Please note that the comments expressed herein are solely my personal views

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10 November 2011

- File No. 4-640
- Inaugural Roundtable of the Financial Reporting Series Entitled "Uncertainty in Financial Statements: How Much to Recognize and How Best to Communicate It"

Dear Sir.

Thank you for giving us the opportunity to comment on your notice of roundtable discussion: Inaugural Roundtable of the Financial Reporting Series Entitled "Uncertainty in Financial Statements: How Much to Recognize and How Best to Communicate It".

The Commission staff will hold a public roundtable discussion to consider the topic of financial statement measurements (and associated disclosures) that incorporate judgments about future events. This is becoming more important as financial statements increasingly incorporate a more market-consistent approach, which generally involves greater use of projections, models, assumptions and judgments about future events. I would like to make two comments: firstly about the importance of managing the expectations of users regarding financial statements that incorporate judgments about future events; and secondly on how we should analyse and present measurement uncertainty in order to better and more appropriately manage the expectations of users.

Managing the expectations of users

Users should clearly understand and expect that any financial statement measurement which contains subjective elements, or judgments about future events, will almost certainly turn out to be "wrong". In fact, the only thing that you can usually predict with any certainty is that the actual outcome will be different from that originally measured, estimated or predicted. Whilst most experienced users understand this concept, for some, including the general public, the increasing burdens on financial statement preparers, and greater input of skilled resources required thereon, coupled with increasing auditing requirements and oversight, may imply that the financial statements should be "correct" and that any judgments about future events that are incorporated into financial statement measurements should be "right". When such judgments actually turn out to have been "wrong", some users may believe that the financial statements themselves were "wrong", or had been prepared incorrectly or incompetently, and that there was a failure of process either at source, or during the auditing and oversight stage. This is mostly not the case. Therefore it is important that we manage the expectations of users in this regard, and provide enough guidance and disclosure in order to illustrate the potential measurement uncertainty that exists in financial statement measurements that incorporate judgments about future events.

Measurement uncertainty analysis

It is important that preparers should present a range of reasonable outcomes, rather than a point estimate, when incorporating judgments about future events in financial statement measurements. Such a range of reasonable outcomes should at least consider the following:

1) the change in the measurement to changing individual judgments and/or assumptions (sensitivity analysis);
2) the change in the measurement to changing several judgments and/or assumptions at the same time, where the judgments and/or assumptions could reasonably be expected to change together (scenario analysis);
3) the dependencies assumed between the judgments and/or assumptions.

This measurement uncertainty analysis should consider materiality, and allow for those judgments or assumptions which have a significant impact on the measurement.[1] In my opinion, such measurement uncertainty analysis will help to manage the expectations of users regarding financial statement measurements that incorporate judgments about future events. This is both a reasonable and proportionate approach.

Yours faithfully

Chris Barnard

[1] This is being considered to some extent in US GAAP and IFRSs; for example the recent proposal that would require entities to disclose a quantitative measurement uncertainty analysis for fair value measurements using significant unobservable inputs (Level 3 of the fair value hierarchy), of the effect of the measurements on profit or loss or other comprehensive income for the period. The IASB and FASB are currently incorporating the requirement for a narrative description, by class of asset or liability, of the sensitivity of a recurring fair value measurement categorized within Level 3 to changes in the unobservable inputs used in the measurement if a change in those inputs to a different amount would result in a significantly higher or lower fair value measurement. This is a good start, but more needs to be done here.