COMPLEXITY IN CORPORATE FINANCIAL REPORTING: RECOMMENDATIONS FOR IMPROVEMENT

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ABSTRACT
Despite the improvements in financial reporting stemming from Sarbanes-Oxley, the US financial reporting system continues facing a number of difficult challenges. Conceivably, most significant and urgent is the need to reduce complexity and improve the transparency as well as increase usefulness of reported financial information to constituents. This paper examines the Final report of the Advisory Report of the Advisory Committee on Improvements to Financial Reporting that offers a number of recommendations to progressively redress accounting standards in major areas for which the existing complex systems of standards, rules, and regulations that fail to provide relevant and transparent financial information. This complex system echoes the complexities inherent in reporting on progressively more varied and complicated business transactions and arrangements. Furthermore, this complexity has been mounting for many years as a result of different structural, institutional, cultural, behavioral, and political forces in the financial reporting system. It is believed that these recommendations, if implemented, would achieve dramatic improvements to the current financial reporting system. The paper concentrates on the sources that create substantive complexity and provides an analytical insight of the recommendations. This paper also provides implications for accounting educators as well as practicing professionals.

INTRODUCTION

The impact of market financial innovation and regulation: Financial innovation is fundamentally market driven and generally more complex and less understood at inception. In conjunction with it the corporate financial reporting is becoming as complex as the US tax system. In general, complexity may effectively impede communication through the feed of financial information between a company and its stakeholders by creating inefficiencies in the marketplace (e.g., increased investor, preparer, audit, and regulatory costs) and producing suboptimal allocation of capital. Over the past two decades, the US experienced several major financial crises. These include the S&L crisis, the reporting scandals, the dot.com bubble, and more recently the ongoing global problems in the credit and financial markets. [1]

Formulating a proper regulatory response to financial innovations is a challenging task for the standard setters (SEC, FASB, AICPA, EITF, ISAB and others). Many have argued that the US should strive to implement a regulatory regime that is principles-based, risk-focused, and consistently applied that can provide needed transparency and safe haven from legal and regulatory risks. Rules should implement principles rather than develop in an ad hoc manner and

financial globalization and financial innovations are closely tied, thus global regulatory collaboration and coordination are now more vital than ever.[2]

The issue of complexity is one of the most important aspects in financial reporting, and financial instruments are among the most complex on which to report clearly. For example, the concept of fair value, which was intended to help bring transparency, was scorned by some as a "villain", exacerbating the current turmoil, and heralded by others as a savior in revealing the problems on a timely basis. Financial market consequences are of particular relevance to accounting regulators; many empirical studies have investigated the market's response to the deliberations surrounding and enactments of specific kinds of regulation and to the information content of data that companies were to disclose as a result of enacted regulation.[3] Given the complexities of pronouncements by accounting standard-setters, research on the consequences of regulation is expected to be long-drawn-out. While the proposed recommendations will remain relevant in both international and US financial reporting, the point of views here will primarily be conducted in the context of current US environment. [4]The remaining parts of this paper start with evaluation of SEC proposed recommendations that have attracted relatively concerted attention and challenges. The paper will briefly discuss each area, followed by a detailed discussion of complexities pertaining to area three; that is the substantive complexity and articulation of new standards. Significant implications for accounting education and professionals are present last.

PROPOSED REGULATIONS

The need for new regulations: Complexity represents one but a major strand in a web of interrelated factors and propositions influencing financial reporting in a dynamic global market. Nevertheless, it has been singled out as a factor affecting relevance and compliance and a study of its effect thereon can be viewed as one step in an ongoing program of rulemaking process. Some users and prepares of financial information argue that, over time, financial reporting has become a burdensome compliance exercise with decreasing relevance to investors. This effect can be attributed, in part, to: (1) the evolution of new business strategies and financing techniques that stretch the limits of what the traditional reporting framework can effectively convey, and (2) an overly controversial traditions that, arguably, results in financial reporting designed as much to protect against legal responsibility as to inform investors. As financial reporting has become more and more complex, many investors have expressed concerns that it is often difficult to understand the financial reports of companies in which they invest. Likewise, on the preparers' and auditors' side, companies have expressed concerns that it is difficult to ensure compliance with U.S. GAAP and SEC reporting rules when preparing financial reports. In June of 2007, the Chairman of the SEC announced the creation of the SEC Advisory Committee on Improvements to Financial Reporting (better known by its acronym, CIFiR) that consist of members representing investors and other key constituencies in America's capital markets.

