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September 18, 2008

Financial Accounting and Reporting Section of the American Accounting Association

Financial Reporting Policy Committee

Response to the IASB Discussion Paper: REDUCING COMPLEXITY IN REPORTING FINANCIAL INSTRUMENTS

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INTRODUCTION

The Financial Reporting Policy Committee (the Committee) of the Financial Accounting and Reporting Section of the American Accounting Association (the AAA) is charged with responding to discussion memoranda and exposure drafts on financial accounting and reporting issues.¹ The Committee is pleased to respond to the International Accounting Standards Board (IASB) Discussion Paper: *Reducing Complexity in Reporting of Financial Instruments* (the DP). The comments in this letter reflect the views of the individuals on the Committee and do not represent an official position of the American Accounting Association or the Financial Accounting and Reporting Section.

¹ The Committee is independent of the Financial Accounting Standards Committee (FASC) of the American Accounting Association.

The DP identifies two primary causes for the complexity of reported financial instruments: (1) financial instruments can be intrinsically complex, and (2) international financial reporting standards (IFRS) include numerous alternatives, bright lines, and exceptions for measuring and reporting financial instruments (DP, para. BD15).² The DP proposes possible intermediate and long-term actions designed to reduce complexity and solicits comments on the proposed actions.

In general, the DP suggests that an important cause of complexity is the “many ways of measuring financial instruments” (DP, para. BD17) and, in Table 1 of the DP, illustrates this point with a long list currently acceptable measurement bases for financial assets and financial liabilities. In response, the DP proposes a long-term solution that all financial instruments should be measured on a single basis, most likely fair value. Given that IAS 39 – *Financial Instruments: Recognition and Measurement* includes numerous measurement and disclosure alternatives for derivative and non-derivative financial instruments, the DP also introduces a set of intermediate approaches to the current measurement and reporting problems.

Because the Committee is primarily comprised of university professors with expertise in designing, conducting, communicating and evaluating social-scientific research related to financial reporting, this letter primarily focuses on questions for which academic research can inform the Board’s deliberations.³ The remaining letter is organized as follows. First, we summarize our findings and discuss certain limitations. Second, we review the literature to

² These two sources of complexity loosely conform to the broad categories of unavoidable complexity and avoidable complexity, respectively, as discussed in the Final Report of the Security and Exchange Commission’s (the SEC’s) Advisory Committee on Improvements to Financial Reporting (the CIFIIR, 2008). More generally, the SEC’s CIFIIR defines complexity as the state when it is difficult for users, preparers, and other constituents to understand and apply financial reporting principles (DP, para. BD13).

³ Specifically, we address questions 1-6 and 8-10.

provide insights from an academic research perspective on questions raised in the DP. Our comments are loosely arranged in order of the questions posed in the DP.

SUMMARY

In general, the Committee agrees with the fundamental premise of the DP; that is, the primary causes of complexity of reported financial instruments are the set of non-comparable measurement bases and inconsistent reporting alternatives available under IAS 39. In addition, the Committee agrees with the long-term solution proposed in Section 3 of the DP. However, we have reservations regarding the suggested intermediate approaches. In summary, we note that:

- Current international (and United States) accounting standards include a set of inconsistent measurement attributes and nonsubstantive classification rules that appear to increase the information processing difficulties faced by preparers, their auditors, and users of the financial statements.
- Intermediate solutions, or another incremental revision of current standards, should not be undertaken. A piecemeal or intermediate approach to revising IAS 39 can lead to politically motivated exceptions that inevitably lead to further complexity. Further, an intermediate approach may be inconsistent with individual countries' accounting-standards convergence and/or IFRS-transition plans currently adopted by national regulators.
- All financial instruments should be reported at fair value and the unrealized gains and losses should be reported in income.
- Hedge accounting is simplified if all recognized financial instruments are reported at fair value. Under a single, fair-value measurement basis, fair-value-hedge accounting is

generally no longer necessary. Consistent with the recommendations of the FASC (AAA 2002a), a majority of Committee members agree that hedge accounting should be retained for forecasted transactions (i.e., similar to cash-flow-hedge accounting permitted in IAS 39).

