

**ADVISORY COMMITTEE
ON IMPROVEMENTS TO
FINANCIAL REPORTING**

DRAFT DECISION MEMO

January 11, 2008

CHAPTER 2: SUBSTANTIVE COMPLEXITY

I. Scope

This chapter of the Draft Decision Memo focuses on avoidable substantive complexity that currently exists in GAAP. Subsequent chapters address financial reporting improvements through changes in the standard-setting, audit, regulatory, and information delivery processes.

The Committee has identified the following manifestations of avoidable substantive complexity:

- Exceptions to general principles in the form of:
 - Industry-specific guidance
 - Alternative accounting policies
 - Scope exceptions other than industry-specific guidance
 - Competing models
- Bright lines
- Mixed attribute model and the appropriate use of fair value

Exceptions to general principles create complexity because they deviate from established standards that were developed in due process. In effect, users and preparers no longer speak a uniform language to communicate financial information; they must learn new dialects. Other constituents in that communication process are similarly impacted.

Bright lines are problematic because they create superficial borders along a continuous spectrum of transactions. However, the more fundamental issue is the fact that financial reporting standards require drastically different accounting treatments on either side of a bright line.

The mixed attribute model results in amounts that are a blend of accounting conventions. Some assets and liabilities are measured at historic cost, others at lower of cost or market, and still others at fair value. Combinations or subtotals of these numbers thus may not be intuitively useful to users. While some advocate using fair value for the entire balance sheet as a solution, there are difficult questions about relevance and reliability with which to contend, including considerable subjectivity in the valuation of thinly-traded assets and liabilities.

The remainder of this chapter discusses each of these areas and the manner in which they contribute to complexity in greater depth. It also contains developed proposals or conceptual approaches to reduce their effects. The sequence in which these areas are presented does not necessarily indicate their relative priority to one another. Rather, certain areas warrant additional research and deliberation before reasonable proposals can be fully developed, such as the mixed attribute model and more meaningful grouping of

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