In August of 2008, the chairman of CIFiR presented the final report containing recommendations that can be implemented by the SEC, the Financial Accounting Standards Board (FASB), and the Public Company Accounting Oversight Board (PCAOB).

The CIFiR recommendations: The CIFiR's dual mandate was to reduce unnecessary complexity in the U.S. financial reporting system and make financial reports clearer and more understandable to investors. CIFiR's final report provided key recommendations to improve financial reporting in following five general areas:[5]

1. Increasing the usefulness of information in SEC filings
2. Enhancing the accounting standards-setting process
3. Improving the substantive design of new standards
4. Delineating authoritative interpretive guidance
5. Clarifying guidance on financial restatements and accounting judgments

As this paper discusses a summary of all areas, it will entail much more forethought and analysis of area three that deals with substantive complexity and articulation of new improvement. With regard to the first area, the CIFiR noted that many individual investors find company filings with the SEC to be overly complex and detailed; hence it has recommended that the inclusion of a short executive summary at the beginning of a company's annual report would describe concisely the main aspects of its business and its key performance metrics or indicators (KPI). Proper performance of the KPI will highlight whether a company is achieving its strategic objectives. They measure not only financial outcomes, but also drivers of performance related to customers, people and innovation. CIFiR encourages the development of the KPIs by the private sector to on an activity and industry basis as appropriate.

In area two, the CIFiR believes that the financial reporting system would be best served by recognizing the pre-eminence of the perspective of investors as they are the primary users of financial reports. The CIFiR called for more investor participation in accounting standard setting by increasing investor representation on the FASB and Financial Accounting Foundation (FAF). To be responsive to the ever-changing financial landscape, the CIFiR also called for the creation of a Financial Reporting Forum (FRF), on which key public and private parties would be represented.

To reduce the proliferation of U.S. GAAP, the CIFiR strongly supports FASB's efforts to complete the codification of all authoritative accounting literature into one document. In this fourth area, the CIFiR believe that there should be a single standards-setter for all authoritative accounting standards and interpretive implementation guidance of general significance. The FASB should perform this function for U.S. GAAP, while the SEC should focus on registrant-specific guidance issues.

With respect to area five, the preparation and audit of financial statements have always required the exercise of judgment. For example, the more frequent use of fair value involves estimates of value that may be less objectively determined than historical cost measures. Similarly, the revised auditing standard applicable to audits of internal control over financial reporting emphasizes the need for professional judgment in taking a risk-based approach to performing internal control audits[6]. Notably, international accounting standards generally contain less regulatory guidance and more reliance on general principles than U.S. GAAP. In recognition of the increasing exercise of accounting and audit judgments, the CIFiR recommends that the SEC and PCAOB adopt policy statements on this subject, adding that this policy statements would not only provide more transparency into how the SEC and the PCAOB evaluate the reasonableness of a judgment, but also encourage preparers and auditors to follow a disciplined process in making judgments. Many issues in the above areas interrelated and are discussed further below.

FINANCIAL REPORTING COMPLEXITY AND ITS EFFECT ON OF FINANCIAL INFORMATION

Financial reporting complexity: The CIFiR defines complexity as the difficulty for all stakeholders; investors [7]to understand the economic substance of a transaction or event and the overall financial position and results of a company, preparers to properly apply U.S. GAAP and communicate the economic substance of a transaction or event and the overall financial position and results of a company, and other constituents that audit, analyze, and regulate a company's financial reporting.[8]

Substantial complexities can come from the intricacies of certain transactions and/or by the events themselves. By their very nature the accounting treatment for such transactions is complicated and hence beyond the boundaries of the regulators. Therefore from the outset it is imperative to acknowledge and distinguish between two types of complexity in financial reporting: (1) that which is inescapable, due to the inherent complexity of transactions (e.g., derivative; futures, forwards, options and swaps), and (2) that which could be avoidable, having

been brought about by accounting standards themselves. The issue of products complexity including embedded multifaceted elements, which have to be split out from the underlying contract and accounted for accordingly, is not confined to derivative financial instruments, as the host contract might be a lease or a sale or purchase contract. [9] Certainly multiple-element product and service agreements, increasingly used in business transactions can also be challenging to interpret from an accounting perspective.