- Any intermediate approaches should include fewer restrictions on qualifying for hedge accounting (e.g., fair value option with enhanced disclosure of reasons for exercising the option).

The Committee also has two primary concerns with the DP's focus on "complexity." First, reducing avoidable complexity in the reporting of financial instruments is a desirable outcome, but it should not be elevated to the status of a primary goal. As we stated in our letter dated September 5, 2008 (in response to the IASB Discussion Paper: *Financial Instruments with Characteristics of Equity*), while "we concur that simplicity is desirable, *ceteris paribus*, we view realized levels of transactional or reporting complexity as a financial reporting constraint, not an objective." Consistent with that message, the Committee suggests that the focus of any standard-setting activity should be promulgating accounting principles that are congruent with the extant Framework (IASB 1989). Thus, a focus on the conceptual definitions of the financial statement elements and on the qualitative characteristics of relevance, reliability, consistency and comparability is of paramount importance.

Our second concern with the complexity-oriented focus of the DP is that psychology-based research suggests that complexity is not a universal construct that applies across settings and individuals. Instead, it is based on task complexity, which is specific to the individual and the setting (AAA 2008, 6). Therefore, information that is complex to one individual may not be complex to another. Consequently, efforts to exogenously change existing accounting standards

(even in an effort to arrive at a more conceptually consistent accounting standard) may increase or decrease complexity depending on the circumstances (cf., Nelson 2003). Accounting research also indicates that effect of eliminating choices in reporting or measurement is *ex ante* uncertain (AAA 2008). Thus, a focus on complexity may not yield better accounting standards.

I. MEASUREMENT PROBLEMS

Accounting standards include an inconsistent set of measurement principles that create comprehension and processing difficulties for preparers, their auditors, and users of the financial statements. The IASB has acknowledged the need to improve the reporting of financial instruments and to reduce the complexity of that reporting. Although IAS 39 has been amended several times for various reasons, preparers, their auditors, and users still find the standard to be complex.

The alternative ways of measuring and reporting similar financial instruments is considered a primary source of complexity in IAS 39. In existing financial reporting standards, the measurement/reporting method largely depends on the intent-based categorization of the financial instrument and whether a form of hedge accounting has been applied. Specifically, IAS 39 includes four basic classifications that are used to measure and report financial assets after initial recognition:

- Fair value through profit and loss (FVTPL)
- Available for sale financial assets (AFS)
- Loans and receivables (LAR)
- Held to maturity (HTM)

When combined with other accounting practices such as interest recognition and recognition of impairments, the variations in measurement and financial-statement-reporting treatment are numerous. The DP acknowledges this point and, in Table 1 of the DP, lists the numerous measurement methods for financial instruments currently permitted or required under IFRS and United States (US) generally accepted accounting principles (GAAP).

According to the Framework (IASB 1989, para. 12-14), the objective of financial reporting is to assist a wide-range of users in making economic decisions and to assess the accountability of management for entrusted resources.⁴ The essential criteria for meeting these objectives are that reported information must be relevant, reliable, understandable and comparable. With the availability of so many measurement and reporting alternatives for financial instruments, the ability of current financial reporting to meet these objectives is restricted. Therefore, the Committee supports the application of a single measurement basis for all financial instruments. Consistent with the conclusions of the AAA FASC (1998, 2000, 2002b, 2005), the Committee agrees that fair value is the measurement basis that results in the highest combination of the Framework's qualitative characteristics.

