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30 November 2012

**Re: Discussion Paper, *Disclosure Framework***

Dear Ms. Cospers:

We appreciate the opportunity to comment on the Discussion Paper, *Disclosure Framework* (the Discussion Paper).

We support the decision by the Financial Accounting Standards Board (FASB or Board) to address disclosure effectiveness and to develop a framework to promote consistent decisions about disclosure requirements. We also support the Board's efforts to address stakeholder concerns about the relevance of information in the notes to the financial statements, missing information and the sheer volume of required disclosures. We find the volume of required disclosures most concerning because it often makes the most important information difficult to find and may discourage many "users" from attempting to use the financial statement notes.

*Disclosure Overload and Our Recommendation*

The Board has indicated that while reducing disclosure is not an objective of the project, it hopes that will be the result in most cases. We believe that disclosure overload is one of the more pressing issues the Board should address. We also recognize that addressing it (or even saying it exists) opens the Board up for criticism from certain constituents. But anyone who questions whether disclosure overload exists need look no further than the several hundred pages of required disclosures in the Accounting Standards Codification (ASC) and the fact that the volume continues to grow with each new standard. As further evidence, we recently updated a study of 40 years of financial statements that demonstrated a compound annual growth rate of 7.6% in disclosure with disclosures roughly doubling every 10 years.<sup>1</sup> Anyone who argues this rate will abate should look at the significant additional disclosures that would be required if the Board moves ahead with its proposed Accounting Standards Updates on Liquidity and Interest Rate Disclosures, Revenue Recognition and Leases.

Hoping to reduce disclosure as a byproduct of reviewing disclosure effectiveness will not sufficiently address the issue of disclosure overload. In addition, we believe that overlaying a judgment framework

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<sup>1</sup> See Ernst & Young To the Point, *Now is the time to address disclosure overload*, where we studied the annual reports of 25 large, well-known companies to determine the average number of pages in the notes to the financial statements and to predict the future volume if growth continued at historic rates. (We have attached this article as Appendix B.)

that may be used to determine whether “required” disclosures are required in a specific instance is fundamentally flawed and will not succeed in the current regulatory and legal environment. Instead, the Board should focus on reducing the volume of required disclosures and perform a comprehensive review of what is required. While we recognize this would be challenging, it is necessary to address the already overwhelming population. We also recognize that each disclosure was added for a particular reason and, in isolation, provides information that certain users want. But that one-off analysis gives equal weight to all required disclosures and fails to recognize that users (and people who should be users) are forced to wade through a large volume of information in the hope of finding what is most important. For these reasons, the Board should perform a comprehensive, top-down review of all required disclosures with an eye toward reducing those requirements. This could be accomplished by first establishing a limited number of overarching disclosure objectives. We urge the Board to make reducing disclosure requirements a priority, and to limit new disclosure requirements until the project is completed. Once existing required disclosures are reduced, further efforts to develop effective disclosures should be addressed.

Further, we believe the Board should continue to perform comprehensive reviews of required disclosure to avoid disclosure overload in the future. We believe the Board should develop a procedure to routinely review existing requirements as part of the framework and consider mandating that new required disclosures be offset by eliminating other required disclosures. To formalize this process, the Board should consider disclosure requirements every five years or allow them to sunset – or disappear – if they are not reaffirmed by the Board.

Although the Board has acknowledged that disclosure overload exists, we are concerned that some mistakenly attribute this to the use of disclosure checklists by auditors and regulators.<sup>2</sup> We believe this criticism is misplaced and effectively states that knowledge of and compliance with the requirements of the standards is the problem. It is unreasonable to conclude that a checklist, which simply aggregates several hundred pages of required disclosures dispersed throughout several thousand pages of accounting standards, is the cause of disclosure overload. Instead, the several hundred pages of required disclosures, which are rarely challenged, are the root cause of disclosure overload. In fact, in lieu of audit firms and regulators developing disclosure checklists, it would seem that a disclosure checklist developed and maintained by the FASB would be a useful tool. This would serve two important functions. First it would enable the FASB to control the presentation of disclosure requirements and the accompanying message. Second, and more importantly, it would force the creators of disclosure requirements to annually examine the entire population of required disclosures.