Unnecessary accounting complexity: A major focus of CIFiR final report is on avoidable complexities which are currently embedded in GAAP. With aforementioned inherent complexities in mind, it is vital that regulators take every opportunity to reduce any complexity that is solely a result of the financial reporting system. [10] A informal review of an audited financial statements may create a perception that amounts reported are predetermined and defined while they could reflect a great deal of estimation, choice, and judgment. Consistency of information across entities or time periods enhances its comparability, which improves its decision usefulness. Consummately, GAAP is expected to provide clear and consistent guidance for preparing financial statements, but this may not always be true, and that may hinder effective comparison of financial performance between companies. Consider the following scenario, a large company that purchases a smaller company to the purpose of acquiring its newly-developed intangible asset (a promising new product). The large company would value the patent and record it as an asset under GAAP. On the other hand, if the smaller company is not purchased, but continues to develop the product on its own, it would be constrained by GAAP from recording an asset to reflect the patent on its balance sheet. Regardless of how comparable information may be, it will not be useful if it is irrelevant to users' decisions or does not faithfully represent the economic phenomena it purports to represent. This example is just one depiction of the avoidable complexity currently embedded in GAAP. The CIFiR final report suggests that financial reporting complexities experienced by the constituent groups (investors, prepares, and auditors) are largely caused by "avoidable" factors, like incomparable and inconsistent accounting reports, overly long, inconsistent, poorly written and voluminous accounting standards, audit and regulatory systems that deliver information that is not useful to investors, antiquated initial and continuing education of accountants, and the fact that accounting reports provide investors with surplus of less useful information.

THE FOUR MOST CRITICAL CAUSES OF AVOIDABLE COMPLEXITY

The CIFiR identifies the following as the most pressing sources of substantive financial reporting complexity:

(1) The mixed attribute model that blends the use of fair value and historical cost.
(2) The lack of a holistic approach to disclosures.
(3) Certain bright lines.
(4) Exceptions to general principles.

This paper will detail the CIFiR list of recommendations pertaining to these four challenges; analysis and critique of them are presented next. [11]

1. The mixed attribute model: In this model the carrying amounts of some assets and liabilities are measured at historic cost, at lower of cost or market, or at fair value. Historic cost, amortized cost, and fair value measurements are all subject to reliability concerns. Under historic and amortized cost accounting, the need to determine whether assets are impaired illustrates these concerns, as do decisions about the way certain costs should be allocated across quarterly and annual periods. However, in the absence of quoted prices, the implementation of fair value can be complicated. [12]Complexity arising from the mixed attribute model is compounded by requirements to record some adjustments in earnings, while others are recorded in equity (i.e., comprehensive income). Earnings volatility resulting from the use of credit derivatives is manifested in recent market experience. Under GAAP, credit derivatives are measured at fair value and in general are required to be recognized as an asset or liability. The gain or loss

resulting from the change in fair value must be recorded in earnings. Assuming the hedge is effective most credit derivatives do not qualify for hedge treatment that could allow its gain or loss be reported in the same period as the gain or loss on the position being hedge; hence, using credit derivatives can produce enormous earnings volatility.

Consider, for example, a credit derivative that hedges credit risk of a loan, as the loan's credit quality deteriorates, the value of the credit derivative improves. Since the loan is recorded at historical cost, and the credit derivative is marked to fair value, a gain from the change in value of the derivative is recognized in earnings. Conversely, if the loan's credit quality improves, the value of the credit derivative declines, resulting in a reported loss. These gains and losses may be offset by the level of provisions that are established for estimated credit losses on the loan, but this would likely result in only a partial offset. Is the answer to this volatility issue is fair value accounting? If the hedged asset were measured at fair value, the changes in values of the hedged item and the credit derivative may offset each other, reducing the volatility that arises when only the derivative is marked to market and not the hedged item. Of course, the degree of the earnings volatility under a full fair value accounting approach would depend on the effectiveness of the hedge. FASB developed SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities that permits the fair valuation of certain assets and liabilities. Using this option, companies are permitted to apply fair value accounting to certain financial instruments that they designate at the time of purchase or origination. Accordingly, firms using the fair value option could mark to market both the credit derivative and the hedged position and report changes in their fair values in current earnings. As a result, some assets and liabilities are measured at fair value, while others are measured at amortized cost or some other basis. SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, requires certain investments to be recognized at fair value and others at amortized cost. The CIFiR still advises that fair value should not be the only measurement attribute and a judicious approach to expanding the full use of it delayed until a systematic measurement framework is developed.