II. INTERMEDIATE APPROACHES - OVERALL

Given the pervasiveness of conceptually inconsistent accounting included in IAS 39, achieving the long-term goal (i.e., fair value recognition with fair value changes recognized in

⁴ The IASB Exposure Draft issued on May 29, 2008 (i.e., *Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Reporting Information*) proposes a slightly different financial reporting objective. In particular, the proposed objective omits stewardship as an objective, instead stating that (the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers" (IASB 2008, para. OB 2). This proposed revision does not affect the conclusions included in this letter.

operating income) will require significant investment by the Board and its staff. To allow for more-immediate progress in simplification of IAS 39, the IASB proposes alternative intermediate approaches designed to achieve reduced complexity in the short term. These include:

- Amending the measurement requirements; for example, by reducing the number of categories of financial instruments
- Replacing the existing requirements with a fair value measurement principle and some optional exceptions to fair value measurement
- Simplifying the current hedge accounting requirements

If the Board chooses to pursue an intermediate approach, the Committee cautions against viewing expanded disclosure as a means to provide a short-term solution to the current recognition and measurement deficiencies in IAS 39. Two recent papers suggest that a disclosure-based intermediate approach may not help users and other stakeholders better understand a company's risk exposure and its corresponding risk management policy. Ahmed et al. (2006) investigate derivative financial instrument recognition pursuant to SFAS 133 and find that the extent to which information affects stock prices depends on whether the instruments are disclosed or recognized.⁵ In addition, Koonce et al. (2005) find that the labels firms use to describe financial instruments and derivatives cause investors to assess economically equivalent instruments as different in terms of risk. The latter study suggests that investors may also be misled by the *labels* used by firms to report their use of derivative and non-derivative financial instruments. Taken together, these studies indicate that an intermediate approach that relies on

⁵ While Seow and Tam (2002) find that derivative disclosures contain information for returns incremental to market beta and earnings, their study is based on a wholly disclosure-focused accounting standard (i.e., SFAS No. 119 required only expanded disclosure of derivatives, with no changes in recognition or measurement).

disclosures as a substitute for recognition may not improve the usefulness of reported accounting information.

If the Board decides that fair value best satisfies the Framework's qualitative characteristics, then the Committee agrees that the most desirable path is to bypass intermediate approaches and develop a comprehensive and consistent standard that conforms to the prescriptions of the Framework. To do otherwise runs the risk of inserting additional, nonsubstantive (and perhaps unintended) exceptions into IFRS. This type of short-term strategy could also raise concerns among regulators in the jurisdictions currently attempting to converge with, harmonize with, and/or transition to IFRS. For example, the US SEC is currently circulating for comment a proposed roadmap that would lead to all U.S. issuers using IFRS by 2014 (SEC press released 2008-184, dated August 27, 2008). Intermediate approaches that provide alternatives or allow exceptions (and therefore increase complexity in the near term) may impede these efforts if the intermediate approaches result in increased divergence

III. INTERMEDIATE APPROACHES – EXCEPTIONS

Our response to Question 4 is organized around three themes. First, we discuss reporting financial instruments at fair value. Second, we discuss reporting of unrealized gains and losses. Third, we address other related issues.

Recognizing Financial Instruments at Fair Value

Prior research on the fair values of financial instruments jointly tests, usually in a stock-market-based setting, the relevance and reliability of fair value estimates. Much of this research is based on financial information without a single, common fair value definition (i.e., studies are

pre-SFAS 157 in the U.S.). Positive associations between reported or disclosed fair value amounts and share prices indicates that the reported or disclosed fair value estimates are sufficiently relevant and reliable to be detected in stock prices.

In summary, prior research suggests that reported or disclosed fair value estimates for most, but not all, financial instruments appear to be incorporated into share prices.⁶ These reported and disclosed fair value estimates appear to incrementally vary with the levels of stock prices above the level of variation observed for financial instruments reported and disclosed using other measurement bases (e.g., amortized cost). The research in this area is discussed in more detail in the following paragraphs.