#### *The Board's Proposed Approach*

We do not believe the framework described in the Discussion Paper could be implemented in today's regulatory and legal environment. The framework introduces the concept of flexible disclosure requirements that would allow preparers to exercise judgment to determine which “required” disclosures are, in fact, required in their fact pattern. Although conceptually we support a flexible approach to disclosure, we do not believe a flexible approach that provides a list of required disclosures is practicable because preparers would be second-guessed by regulators and the legal system. If a flexible approach were to be developed to create effective disclosures and address disclosure overload, it would need to be truly flexible. It would have to provide preparers with flexibility on not only whether

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<sup>2</sup> Paragraph 4.31 of the Discussion Paper.

but also how to provide a disclosure and would consist solely of a brief listing of specific disclosure objectives by topic. It would not provide a list of required disclosures, examples for disclosure or questions and considerations, such as those included in the Discussion Paper.

If the Board proceeds with this project, it should continue to coordinate with other standard setters and regulators, such as the Securities and Exchange Commission (SEC), the Public Company Accounting Oversight Board (PCAOB), other regulators (e.g., financial institution regulators) and the American Institute of Certified Public Accountants (AICPA), at the outset and consider what accounting, auditing and regulatory guidance could be issued on a combined basis to attempt to mitigate second-guessing. Coordination also could reduce duplication of required disclosures in the notes to the financial statements and regulatory filings. But even if the above efforts were successful, we have significant concerns about whether the US regulatory and legal environment is conducive to a framework that attempts to determine which “required” disclosures are required.

We also believe that some of the fundamental principles underlying the framework need to be challenged and debated. The strong reliance on the principle of prospects for net cash inflows to the entity<sup>3</sup> and the lack of a clear boundary for financial statement note disclosure<sup>4</sup> could increase required disclosures and result in overlap with other disclosures required outside of financial statements for public companies. Further, the decision questions in Chapter 2 and throughout the Discussion Paper include phrases such as “might have an impact,” “may have an impact” or “could have an impact.” We believe that the use of these phrases will result in disclosure of forward-looking information in the notes to the financial statements without the safe harbors that currently exist for forward-looking information in Management’s discussion and analysis (MD&A). This will increase disclosure and expand the existing “de facto boundary” of the financial statements. Furthermore, adding forward-looking information to the notes introduces liability issues for preparers and auditors and verification concerns for auditors.

To remedy these concerns, a disclosure framework needs to clearly define the boundaries of the notes to the financial statements. We believe the notes to the financial statements should be limited to explaining information included in the financial statements. Forward-looking information that does not explain information in the financial statements and other disclosure should be provided outside the notes to the financial statements (e.g., in MD&A for public companies where certain safe-harbor protections exist).

A full discussion of materiality as it applies to note disclosure also should be part of the framework. This would provide preparers with a guideline for determining relevant disclosures and would reduce second-guessing by regulators and the legal system. Furthermore, we disagree that reexamining the description of materiality in Concepts Statement No. 8<sup>5</sup> is beyond the scope of this project. Because that description contains the concept of “could influence decisions that users make,”<sup>6</sup> it may broadly

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<sup>3</sup> Paragraph 1.12 of the Discussion Paper.

<sup>4</sup> Paragraph 1.14 of the Discussion Paper states that the framework does not attempt to define in a single sentence a boundary for notes to financial statements. Instead the Discussion Paper states that the decision questions discussed in Chapter 2 (and SEC requirements) would limit the information required for notes to financial statements.

<sup>5</sup> FASB Statement of Financial Accounting Concepts No. 8 (Concepts Statement No. 8), *Conceptual Framework for Financial Reporting*.

<sup>6</sup> Concepts Statement No. 8 paragraph QC 11.

expand required disclosures. We believe Concepts Statement No. 8 should be amended to be consistent with existing regulatory guidance and Supreme Court decisions. Amending a Concepts Statement should be within the scope of the project as the Board indicates that a Concepts Statement is a possible outcome of this project.

We understand that the Discussion Paper is not a proposal but rather a first step in soliciting input on ways to improve disclosure effectiveness. We believe the Board should perform a cost-benefit analysis of the alternatives it is considering for the framework. We believe there could be a significant cost to preparers to implement a conceptual framework based on disclosure flexibility, especially for companies that are required to comply with the internal control provisions of the Sarbanes-Oxley Act. We also believe the framework itself should incorporate a cost-benefit analysis to evaluate proposed and existing disclosures. We believe only disclosures for which the Board concludes the benefits outweigh the costs should be added. While we understand that the benefits of a particular disclosure may be difficult to quantify, the Board should be able to qualitatively articulate them to compare the benefits to the cost.