2. The lack of a holistic approach to disclosures: In restoring public confidence, Congress passed the Sarbanes-Oxley Act of 2002 and the SEC promulgated numerous new regulations designed to improve corporate governance, enhance auditor independence, and elicit more meaningful corporate disclosure. Regulators continue to focus on ensuring compliance with GAAP, its technical standards and the disclosure rules, but they should also examine the actual requirements of the standards and rules themselves. FASB and GAAP, our current prescriptive accounting rules, have contributed to a lack of transparency in financial reporting, thus, it appears that reducing accounting complexity and migrating to a more principles-based accounting system would encourage more accurate and complete financial disclosure. Therefore, regulators should consider how accounting standards and disclosure rules can be re-designed to elicit information that is complete, clear and concise, and thus, more useful to users. [13]

The ultimate purpose of disclosure requirements is to elicit full and accurate disclosure of material information. Information is material where there is a substantial possibility that a reasonable person would consider it important in the total mix of available information to formulating an investment decision. The current questions about the ability of our accounting and reporting framework to communicate meaningful information to investors arise, in part, because the economy continues to evolve at a rapid pace, while reporting standards and mechanisms are in a "catch-up" mode. Globalization and the emergence of new economies and capital markets have increased dramatically. Advances in technology, including the emergence of the Internet, faster and more ubiquitous communication and other technological developments, have changed the way companies do business, as well as changing the types of financial arrangements and instruments that businesses utilize. As the business world has become more complex, so have financial reports and accounting standards. Thus regulators need to analyze and empirically test whether disclosure can actually reduce cost of equity capital by mitigating investors' uncertainty,

improved market liquidity and at the same time reduced litigation costs and maintain direct costs and proprietary competitive advantage of the company.

3. Bright lines: In general, bright lines refer to quantified thresholds and pass/fail tests. Bright lines may be justified in some parts of GAAP, but not in others. Purposely, bright lines should be minimized in recognition guidance, but may serve an important role in the areas of measurement and presentation of items on the financial statements.[14]

Under current GAAP requirements, bright lines example is evident in the application of SFAS No. 13, *Accounting for Leases*. It requires, among other criteria that leases be classified as capital leases and recognized on the lessee's balance sheet where: (1) the lease term is greater than or equal to 75% of the estimated economic life of the leased property or (2) the present value at the beginning of the lease term of the minimum lease payments equals or exceeds 90% of the fair value of the leased property. A simple 1% difference in the test results in two significantly different recognitions on the company's balance sheet: (1) reflect an asset and a liability on its balance sheet, as if it owns the leased asset, or (2) reflect nothing on its balance sheet (an operating lease).

One could define bright-line standards as one end of a continuum representing hard information, while soft information refers to the other end of this continuum. Bright-line standards are always understood the same way by prepares, auditors, and investors. For example, when long-term investments account is shown at historical cost, there is relatively little room for disagreement about what the amount represents. If the same is measured on the basis of fair value or replacement cost, the reported amount might not produce the same agreement (especially when exit price is not market determined). Numerous judgments would be implicit in the calculation, and footnote disclosure about the company's accounting policies might not eliminate the ambiguity. This is an example of soft information. Hard information describes communication or reports that have the same meaning for everyone, while soft information may have different meanings for different people. As it relates to bright-line, when the auditor's level of expertise is exogenous, the value of the basic auditing increases under bright-line standards relative to soft standards. For the auditor with financial reporting expertise, the value of this expertise relative to the auditor's basic verification role decreases under bright-line standards.

