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Competitiveness of the U.S. Capital Markets:

FEI's Recommendations to Address Complexity in Financial Reporting

Background: Complexity in financial reporting harms the competitiveness of the U.S. Capital Markets.

- **Investors are not well served** by complexity of financial reporting. The complexity and technical demands of accounting and disclosure standards have increased considerably in recent years. FEI believes complexity harms the ability of users of financial statements to understand the information provided and impairs the ability of preparers to explain their financial results in a meaningful way. Nor are investors helped by frequent restatements of previously reported financial data as a result of differences of opinion between companies and regulators on the application of these complex requirements. Easier-to-understand financial statements that lend themselves to sustainable, high-quality application should be our mutual goal.
- **Investors also are not well served** by the drain on shareholder wealth from the excessively complex compliance process. The cost of meeting the increasing technical demands of accounting standards issued in recent years, coupled with new internal control requirements, are ultimately borne by shareholders. Furthermore, investors are exposed to the financial consequences of differences of opinion on interpretations of complex rules, often referred to as inadvertent non-compliance, which frequently leads to restatements and invites costly litigation.
- **The capital markets are not well served**, and U.S. competitiveness is hindered, when scarce financial resources are not used in value-enhancing business initiatives but to satisfy disclosure and accounting requirements that fail to meet cost-benefit tests. Additionally, capital markets bear an opportunity cost when intellectual capital and leadership talent is diverted from more productive and creative uses, such as developing new technologies, products and markets. Rival enterprises that operate in more principles-based regulatory regimes derive a competitive advantage by having the freedom to focus significantly more attention on their true economic mission of increasing shareowner wealth through innovation and growth.

FEI's Recommendations to Address Complexity

1. **The FASB and SEC, in coordination with key financial reporting stakeholders (preparers, auditors and financial statement users), should take steps to end the proliferation of detailed rules.**
    a. Agree to a stable platform for a specified period of time, during which no new accounting standards would be issued. Efforts would be shifted from new standards to completion of the conceptual framework, including the development of a comprehensive accounting and disclosure model that is integrated with the codification project. The objective of this effort would be to look holistically at the model from the standpoint of usefulness and understandability. Also during this time, preparers, auditors and users would work together to develop proposals to simplify the most complex accounting standards (FAS 133, FAS 140 and FIN 46, among others).
    b. Upon completion of the model, work jointly with the IASB to evaluate proposals by stakeholders to improve and simplify the most complex standards by making them more principles-based, and eliminate important differences between US GAAP and IFRS. Stakeholders in the financial reporting process should continue to encourage global convergence and mutual recognition of high-quality accounting standards.

2. **Congress should consider meaningful class-action reform.** The litigious environment in the U.S. breeds frivolous class-action lawsuits. Preparers and auditors, required to follow overly prescriptive standards and regulations, are often subject to unwarranted and expensive second-guessing. In their January 2007 report, *Sustaining New York's and the U.S.'s Global Financial Services Leadership*, New York Mayor Michael Bloomberg and U.S. Senator Charles Schumer noted that for foreign firms considering a public offering, the fear of potential litigation outweighs any incremental benefits of listing in the U.S.

3. **The SEC and PCAOB should develop a framework that provides effective regulation in a principles-based environment, one that balances the objective of investor protection with the need to maintain market competitiveness.** This effort would seek to define what investor protection means in operational terms: when should a difference of opinion between a company and a regulator or diversity in practice result in the need for any of the following actions: a staff speech or staff announcement, a request for standard setting, a restatement, an enforcement action or some other response.

4. **Stakeholders should come together to form an independent "Committee on Complexity."** FEI welcomes and fully supports calls by both SEC Chairman Christopher Cox and FASB Chairman Robert Herz to reduce complexity in financial reporting. FEI believes this effort will require coordination among all stakeholders in the financial reporting process. The Committee should be chaired by and include high-profile leaders of integrity who possess expertise in this area. FEI believes that the success of this endeavor will depend on a shared commitment by all constituents to fundamentally change those facets of the financial reporting process that contribute to complexity.

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