#### *Interim Disclosures*

We agree that a framework for disclosures for interim financial statements also should be developed. Until then, the Board should suspend its recent practice of requiring all or nearly all new annual disclosures in interim financial statements and resume following the approach in ASC 270<sup>7</sup> consistent with past practice and SEC regulation. The current approach seems to be in contrast to the premise<sup>8</sup> that only disclosures that materially update those in the prior annual financial statements should be required and fails to recognize the time constraints on interim reporting.

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Although we believe that certain changes need to be made to the framework, we believe that this is an important project for the Board. We therefore answer each of the Questions for Respondents in Appendix A to provide the Board with considerations for developing a framework.

We would be pleased to discuss our comments with Board members or the FASB staff at your convenience.

Very truly yours,



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<sup>7</sup> ASC 270, *Interim Reporting*.

<sup>8</sup> This premise is based on SEC Regulation S-X Rule 10-01(a)(5), which requires that the notes to the interim financial statements include disclosure of events that have occurred since the previous year-end through the filing date that have a material impact on the company.

Responses to specific questions raised in the Discussion Paper, *Disclosure Framework*

**Question 1:**

The details of this Invitation to Comment do not focus on the informational needs of donors to not-for-profit organizations. How, if at all, should the Board's decision process (see Chapter 2) be supplemented to consider the needs of donors? How, if at all, should not-for-profit reporting entities modify their decision-making process (see Chapter 4) for the needs of donors when deciding which disclosures to include in notes to financial statements?

**Response:**

We believe that Chapter 2 and Chapter 4 are relevant to not-for-profit entities but should be expanded to consider unique aspects of not-for-profit reporting as well as the needs of donors to nonbusiness not-for-profit entities.

Concepts Statement No. 4<sup>9</sup> states several objectives of financial reporting by nonbusiness entities including providing information (1) about economic resources, obligations and net resources, (2) that is useful in making resource allocation decisions, (3) to assess services and the entity's ability to continue to provide services and (4) to assess management's stewardship and performance. While this statement is more than 30 years old, we believe the objectives are still relevant when considering the financial reporting and disclosure needs of donors to not-for-profit entities.

Chapter 2 of the framework is designed to result in disclosure of information that helps users assess the cash flow prospects of a commercial enterprise. We suggest a not-for-profit supplement, or separate framework, be developed that builds off the commercial enterprise framework but considers the unique aspects of a not-for-profit (i.e., the objectives articulated in Concepts Statement No. 4).

Although the questions in Chapter 2's decision process would encompass some of the disclosure requirements appropriate for nonbusiness not-for-profit entities, when considering the information for disclosure, the Board would focus on information about prospects for cash inflows that would enable the entity to fulfill its mission. In particular, that consideration should encompass the nature of any donor restrictions on cash inflows. The Board should consider applying each of the questions to flows of economic value other than cash (e.g., in-kind contributions, contributed services). We believe the framework also should consider disclosure of information about historical financial performance (e.g., liquidity of cash flows, details of whether resources were used to fund programs or administration) that would be useful when a donor is analyzing the stewardship of a not-for-profit entity.

We believe the measure of relevance for nonbusiness not-for-profit entities should (1) provide information about historical financial performance that would be useful when a donor is analyzing the stewardship of an entity and (2) be sensitive to the nature of typical users (i.e., donors are more diverse and may be less accustomed to using financial statements than are users of typical for-profit financial statements).

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<sup>9</sup> FASB Statement of Financial Accounting Concepts No. 4 (Concepts Statement No. 4), *Objectives of Financial Reporting by Nonbusiness Organizations*.

**Question 2:**

**Do the decision questions in this chapter and the related indicated disclosures encompass all of the information appropriate for notes to financial statements that is necessary to assess entities' prospects for future cash flows?**

**Response:**

The decision questions are so broad that they likely encompass any current or proposed disclosure. While that likely means they encompass "all of the information appropriate for the notes to the financial statements that is necessary to assess entities' prospects for future cash flows," it also means they are unlikely to ever exclude any proposed disclosures.

