relevance is one of the 2 fundamental qualitative characteristics that make financial information useful)
- Reliability (faithful representation) is not dependent on absolute verifiability
- Amortized cost is verifiable but not representationally faithful
- Fair value is at least as reliable as amortized cost
- Fair value estimates are reasonably and sufficiently reliable
- Confidence in reliability can be increased by management through improved disclosures and effective corporate governance with strong internal controls

Why Fair Value? (cont'd)

- **Highly relevant information that represent economic reality** belongs on the statement of financial position not in supplementary disclosure
- Reporting fair value measures in financial statements will increase reliability
- Amortized costs, while verifiable, are not representationally faithful (reliable)
- Fair value measures are already in use
- Fair value accounting is not "mark-to-market" accounting
- Fair value will increase comparability among companies

"…the issue … is one of relative improvement in estimates, information quality, transparency and ... The issue isn't one of perfect reliability or verifiability. Our view is that fair value can improve information quality, transparency and decision-usefulness."

Reporting of Intangibles

- An item that meets the definition of an element should be recognised if :
  a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and
  b) the item has a cost or value that can be measured with reliability.

IAS 38

21. An intangible asset shall be recognised if, and only if:
  a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
  b) the cost of the asset can be measured reliably.

63. Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets.

Questions to Answer

CBRM

- Does the information improve the ability: a) to evaluate companies' performance and financial condition, or b) to make well-informed investment decisions?
- Is the information relevant and reliable?

Conceptual framework

- Is the information useful in assessing future net cash inflows to the entity?
- Is the information relevant and a faithful representation (reliable)?

Reporting of Intangibles

Unless the questions on the preceding slide can be answered in the affirmative, it is unlikely that the information will be recognized on the financial statements.

Users of financial statements will make adjustments for information that they do not consider useful. Useful information is relevant and reliable (a faithful representation).

Comparability may be an argument for recognition but until the relevance and reliability issue is addressed, it is likely to be viewed as secondary.

Thank you