# CONTENTS

Foreword .......................................................... vi 
Charge to the Committee .......................................... viii 
Executive Summary ............................................... 1

Preface

- AIMR Membership .............................................. 8
- Advocacy by AIMR ............................................. 9
- Purpose and Content of This Report ......................... 9
- Reasons for Reporting At This Time ....................... 11

Financial Analysis and Financial Reporting

- The Nature and Role of Efficient Markets .................. 12
- Analysts Look for Anomalies Between Price and Value .... 13
- Sources of Information ........................................ 14
  - Economic and Industry Reports ............................. 14
  - Company-Specific Information .............................. 14
- Financial Reports Used By Analysts ......................... 15
- Distinguishing Financial Analysis from Financial Reporting 17

The Changing World and Its Implications for Analysis

- Globalization and the Spread of Free Enterprise .......... 22
  - Common Accounting Methods .............................. 22
  - Adequate Detailed Disclosure .............................. 23
  - Frequency of Reporting ................................... 24
  - Auditing or Other Forms of Enhancing Financial
    Statement Credibility ................................... 24
  - Preclude the “Lowest Common Denominator” Syndrome .... 25
- Quantum Increases in Computing Power and Access to It .... 25
  - Use of Data Bases and Quantitative Techniques .......... 26
  - The SEC’s Electronic Data Gathering and Retrieval System ........................................... 27
- Business Activities That Do Not Fit a Manufacturing/
  Mercantile Accounting Model ............................... 27
  - Changes in Business Ownership ........................... 27
  - Rise in the Proportion of Economic Activity Conducted
    by the Service Sector .................................. 29
Financial Services and the Proliferation of Financial Instruments ........................................... 30
Growth in the Size of Institutional Ownership of Securities ...................................................... 31

Qualitative Characteristics of Financial Statements
Relevance ................................................................................................................................. 33
Reliability: General .................................................................................................................. 34
Reliability: Verifiability .......................................................................................................... 34
Reliability: Representational Faithfulness .............................................................................. 35
Timeliness ............................................................................................................................... 36
Neutrality ............................................................................................................................... 37

Broad Topics of Current Importance to Analysts
Mark-to-Market Accounting: Value versus Valuation ......................................................... 38
  Knowing What Market Value Is ............................................................................................ 39
  Applicability Limited by Measurement Problems ............................................................. 39
  How to Implement Mark-to-Market Accounting .................................................................. 41
  Effect of Market Value Changes on Trend Analysis ............................................................ 43
  Effect of Market Value Changes on Income ......................................................................... 43
  Prognosis for Mark-to-Market Accounting ......................................................................... 44
Accounting for Intangible Assets ............................................................................................. 45
  Nature of the Problem .......................................................................................................... 45
  Sources of Future Cash Flows ............................................................................................... 46
  A Note on Stock Compensation Cost .................................................................................. 47
  The Problem of Goodwill ...................................................................................................... 48
  Contractual Arrangements ..................................................................................................... 49
  Discovery Values .................................................................................................................... 50
  Costs to Create Intangible Assets ......................................................................................... 50
  The Importance of Cash Flows ............................................................................................... 51
  Conclusions about Intangible Assets .................................................................................... 52
Financial Statement Dissemination ............................................................................................ 52
  Arguments Supporting Mandated Quarterly Reporting ...................................................... 54
  Rebuttal of Assertions Against Quarterly Reporting ............................................................ 55
  Quarterly Segment Reporting ............................................................................................... 57
  Integral versus Discrete Approach to Interim Reporting ..................................................... 57
  Auditor Involvement .............................................................................................................. 58
Disaggregated Financial Statements .......................................................................................... 59
  Reporting How the Business is Managed ............................................................................ 60
  Research in Progress and Prognosis for Change ................................................................. 61
<table>
<thead>
<tr>
<th>Topic</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consolidating Financial Statements</td>
<td>61</td>
</tr>
<tr>
<td>Income and Cash Flow Statements</td>
<td>62</td>
</tr>
<tr>
<td>Comprehensive Income</td>
<td>62</td>
</tr>
<tr>
<td>The Statement of Cash Flows</td>
<td>65</td>
</tr>
<tr>
<td>The Direct Method of Reporting Cash Flow from Operations</td>
<td>65</td>
</tr>
<tr>
<td>Need for an Authoritative Literature on Cash Flow</td>
<td>67</td>
</tr>
<tr>
<td>Transition to New Standards</td>
<td>69</td>
</tr>
<tr>
<td>A Note on Field Testing</td>
<td>73</td>
</tr>
<tr>
<td>The Standard-Setting Process</td>
<td>74</td>
</tr>
<tr>
<td>National Standards-Setting for Global Financial Markets</td>
<td>74</td>
</tr>
<tr>
<td>The Role of the FASB</td>
<td>76</td>
</tr>
<tr>
<td>Need for User Viewpoints in Standard-Setting Bodies</td>
<td>77</td>
</tr>
<tr>
<td>Recent Criticism of the FASB</td>
<td>78</td>
</tr>
<tr>
<td>Summary of Important Positions and Guide to Future Actions</td>
<td>84</td>
</tr>
<tr>
<td>Strive for a World-Wide Acceptable GAAP, Including</td>
<td>85</td>
</tr>
<tr>
<td>Disclosure Standards</td>
<td>85</td>
</tr>
<tr>
<td>Set Financial Information in Its Business Context</td>
<td>85</td>
</tr>
<tr>
<td>The Role of Current Values in Financial Reports</td>
<td>86</td>
</tr>
<tr>
<td>Recognize All Executory Contracts</td>
<td>87</td>
</tr>
<tr>
<td>Develop Standards for Reporting Comprehensive Income</td>
<td>88</td>
</tr>
<tr>
<td>Provide Frequent and Detailed Financial Reports</td>
<td>88</td>
</tr>
<tr>
<td>Cost/Benefit Analysis from a User Viewpoint</td>
<td>89</td>
</tr>
<tr>
<td>Conclusions</td>
<td>90</td>
</tr>
<tr>
<td>Appendix A: Comment Letters Sent by AIMR’s Financial Accounting Policy Committee, April 8, 1988 through April 6, 1993</td>
<td>92</td>
</tr>
<tr>
<td>Appendix B: Comment Letters Sent by Other AIMR Committees, February 2, 1989 through April 10, 1991</td>
<td>96</td>
</tr>
<tr>
<td>Appendix C: Members of the Financial Accounting Policy Committee, July 14, 1992</td>
<td>98</td>
</tr>
</tbody>
</table>