Barth (1994) investigates fair value accounting for investment securities. She finds that fair values of investments are correlated with the levels of the investing entities' stock prices and contain less measurement error than other measurement bases (e.g., amortized cost). Khurana and Kim (2003) also find that U.S. banks' investments classified as held-to-maturity and available-for-sale are associated with the banks' stock prices. Petroni and Wahlen (1995) investigate property and casualty insurers and find that only fair values of equity investments and U.S. Treasury investments are value-relevant, while other types of investment securities, such as municipal and corporate bonds, do not explain share prices beyond historical values. These results suggest different types of securities have different levels of reliability.

Barth et al (1996) investigate SFAS 107 fair value disclosures of banks and find that fair values of net loans and long-term debt value relevant, but not bank deposits or off-balance sheet

⁶ The preponderance of the available research (1) involves U.S.-based financial institutions that are traded on U.S. stock exchanges and (2) assumes market efficiency. Necessarily, this may affect how our comments are viewed, as the evidence we discuss may or may not be extrapolated to non-financial institutions or the global market.

financial instruments. Eccher et al. (1996) find similar results. However, Nelson (1996) does not find any association between fair values of net loans, depositions, long-term debt, or off-balance sheet instruments and stock prices. Venkatachalam (1996) followed up these studies by investigating expanded SFAS 119 derivative disclosures made by large banks in 1994. He finds that derivatives used in asset-liability management are value-relevant, but other off-balance sheet financial instruments do not appear to be value relevant. These authors attribute the lack of value relevance for certain financial instruments to a combination of (1) ambiguous fair value disclosures and (2) lack of a properly defined fair value measurement (for example, bank deposits).

Recent research appears to suggest that valuation techniques and the ability to make fair value estimates improved in recent years. In addition, financial statement users appear to be more familiar with fair value disclosures such that more items are now value-relevant. In a more recent sample period, Khurana and Kim (2003) find that investments, loans, deposits, and other financial liabilities are value-relevant (recall that earlier research, such as Nelson (1996), was not able to document many of these associations). Additional analysis indicates fair values are more relevant when the estimates are based on objective market-oriented data. Moreover, in an analysis of closed-end mutual funds, Carroll et al. (2003) find that investments in thinly traded markets are also value-relevant.

Ahmed et al (2006) examine investor valuations of derivative financial instruments. They find that the value relevance depends on whether the derivative financial instruments is disclosed or recognized, with the fair values of recognized derivative financial instruments being value-relevant. Hirst et al. (2004) find similar evidence. In an experiment comparing full fair value income recognition with partial recognition, equity analysts receiving full fair value

information made risk and stock-price estimates that more fully incorporated the underlying riskiness of the net assets held by the analyzed bank.

Taken together, the research suggests that recognition of the fair value of financial instruments is more informative than disclosure. While there is mixed evidence of value relevance when examining individual assets and liabilities, the informativeness appears to be the lowest when the potential for measurement error is the greatest (e.g., due to lack of objective market-based data or adequate valuation models). However, as time progresses, investors increasingly appear to be incorporating fair value information into their investment decisions, and, as noted above, even investments in thinly traded markets have become informative in empirical tests.

Prior research does not, however, provide support for a stock-market-based preference for exceptions to fair value recognition. For example, disclosed fair values for held-to-maturity securities (i.e., investments that are recognized at amortized cost based on management's intent to hold the securities) incrementally explain variation in companies' stock prices above the levels observed for reported amortized cost values. While the amortized cost values may be beneficial as part of a financial instruments disclosure, the Committee could find no evidence that the recognition of amortized cost is preferred by investors to recognition of fair value. In addition, the Committee could find no empirical evidence that investors' judgments were improved via the theoretically unsupportable exceptions included in IAS 39.