The Board indicates that consideration of the appropriate content of notes to financial statements begins with the purpose of financial reporting in general. However, the Board does not specifically develop a definition or purpose of the notes to the financial statements to provide context to the decision questions. We believe the Board needs to do so to determine the boundaries of information that should be included in the notes to the financial statements. Without such a definition, we cannot assess whether the decision questions in Chapter 2 and the related disclosures encompass all the information appropriate for the notes to the financial statements.

We also believe the framework should include a decision question that requires the Board to conduct a cost-benefit analysis to evaluate proposed and existing disclosures. We believe only disclosures for which the Board concludes the benefits outweigh the costs should be added. A qualitative cost the Board should include in this analysis is the cost to users and preparers of a disclosure's contribution to existing disclosure overload. Further, while we understand that the benefits of a particular disclosure may be difficult to quantify, the Board should be able to qualitatively articulate them to compare the benefits to the cost.

**Question 3:**

**Do any of the decision questions or the related indicated disclosures identify information that is not appropriate for notes to financial statements or not necessary to assess entities' prospects for future cash flows?**

**Response:**

As noted above, we believe there should be a defined boundary to the notes to the financial statements. We believe the notes should be limited to explanations of information included in the financial statements. Forward-looking information and other disclosure should be provided outside the notes to the financial statements (e.g., in MD&A for public companies). We believe the framework's strong reliance on the principle of prospects for net cash inflows would result in the inclusion of forward-looking information in the notes to the financial statements. Further, the decision questions in Chapter 2 and throughout the Discussion Paper include phrases such as "might have an impact," "may have an impact" or "could have an impact." We believe that the use of these phrases would also drive toward the disclosure of forward-looking information in the notes to the financial statements. Adding forward-looking information in the notes introduces liability issues for preparers and

verification issues for auditors. We also believe other questions in Chapter 2, such as O5<sup>10</sup> and O6<sup>11</sup>, include information that is outside the boundary of the notes to the financial statements as we have defined it. We believe the decision questions would result in an increase in disclosure. This is because the questions focus on future cash flows, do not use specific language and use terms (e.g., “particular concerns”<sup>12</sup>) that are not clearly defined. Additionally, we believe the questions in Chapter 2 would eventually lead to disclosure of information that either duplicates or overlaps with SEC requirements. In addition, because the scope of the project is not limited to public companies, nonpublic companies may be required to disclose forward-looking information that public companies disclose in MD&A today. For example, we believe question O7<sup>13</sup> is similar to existing disclosure required by Regulation S-K Item 305(a)(1),<sup>14</sup> which would result in MD&A-type disclosure in the notes to the financial statements, while question L13<sup>15</sup> would result in disclosure similar to existing disclosure required by

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- <sup>10</sup> Question O5 asks whether there is uncertainty in an entity’s access to the markets for its inputs or outputs (whether resolution of the uncertainty would result in increased or decreased access). It provides the following information to be considered for disclosure: the existence and possible causes and effects of the uncertainty about restrictions in access to inputs and outputs markets, the potential effects on the financial statements of significant access restrictions to inputs and outputs markets, and how the entity plans to mitigate adverse financial statement effects arising from restrictions to its access to inputs and outputs markets.
- <sup>11</sup> Question O6 asks whether there is significant uncertainty about an entity’s ability to maintain a qualified workforce and suitable physical facilities (whether resolution of the uncertainty would result in increased or decreased ability). It provides the following information to be considered for disclosure: (a) the existence and causes of the significant uncertainty to maintain a qualified workforce and suitable physical facilities, (b) the potential effects of that uncertainty on financial statements and (c) how the entity plans to mitigate adverse financial statement effects arising from the significant uncertainty about maintaining a qualified workforce or suitable physical facilities.
- <sup>12</sup> Question G3 uses the phrase “particular concerns.” The question asks whether there are restrictions on the entity’s use of assets and potential concerns about the entity’s cash flows that are not otherwise apparent from the financial statements.
- <sup>13</sup> Question O7 asks whether an entity’s possible future cash flows could be subject to significant changes because of the effects of possible future changes in interest rates, the entity’s ability to obtain financing, foreign currency exchange rates, commodity prices (whether exchange-traded or not) or volumes, stock market prices or volumes, or other financial market prices or market conditions. It provides the following information to be considered for disclosure: an explanation of the macroeconomic factor(s) that affect particular assets, liabilities, or equity instruments and the potential effects of changes in the macroeconomic factors on the assets, liabilities, and equity instruments and on net income and other comprehensive income.
- <sup>14</sup> In Summary, Regulation S-K Item 305(a)(1) requires registrants to separately disclose quantitative information about risk exposure from interest rates, foreign currency, commodity price or other markets.
- <sup>15</sup> Question L13 asks whether a line item will be affected in future years by transition to an accounting standard that has been issued but is not yet effective or not fully effective. It provides the following information to be considered for disclosure: when the transition will occur, a description of the anticipated effect on future financial statements and the pro forma effect on current-year financial statements.