The extent of bright-line reporting varies by industry as well. Some industries are characterized by the existence of significant intangibles (soft assets) and contingent liabilities. For example, high-tech and pharmaceutical companies face substantial impairment and litigation risks in connection with their products, and many face large environmental liabilities. The audit of these companies requires expert judgment regarding the valuation of contingent liabilities. Similarly, the financial credit crisis arose primarily from the emergence of significant valuation issues caused by changing real estate prices, deregulation, and some unregulated markets. Hence, the circumstances that led to this crisis also created a demand for the auditor's interpretation role in an industry in which auditors were accustomed to providing verification services. Some auditors appear to have been caught unprepared by this shift in required expertise.

In 2003, FASB issued FIN 46R *Consolidation of Variable Interest Entities*, which corrected many of the financial reporting inconsistencies generated by patchwork guidance on consolidation that evolved during the 1990s. Duchac (2004)[15] argues that bright line tests have overshadowed professional judgment resulting in decisions that were consistent with established rules, but inconsistent with policy goal of providing the most useful financial information. Thus, bright-line standards may not only have added layers of complexity to the existing rule structure of GAAP but also squeezed judgment out of the financial reporting system, weakening the accounting profession's ability to apply sound professional judgment.

The CIFiR recommends that bright lines should be minimized in favor of "proportionate recognition" in contrast to the current all-or-nothing recognition approach in GAAP.[16] If proportionate recognition is not feasible or applicable, a secondary approach is recommended that is based on qualitative factors, supported by presumptions, as necessary. Enhanced disclosure

should supplement both approaches, and there may be some cases where disclosure is the only effective method of reporting information to investors.

4. Exceptions to general principles: Collectively, these exceptions create additional complexity because they deviate from established standards that are applicable to most companies. This multiplicity of application requires all constituents (prepares, auditors and investors) to understand varied implementation methods, even though they are derived from the same fundamental principles. The final report of CIFiR has identified four types of exceptions that contribute to this added complexity:

A. Industry-Specific Guidance and Exceptions: The increase of specialized industry standards causes two problems that can thwart the efforts to issue subsequent standards using a more principle-based objective. First, the existence of specialized industry practices makes it more difficult for standard setters to eliminate scope exceptions in subsequent standards (e.g., many standards contain exceptions for insurance arrangements subject to specialized industry accounting). Second, the specialized standards may create conflicting GAAP, which makes it more difficult for accounting professionals to determine the appropriate accounting.

Industry-specific guidance and exceptions include (1) exceptions to general accounting standards for certain industries (2) industry-specific guidance created in the absence of a single underlying standard or principle, and (3) industry practices not specifically addressed or based in U.S. GAAP. [17]

For example, revenue recognition of upfront fees for gym memberships are not given equal treatment as initial hookup activities that cover cable television companies. SFAS No. 51 requires that initial hookup revenue (a type of nonrefundable upfront fee) is recorded to the extent of direct selling costs incurred; the remainder is deferred and recorded in income over the estimated average period that subscribers are expected to stay connected to the system. However, generalized guidance indicates this practice is inappropriate unless it is specifically prescribed elsewhere (e.g., SFAS No. 51).Therefore, similar activities like upfront fees are not afforded equal treatment. CIFiR believe that industry-specific guidance should be eliminated to reduce avoidable complexity.

B. Optionality in GAAP: Alternative accounting policies or accounting choice in GAAP is broad and includes issues of implementation, timing, display, transaction structuring, production decisions, investment decisions, and the level of disclosure, among others (Francis, 2001). Examples are including but not limited to: the indirect versus the direct method of presenting operating cash flows on the statement of cash flows, the application of hedge accounting, the option to measure certain financial assets and liabilities at fair value, the successful efforts or full cost accounting method followed by oil and gas producers. Alternative accounting policies contribute to avoidable complexity by making financial reports less comparable. This is evident across companies when identical activities are accounted for differently. The view of CIFiR is that alternative accounting policies should be eliminated, except when: (1) multiple accounting alternatives exist that are consistent with the conceptual framework, and none portray economic substance more accurately than others, or (2) an alternative can be developed more quickly than a final "perfect" standard to minimize the effect of other unacceptable practices. If one or both of the justifications above apply, the CIFiR believes that the provision of alternative accounting principles should be coupled with a long-term plan by the FASB to eliminate the alternatives through the use of sunset provisions. One of the key considerations in the decision to eliminate GAAP alternatives should be the cost-benefit trade-offs from such an action and academic researchers have provided little evidence as to the cost-benefit trade-offs from accounting choice. There is more evidence supporting the benefits of accounting choice[18] than there is evidence as to its costs, although there has been little effective analysis of the magnitude of the trade-offs. One of the main reasons for this lack of evidence is that it is difficult, if not impossible, to rank order accounting choices on any salient dimension.