Unrealized Gains (Losses)

While the inclusion of unrealized gains and losses in income increases the volatility of net income, the evidence suggests that the increased volatility is more consistent with the economic circumstances faced by companies. For example, Barth et al. (1995) find that changes

in interest rates are associated with changes in bank share prices, suggesting that banks are not fully hedged against interest rate changes and that reporting unrealized gains and losses in income will reveal this risky position to investors. Bernard et al. (1995) find that unhedged positions are the source of fair value earnings volatility for a sample of Danish banks. Carroll et al. (2003) investigate investments for a sample of closed-end mutual funds and find that the association between stock returns and income improves if the unrealized gains and losses are included in income. Owusu-Ansah and Yeoh (2003) show that the relative value relevance for unrealized gains and losses for real estate recognized in the income statement are no different from using a revaluation reserve.

Another benefit of including fair value gains and losses in reported income is that it curtails the potential for recycling prior years' gains and losses from other comprehensive income (OCI) into current period reported earnings (e.g., gains-trading). Hirst and Hopkins (1998) use this setting to investigate whether reporting unrealized gains and losses associated with available-for-sale securities affects buy-side financial analysts. They find that the professional investors often failed to acquire and use unrealized gain and loss information when it is reported in stockholders' equity, but were better able to use the information when it was presented in a single performance statement. Maines and McDaniel (2000) find similar evidence using nonprofessional investors.

More recently, Hodder et al. (2006) investigate the risk relevance of three income measures (i.e., including constructed full-fair-value income, reported comprehensive income, and reported net income) for a sample of U.S. banks. As expected, they find that the volatility of a constructed (i.e., "as if") measure of full fair value income is priced as risk to a much greater extent than a reported (and audited) income measure that includes amortized cost-based interest

income. In addition, they find that this incremental volatility is associated with volatility of stock returns, interest rate sensitivity of stock returns, and market beta. They conclude that volatility of fair value income is more consistent with capital-market pricing of that risk.

Finally, Chambers et al. (2007) provide evidence that recognized OCI (as compared to the volatility of the historical OCI series) is priced by investors. They also show that the pricing is conditional on the type of financial statement in which OCI is recognized. In particular, investors pay greater attention to OCI information reported in statement of changes in equity rather than statement of financial performance, perhaps because investors are used to finding the information in that statement.

Combined, the majority of evidence suggests that the information will be less useful to investors if unrealized gains and losses are reported in comprehensive income. While greater income volatility will result from reporting the unrealized gains and losses in income, the resulting volatility appears to be representative of the firm's underlying economics. The Committee therefore supports recognizing in reported net income the unrealized gains and losses attributed to changes in fair values of financial instruments.⁷

Other Issues

The Committee notes that recognition of all financial instruments at fair value on the balance sheet and the resulting unrealized fair value changes in reported income (as discussed in the preceding paragraphs) will largely mitigate the need to separately recognize impairment losses on financial instruments. In addition, eliminating the separate classifications of financial

⁷ Previous FASC commentaries have also consistently recommended that unrealized gains and losses attributed to changes in fair values of financial instruments be reported in income (for example, see FASC 1998, 2000).

instruments (and measurement bases) will mitigate the need for accounting guidance related to reclassifications, including recycling, among categories.

IV. INTERMEDIATE APPROACHES – HEDGE ACCOUNTING

In this section, the Committee responds to the questions on the intermediate approaches concerning hedge accounting (questions 5 and 6).

Eliminate Hedge Accounting (Question 5a)

As already stated, the Committee believes the empirical evidence supports fair value recognition of all financial instruments and net income recognition of the unrealized gains and losses on those instruments. In this basic situation, if a financial instrument is obtained as an effective hedge and if the hedged item is also a recognized financial instrument, then conceptually, there is no longer a need for hedge accounting. In contrast, if the hedged item is a non-financial instrument or a transaction that is not recognized in the financial statements at the time of the hedge, then hedge accounting might be necessary to provide a smooth pattern of offsetting gains and losses. As noted by the FASC (AAA 2002a), prior research suggests that volatility is an important firm characteristic that is assessed in both the equity and debt markets.