SAB Topic 11M Question 2.<sup>16</sup> As discussed above, we believe adding forward-looking information in the notes (e.g., future cash flows) introduces verification issues for auditors. If the Board decides to move forward with the approach described in this chapter, it will need to coordinate its decision making with the PCAOB and AICPA. This is because the auditing of forward-looking information included in the notes to the financial statements is generally not well-defined in the auditing literature. For this information to be audited, the PCAOB and AICPA will have to develop new audit guidance to address auditor responsibilities, procedures and documentation requirements, including auditing a company's internal control systems surrounding the preparation of such information.

**Question 4:**

**Would these decision questions be better applied by reporting entities instead of the Board? In other words, should the Board change its practice of establishing detailed requirements in each project and, instead, establish a single overall requirement similar to the questions in this chapter?**

**Response:**

Consistent with our above comments, we do not believe a framework using a flexible approach when there is a list of required disclosures could be implemented by reporting entities in today's regulatory and legal environment. Accordingly, we do not believe the questions in Chapter 2 should be applied by either the Board or reporting entities. We believe these questions are too broad, use imprecise language and are not operational.

We believe the most practical way of moving forward is for the Board to simply recognize that disclosure overload exists, it is caused by the large volume of required disclosures in the Accounting Standards Codification, and the most effective way to address it is to reduce the volume of required disclosures that exist today and that are created in the future (see our cover letter for more details). Instead, if a flexible approach is to be developed, it would need to be truly flexible to create effective disclosures and address disclosure overload. It would have to provide preparers with broad discretion on whether and how to provide a disclosure. It would not provide a list of required disclosures, examples for disclosure or questions and considerations, such as those included in the Discussion Paper. To implement such an approach, the Board would first eliminate all required disclosures. Then the Board would provide specific and actionable disclosure objectives for each ASC Topic. We would not expect this to be a lengthy list by topic or in total, but it would be specific. To assess the operability of this concept, we believe the Board should test it by either eliminating all existing disclosures for a particular ASC Topic (e.g., pensions or segments) or use this concept when developing disclosures for a new standard (e.g., revenue recognition).

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<sup>16</sup> For a new accounting standard that has been issued but not yet adopted by the registrant, SAB Topic 11M Question 2 requires registrants to disclose: (1) a brief description of the new standard, the date that adoption is required and the date that the registrant plans to adopt, if earlier, (2) a discussion of the methods of adoption allowed by the standard and the method expected to be utilized by the registrant, if determined, and (3) a discussion of the impact that adoption of the standard is expected to have on the financial statements of the registrant, unless not known or reasonably estimable. In that case, a statement to that effect may be made and disclosure of the potential impact of other significant matters that the registrant believes might result from the adoption of the standard (such as technical violations of debt covenant agreements, planned or intended changes in business practices) is encouraged.