C. Scope exceptions: The CIFiR lists exceptions to general principles as a pressing form of avoidable substantive complexity in financial reporting. The exceptions represent departures from the application of a principle to certain transactions. For example, SFAS No. 157 *Fair Value Measurements* scopes out of its definition of fair value guidance related to pronouncements that address *Share-Based Payment* transactions (FASB Statement No. 123R, 2004), and FASB Statement No. 13, *Accounting for Leases*, and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement, among others. In addition, the delay in the adoption of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), effectively scopes out these items for the time being. Scope exceptions may contribute to avoidable complexity because of difficulty in defining the bounds of the exception. As a result, scope exceptions require detailed analyses to determine whether they apply in particular situations, and consequently, increase the volume of accounting literature. Furthermore, where accounting standards specify the treatment of transactions that would otherwise be within the scope, exceptions may result in different accounting for similar activities

D. Competing Models: Distinguished from alternative accounting policies, competing models refer to requirements to apply different accounting models to account for similar types of transactions or events, depending on the balance sheet or income statement items involved. Examples of competing models may include different models for when to recognize for impairment of assets (e.g., inventory, goodwill[19], long-lived assets, financial instruments, and deferred taxes) different likelihood thresholds for recognizing contingent liabilities (e.g., probable for legal uncertainties versus more-likely-than-not for tax uncertainties). Different models can also be found in revenue recognition (e.g., percentage of completion, completed contract, and pro-rata) and in determining whether an arrangement is a liability or equity and in de-recognition of most liabilities (e.g., on the basis of legal extinguishment, as compared to the de-recognition of pension and other post-retirement benefit obligations via settlement, curtailment, or negative plan modification).[20] Competing models contribute to avoidable complexity in that they lead to inconsistent accounting for similar activities, and they contribute to the volume of accounting literature. The CIFiR recommends that similar activities be accounted for in a similar manner. They also believe that in principle accounting standards should be based on business activity, rather than industry-specific guidance and that GAAP should contain few alternatives either models or accounting alternatives.

EDUCATIONAL IMPLICATIONS FOR ACCOUNTANTS

If implemented several policy recommendations of the CIFiR would have significant implications for accounting curriculum content and pedagogy and many of these are not only pertaining to the reduction complexities but also relevant to the new conceptual framework for accounting. The recommendations encourage all constituents (investors, preparers, auditors, and students) of the accounting profession to understand the economic substance and business purposes of transactions, in contrast to mechanical compliance with the rules. A general shortcoming cited by the CIFiR is that accounting education in both (curriculum content and pedagogy) for graduate and undergraduate programs has traditionally accentuated the understanding of mechanics (double-entry bookkeeping) and rules ("check the box" standard) rather than the full understanding of relevant principles.

While many still believe that an educational approach focused on the memorization of rules and exceptions, and/or the use of technology to "research" rules and exceptions continues to be essential for understanding, lately few of the academic community have made great strides to divorce themselves from what is referred to as the "traditional emphasis".[21] Ideally, faculty should be able to explain to students how to analyze the economic substance of a business event consistent with the basic definitions of an asset, liability, revenue, or expense to rationally

determine the proper handling of these items, but it is important to recognize that many today teach only "simplified rules". This is not only because of a lack of time to broach the multi-levels of complexity found in standards, interpretations, bulletins, and discussions of emerging issues, but also because educators' primary responsibility is to provide students with a broad education as a foundation for career success, not professional training. It has become more difficult over time to teach even basic accounting concepts since some accounting faculty find themselves struggling to explain and justifying specific rules in a rational manner given the lack of a coherent conceptual framework. The existing conceptual framework is old and dated, the complexity of the transactions and underlying instruments has changed, and, perhaps most critical, standard setters have not adhered to a consistent set of guiding principles or concepts when establishing the rules, interpretations, and industry exceptions that drive professional practice today. With multiple inconsistent and exception- ridden concept statements and standards, there is a risk that textbooks and faculty as well as continuing educational courses will emphasize rules (given the limitations of the current conceptual framework).