As discussed above, Barth et al. (1995) conclude that the association between interest rates and changes in bank share prices suggests that banks are not fully hedged against interest rate changes and reporting unrealized gains and losses in income will highlight this for investors. Bernard et al. (1995) find that unhedged positions are the source of fair value earnings volatility for a sample of Danish banks. While the inclusion of unrealized gains and losses in income increases the volatility of net income, the evidence suggests that the increased volatility is more

consistent with the economic circumstances (e.g., Hodder et al. (2006) show that fair value volatility is priced as risk).

Hedge accounting in a forecasted transaction defers recognition of the unrealized gains or losses on the hedging instrument (through other comprehensive income) until the income or cash flow effects of the hedged exposure are recognized. The Committee acknowledges that hedge accounting is purportedly necessary for the financial reports to reflect volatility consistent with managers' beliefs about the economic income of the company. However, the IASB should be concerned about whether the financial statements reflect actual earnings volatility or accounting-driven volatility.

Replace Fair Value Hedge Accounting (Question 5b)

If all financial instruments are recognized at fair value with unrealized gains and losses reported in income as suggested above, the Committee believes there is no longer a need for fair value hedge accounting when the hedged item is a financial instrument. As such, the use of a fair value option (similar to SFAS 159) is also not necessary.

Existing Hedge Accounting Models (Question 6)

Academic research is somewhat limited in documenting the merits of the existing hedge accounting models. Three papers shed some light on the issues. Gebhardt et al (2004) use a simulation model to evaluate three sets of hedge accounting rules: old IAS, current IAS / US GAAP, and a full fair value model. They run simulation models for a fully hedged and partially hedged universal bank. Gebhardt et al. (2004) show that the discretion allowed under old IAS provides banks with flexibility in the amount of income to report. The restrictive hedge

accounting rules under current IAS or US GAAP limit the ability of banks to accurately portray their risk management activities. However, under the full fair value model, accounting should properly reflect the underlying economic activity of the bank.

Nan (2007) analytically investigates the early recognition policy related to unqualified hedges. While FASB's objective was to restrain speculation, Nan shows that this policy may actually motivate speculation. As such, the early recognition policy appears to influence firms to not use derivatives for hedging purposes. In a second analytic study, Nan (2008) uses an agency model to study the interaction between hedging and earnings management. While Nan assumes the two are strategic substitutes, hedging may be more costly to the principal than earnings management in alleviating the agency problem when the decision to hedge is not contractible.

Combined, the current hedge accounting restrictions on when hedge accounting can be used appear to be problematic and any simplification proposed by the IASB should limit the number of restrictions.

V. LONG-TERM SOLUTION

In addition to intermediate approaches, the DP seeks comments on a long-term solution for reducing complexity in reporting of financial instruments. Our response addresses measurement related issues (question 8), fair value as the single measurement attribute (question 9), and other possible concerns the IASB should consider (question 10).

Measurement-related Problems (Question 8)

As discussed in our response regarding intermediate approaches above, Barth (1994) Petroni and Wahlen (1995), and Khurana and Kim (2003) investigate fair value accounting for

investment securities. Combined, they find that fair values of investments are value-relevant and contain less measurement error than amounts reported using other measurement bases. However, the results suggest differing levels of reliability for different types of securities.

SFAS 107 disclosures of fair values of financial instruments were also investigated by Barth et al (1996), Eccher et al. (1996), and Khurana and Kim (2003). Venkatachalam (1996) investigated SFAS 119 disclosures of fair values of derivatives. Most, but not all, financial instruments were found to have reported or disclosed fair value information that predictably varied with the stock prices of the companies holding the financial instruments. The absence of predicted fair-value-to-stock-price correlation for certain financial instruments in these studies is attributed to a combination of ambiguous fair value disclosures or lack of a properly defined fair value measurement (e.g., bank deposits). Additional analyses indicate fair values are more relevant when the estimates are based on objective market-oriented data.