**Question 5:**

**Do you think that this decision process would be successful in helping the Board to set more effective disclosure requirements? If not, what would be a better approach?**

**Response:**

As discussed in our response to the previous question, we do not believe that this decision process would help the Board set more effective disclosure requirements. For a better approach, we believe the Board should have a framework in place for developing disclosure requirements for new or amended accounting guidance. We believe a framework for new disclosures should focus on what information a user would need to know to assess the details of the information included in the financial statements. Considerations would include:

- ▶ Whether accounting alternatives exist
- ▶ Unique features to the accounting
- ▶ Judgments that are involved in the accounting

As part of a framework for new disclosure, we believe there should be a mandatory cost-benefit analysis. This analysis should be used to evaluate every new proposed disclosure as well as existing required disclosures. We believe only disclosures for which the Board concludes the benefits outweigh the costs should be added. A qualitative cost the Board should include in this analysis is the cost to users and preparers of a disclosure's contribution to the existing disclosure overload. Further while we understand that the benefits of a particular disclosure may be difficult to quantify, the Board at a minimum should be able to qualitatively articulate the benefits (i.e., provide a specific rationale or benefit for each disclosure versus concluding "users" have requested it) so it can compare them to the cost.

**Question 6:**

**Would any of the possibilities in this chapter (see paragraphs 3.8 and 3.11) be a practical and effective way to establish flexible disclosure requirements?**

**Question 7:**

**If more than one approach would be practical and effective, which would work best? Are there other possibilities that would work better than any of the ones discussed in this chapter?**

**Response:**

If paragraph 3.11.a is intended to provide a truly flexible approach, similar to what we describe in the response to Question 4 (i.e., it would have to provide preparers with broad discretion on whether and how to provide a disclosure and would not provide a list of required disclosures, examples for disclosure or questions and considerations, such as those included in the Discussion Paper), it may be a reasonable starting point if standard setters, auditors, users and regulators are really prepared to accept significant preparer judgment in what is disclosed and how it is disclosed.

Given our concerns about using a flexible approach (see cover letter and prior responses) when there is a list of required disclosures, we believe the concept discussed in paragraph 3.8.a may also have potential to be operational. Under this approach, the Board would take responsibility for setting

different disclosure requirements for different entities based on specific criteria, and it would be clear which requirements were applicable.<sup>17</sup> For this approach to be operational, we believe a rigorous cost-benefit analysis would have to be inherent in the Board's determination of the specific criteria. Without such analysis, we believe this approach could result in increased cost and effort by preparers with no change in the volume of required disclosure. We believe that, in the current regulatory and legal environment, a prescriptive approach to disclosure is necessary. As previously noted, we believe that allowing preparers to exercise judgment when there is a list of required disclosures would result in second-guessing by regulators and the legal community. Assuming that paragraph 3.11.a is intended as we described above, we believe the Board needs to expand the discussion of the concepts in paragraphs 3.8.a and 3.11.a. An expanded discussion is needed to determine whether the concepts are practical and effective. For example, we believe companies could be subject to second-guessing from regulators if the specific criteria used to evaluate disclosures under paragraph 3.8.a are qualitative rather than quantitative. In particular, the information necessary to determine whether the concepts are practical and effective includes:

- ▶ How the Board plans to establish criteria for tiers or determine the different requirements for different entities.
- ▶ Steps taken to coordinate with other standard setters and regulators, such as the SEC, PCAOB and AICPA. This would include the development of new audit guidance to address auditor responsibility and procedures. It would also include the development of expectations of the documentation a preparer (and auditor) would need of its assessment of which requirement applies for each disclosure. Lastly, it would consider extension by the SEC of safe harbors to the financial statements as appropriate as recommended by the SEC Advisory Committee on Improvements to Financial Reporting.<sup>18</sup>
- ▶ Materiality and how it would be applied to disclosure. As discussed further in the response to Question 9, we believe this discussion of materiality for the notes would provide qualitative and quantitative considerations specific to disclosure.
- ▶ Costs and benefits that consider the following:
  - ▶ Effects of applying the various alternatives on the comparability of financial statements from one company to another.
  - ▶ The annual effort from and/or cost to preparers, which we believe would be significant, especially for public companies that would need to develop, document and test internal controls to comply with the Sarbanes-Oxley Act.
  - ▶ The costs of the financial statement and internal control audits associated with the flexible disclosure.
  - ▶ The costs associated with second-guessing from regulators or the legal community.

We do not believe the other ideas in the Discussion Paper have the potential to be operational.

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<sup>17</sup> Examples provided are disclosures that vary based on the size of the reporting entity, business in which the entity engages, entities with particular types of asset mixes, leverage ratios and other factors.

<sup>18</sup> The Discussion of Recommendation 1.3 of the Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission dated 1 August 2008 states "... an optimally-designed disclosure framework should be developed by the FASB under close coordination with the SEC so that these factors are considered, and so that the Commission amends its guidance where appropriate...."