Activity-Based Accounting Concepts vs Rules: If GAAP is focus on activities rather than industries this implies that classroom time should also be focused on activities rather than industries and the present position of accounting education is by-and-large today in concord with this sentiment. Matching concepts and revenue-recognition, for example, are taught by focusing on activities that create an expense from general operating revenue recognized, not from the viewpoint of a particular segment or industry. Likewise, teaching students how to audit revenue and expense transactions should not be focused on specific industry understanding but on operating activities as the basis for transactions.

Technology advancement A Critical Step Toward Simplification: Although the codification project will not change GAAP, it will substantively change how GAAP is presented (all topics will be presented using a standard structure), thus resulting in a critically needed simplification of accounting standards. If a new conceptual framework is forthcoming and the issues of complexity are resolved, the codification and its continuous updating of the current standards would be of great benefit to educators. Students could effectively be taught how to conduct professional research and exercise professional analytical thinking to develop logical extensions consistent with a principles-based mandate. The codification initiative will yield lesser dividends if it simply allows quicker electronic searches of exception-ridden rules and interpretations, especially so if the codification is incomplete and not continuously updated. Educators as well as professionals critically need a comprehensive effort resulting in a well-documented and clearly explained guiding conceptual framework. However, accounting educators and professionals are not quit positioned and prepared to help in this undertaking. Evidence from Hodge et al., (2004) indicates that accounting academics lack familiarity with XBRL (eXtensible Business Reporting Language), the new standard for tagged business information and few are currently including any type of its exposure in their classes. This implies that users are unlikely to use the technology without sufficient awareness and education. Another national survey of chief financial officers and senior comptrollers [22]show that 47 percent of CFOs are not aware of XBRL. The big issue of the academic profession that must address is the critical role of higher education in accounting and the need to deal with the challenges of ever changing technologies of financial reporting and the dynamics of market transformation.

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[1] While financial innovation may create great benefits for the economy, the goal of regulators is to preserve those benefits while achieving important public policy objectives, including financial stability, investor protection, and market integrity. Financial innovations promote certain objectives (e.g., allowing better sharing of risks) but they may pose significant risks. The current credit crisis and previous challenges seem to have been come from a number of systemic issues, at the core of it is the explosion of financial innovations. With all sorts of fictitious payment terms, the so-called "non-traditional" loans, e.g., sub-prime mortgages, not only allowed new less capable borrowers to reach their "dream" of home ownership, but also enabled others who purchased multiple homes and substantial real asset investments as if they were trading commodities. These loans were then passed on by the mortgage brokers, many of whom were not regulated, to the big Wall Street firms that redesigned them into an ever increasingly complex packages of structured securities, inscribed a stack of credit default swaps and other derivatives related to these securities, then sold these to other financial firms, hedge funds, and eager investors for healthier yields in a period of historically low interest rates..

[2] See Cossin and Jung (2005) and remarks of FASB Chairman Robert H. Herz (2005)

[3] See for example Healy and Palepu (2001) on Information Asymmetry and Corporate Disclosure and Lambert and et al. (2006) on accounting information, disclosure and cost of capital. Leuz and Wysocki (2008) surveys both theoretical and empirical literature on the economic consequences of financial reporting and disclosure regulation.

[4] If there is one thing that financial analysts used to do and summarily is glancing at the balance sheet's (Statement of Financial Position's) total assets being equal total liabilities plus equity. With the introduction of International Financial Reporting Standards (IFRS) in 2011 though, it may not be as easy to see that a balance sheet balances. The new financial statement presentation proposed by a joint committee of key regulators (FASB) and (IASB) does not separate assets and liabilities into distinct sections, instead, assets and liabilities are netted together in each of the sections (operating, investing, financing, income taxes, and discontinued operations) of the Statement of Financial Position. For more details see Benzacar (2009).

[5] For greater detail see SEC-Release No. 2008-166; August 1, 2008 Final Report of the Advisory Committee on Improvements to Financial Reporting. This final version went through several progress reports over the last year and many constituents conveyed their opinions and positions with regard to issues raised. In general, many institutional and private investors were in favor of the recommendations while several public accounting firms and professional association (e.g., AAA) were critical of them.