Most of the fair value estimates included in prior studies were obtained from disclosures rather than recognized amounts. In a comparison of recognized and disclosed amounts, Ahmed et al (2006) investigate investor valuations of both recognized and disclosed derivative financial instruments. They find that fair values of recognized derivative financial instruments are value-relevant, but disclosed amounts are not. In an experimental research setting that compares recognition of full fair value income with partial recognition, Hirst et al. (2004) find similar evidence. Their evidence suggests that equity analysts' stock price and risk judgments better reflect the economics of the entity under full fair value recognition.

Combined, the fair values of a majority of financial instruments are value-relevant and recognition of the fair values appears to be more informative to investors than disclosure. However, evidence also indicates that fair values for certain financial instruments classifications

are not value-relevant. The lack of value relevance is attributed to lower reliability from the measurement process (for example, relying on management assumptions rather than market-oriented data).

Fair Value as the only Measurement Attribute (Question 9)

The DP concludes that the long-term solution is a single measurement principle for all financial instruments within the scope of a single standard. This would not only make reported information easier to understand, but also increase comparability. As such, the DP explains why “fair value seems to be the only measurement attribute that provides relevant information for all types of financial instruments,” and that its use could either reduce or eliminate some of the existing complexity related to measurement. However, it is clear that a single measurement approach would not resolve all the current issues, and a number of concerns must be addressed before a general fair value measurement requirement could be introduced.

The DP acknowledges that these would include:

- Volatility of earnings as a result of fair value changes, which are essentially beyond the control of management.
- Questionable relevance from presenting unrealized gains and losses in profit and loss and specific concerns over the counterintuitive nature of reporting unrealized gains on own obligations when an entity’s financial position worsens.
- Difficulty and uncertainty in estimating fair values of financial instruments when no market-based inputs are available.

Notwithstanding these concerns, the Committee believes the fair value measurement approach is supported by extant research (see our responses related to Questions 4 and 8 above) and holds many advantages. The first advantage is conceptual consistency. The Framework

provides no support for measuring financial instruments at the many measurement bases currently allowed in IFRS. Schipper (2003) notes that to the extent that alternatives, as would be the case with mixed-attribute measurement model, cause similar items to receive different accounting treatment, comparability is lost. Comparability is enhanced with a full fair value measurement model for financial instruments.

The second advantage is enhanced relevance for reported financial statement information. Fair value measurement and presentation of an entity's assets and liabilities result in financial statement information that is immediately useful, without requiring the reader of the financial statements to make complex adjustments in analyzing the entity. Finally, financial strength, liquidity and cash flow become more easily assessed on a current value basis. We believe the research supports the value relevance of fair value measurement per previous discussion.

Other Concerns (Question 10)

An issue the IASB should consider is the valuation of illiquid financial instruments. In addressing this issue, all will benefit from clear articulation of acceptable methods to consistently measure such instruments and the conditions under which an entity should recognize profits or losses from these instruments. The Committee does not support separate recognition criteria for such instruments; however, the fundamental measurement issues related to these instruments should be considered. Included in this consideration are questions of whether, when and how to adjust values for changes in market liquidity and price volatility. While this may be beyond the specifics of the DP, it is an important issue that should be resolved in conjunction with reporting of financial instruments.

CONCLUSION

In summary, the Committee agrees with the IASB's suggestion that current international (and United States) accounting standards include a set of inconsistent measurement attributes and nonsubstantive classification rules that appear to increase the information processing difficulties faced by preparers, their auditors, and users of the financial statements. The Committee agrees that all financial instruments should be reported at fair value and the unrealized gains and losses should be reported in income. The Committee cautions against pursuing another incremental revision of current standards because a piecemeal or intermediate approach to revising IAS 39 can lead to politically motivated exceptions that inevitably lead away from the ultimate objective of fair value reporting. Finally, the Committee is concerned with the DP's focus on "complexity," *per se*. The Committee notes that reducing avoidable complexity in the reporting of financial instruments is a desirable outcome, but it should not be elevated to the status of a primary goal.

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