ADDRESSING FINANCIAL REPORTING COMPLEXITY

Standard setters worldwide work to address financial reporting complexity. So far, their efforts have focused on reduced reporting requirements to lower the compliance costs of companies. Missing from this dialogue, until now, has been the investor.

A new CFA Institute study, for the first time, gives investors a voice on the matter. And they have a very different take on what creates complexity in financial reporting — opaque accounting and inadequate communication — and how to reduce it by bringing greater transparency to complex activities.

POLICY DEVELOPMENTS

• In 2009, the International Accounting Standards Board (IASB) published a standard for small and medium-sized enterprises (SMEs) — “IFRS for SMEs,” which the IASB contends reflects cost-benefit considerations and the needs of users of SME financial statements.

• The IASB is now considering allowing jurisdictions to extend these reduced requirements to public companies and financial institutions.

• In the United States, private company managers and their auditors have long called for reduced financial reporting requirements, and in May 2012, the Financial Accounting Standards Board (FASB) established the Private Company Council to create reduced requirements for US private companies. The FASB is now considering extending these reduced requirements to public companies. It also has undertaken a “Simplification Initiative” to amend current public company requirements.

CFA INSTITUTE COMMENTARY

We have spoken out on issues related to developing separate, reduced reporting requirements for private companies and other simplification efforts with the FASB and US SEC. We have published the following:

• October 2013 Comment Letter to FASB on the Definition of a Public Business Entity
• January 2012 Comment Letter to the Financial Accounting Foundation on the “Private Company Plan”
• Simplifying Private Company Accounting Standards: Understanding the Costs (CFA Magazine, May-June 2014)
• FASB Framework to Guide Development of Separate Private Company Standards (Market Integrity Insights, January 2014)

CFA INSTITUTE VIEWPOINT

The principle aim of accounting standards should be to reflect the underlying economics of transactions and events. In place of opaque accounting and reduced disclosures, we need financial statements that serve their intended purpose — as a transparent form of communication to the investment community.

To that end, standard setters need to work toward ensuring that:

• All economic assets and obligations are recognized on the balance sheet.

• Investors receive economically relevant measures (fair value).

• Financial statement presentation is enhanced with a focus on disaggregation, cohesiveness, and the use of roll-forwards and the direct method cash flow statement.

• Disclosures are not used as a substitute for poor presentation.

Furthermore, efforts should aim to increase transparency by eliminating accounting constructs, optionality, smoothening of earnings, and exceptions to principles.