[6] Although the number of restatements appears to have started to decline, the number is still quite high. In 2006, more than 9% of all U.S. public companies restated their financial statements because of accounting errors. The correction and disclosure of any accounting error should not automatically result in a financial restatement using SEC's Form 8-K, only 'material' errors.

[7] The investors' term includes all providers of equity capital (current and potential), creditors, as well as credit rating agencies. Because present and potential capital providers have the most direct and immediate interest in an entity's ability to generate net cash inflows and management's ability to protect and enhance capital providers' investments, the FASB decided to designate them as the primary users of financial reporting information. (FASB, Exposure Draft- May 29 2008)

[8] The issues of complexity and transparency are objectively opposite and construct costly financial reporting corollary, for a recent study see Barth and Schipper. 2008.

[9] Campbell 1988. Provide an insightful analysis of Task Complexity from management point of view.

[10] According to a recent CFOs survey, more than 70% think financial statements are too complex to be used by the average investor and would support supplementing them with nonfinancial measures, Grant Thornton LLP (2008).

[11] Release No. 2008-166; August 1, 2008 , Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission August 1, 2008, available at http://www.sec.gov/about/offices/oca/acifr.shtml

[12] See speech on endorsing fair value approach by SEC Staff , Jackson M. Day (2000)

[13] Cynthia A. Glassman, Speech by SEC Commissioner: "Complexity in Financial Reporting and Disclosure Regulation" Remarks before the 25th Annual USC Leventhal School of Accounting SEC and Financial Reporting Institute Conference, June 8, 2006

[14]One could argue that if standard-setters desire accurate and conservative reporting, they are more likely be able to achieve it by combining (1) standards that are imprecise enough to avoid precise safe harbors, thereby allowing incentive interpretation to occur, and (2) forceful enforcement action that tip the balance of incentives away from aggressive reporting and towards more accurate and conservative reporting. See empirical results in Nelson (2005)

[15] A study by Duchac, J.(2004) illustrates the dilemma of bright line and accounting rules for special purpose entity consolidation.

[16] Proportionate recognition describes accounting for one's rights and obligations as a party to a contract. Determining whether a contract should be accounted for as a single unit of account or whether it should be split into multiple components, also determining whether a contract that has characteristics of both liabilities and equity should be treated as one instead of the other. For extensive insight and discussion see Botosan et al.,(2005)

[17] This list includes insurance, utilities, oil and gas, mining, cable television, financial, real estate, casino, broadcasting, and film. See Appendix G of the Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission August 1, 2008.

[18] Examples are found in Holthausen (1990); Holthausen and Leftwich (1983); and Watts and Zimmerman (1990).

[19] Inventory, for example, is assessed for potential loss of usefulness and reevaluated at the lower of cost or market value on a periodic basis. If its cost exceeds the current market value (replacement), a loss is recorded. In contrast, goodwill is tested for impairment annually, unless there are indications of loss before the next annual test. To determine the amount of any loss, the fair value of a "reporting unit" (as defined in GAAP) is compared to its carrying value on the balance sheet. If fair value is greater than carrying value, no impairment exists. If fair value is less, then companies are required to allocate the fair value to the assets and liabilities in the reporting unit, similar to a purchase price allocation in a business combination. Any fair value remaining after the allocation represents "implied" goodwill. The excess of actual goodwill compared to implied goodwill, if any, is recorded as a loss.

[20] De-recognition relates almost exclusively to assets, liabilities, and equity. It addresses: (1) the criteria, (2) the basis to be to release by providing a substitute or replacement. (i.e., dollar amount), and (3) the timing to be used when derecognizing a particular asset, liability or equity item for purposes of determining gain or loss, if any

[21] Well-known authors of d new accounting textbooks now have orientation that serve the new understanding of principles-based and decision- making concepts and user's perspective, see Warfield Weygandt and Kieso (2008) and Revsine, Collins, Johnson, Mittelstaedt (2009)

[22] According to Grant Thornton LLP (2007) survey almost 50% of CFOs expect such XBRL filings to become mandatory by SEC in 2010.