**Question 8:**

**Are there other possibilities that would work better than any of the ones discussed in this chapter?**

**Response:**

As we noted in our cover letter, hoping to reduce disclosure as a byproduct of reviewing disclosure effectiveness will not sufficiently address the issue of disclosure overload. In addition, we believe that overlaying a judgment framework that may be used to determine whether “required” disclosures are required in a specific instance is flawed and will not succeed in the current regulatory and legal environment. Instead, the Board should focus on reducing the volume of required disclosures and perform a top-down comprehensive review of what is required. While we recognize this would be challenging, it is necessary to avoid adding more disclosures to an already overwhelming population. We also recognize that each required disclosure was added for a particular reason and in isolation, provides information certain users want. But that one-off analysis gives equal weight to all required disclosures and fails to recognize that users (and people who should be users) are forced to wade through a large volume of information in the hope of finding what is most important. For these reasons, the Board should perform a comprehensive, top-down review of all disclosures. This could be accomplished by first establishing a limited number of overarching disclosure objectives. We urge the Board to make reducing disclosure requirements a priority, and to limit new disclosure requirements until the project is completed. Once existing disclosures are reduced, further efforts to develop effective disclosures should be addressed.

**Question 9:**

**This chapter attempts to provide a benchmark for judgments about disclosure relevance by clarifying the objective for the judgments. Is the description of the approach clear enough to be understandable? If not, what points are unclear?**

**Response:**

We believe a full discussion of materiality as it applies to the notes to the financial statements is a necessary benchmark for judgments about disclosure relevance. We believe this discussion of materiality for the notes would provide qualitative and quantitative considerations specific to disclosure. For example, it would describe when accounting policy disclosures would be made from a materiality standpoint, how materiality judgments would be applied to quantitative disclosures of the components of a balance or rollforward of a financial statement amount, and other information.

We believe the assessment of materiality would depend on the financial statement (e.g., balance sheet, income statement, statement of cash flows) that the item is derived from. Further, if the Board moves forward with disclosure about future cash flows, materiality considerations specific to future cash flows will also need to be provided and will need to be more robust than potential cash flows that could affect a user’s decision process. Specific guidance on materiality as it applies to the notes to the financial statements would provide preparers with a guideline for determining relevant required disclosures and could reduce second-guessing by regulators and the legal system. As described in the Discussion Paper, the preparer decision-making process does not specifically address how to assess materiality of disclosure, which we believe is a significant consideration in determining relevant disclosures.

We disagree that reexamining the description of materiality in Concepts Statement No. 8 is beyond the scope of this project. Because that description contains the concept of “could influence decisions that users make,” it could broadly expand required disclosures. We believe Concepts Statement No. 8 should be amended to be consistent with existing regulatory guidance and Supreme Court decisions. Furthermore, in identifying items that should be considered in determining disclosures, the criteria described in the chapter use broad terms, such as “has the potential to make a difference”<sup>19</sup> and “could be different.”<sup>20</sup> Similar to our comment on Concepts Statement No. 8, we believe these terms may lower thresholds for what would be considered material to the users of financial statements.

We believe the Discussion Paper should define the boundaries of the notes to the financial statements and develop principles about why disclosures are made. This chapter proposes that future cash flows should serve as a benchmark for making judgments about required disclosure. However, we believe the strong reliance on the principle of cash flows and the lack of a clear boundary for financial statement note disclosure could increase required disclosure and result in overlap with other disclosures required outside the financial statements for public companies. We believe this overlap and lack of boundaries results in an unclear benchmark for determining disclosure relevance. Further, the Discussion Paper fails to compare the framework’s approach with the reasons for disclosure requirements today. We believe the Board should take into consideration the reasons for today’s disclosure requirements and develop a definition of what is to be included in the notes to the financial statements before developing a benchmark about disclosure relevance.

We believe the Board would need to clarify the concept of a benchmark for the knowledge of users of the financial statements, which is described inconsistently in the Discussion Paper. Paragraph 1.16 says users would be expected to have information about general business risks and general economic conditions, as well as be aware of things such as US GAAP, but paragraph 4.15 says the benchmark would be what a reasonably well-informed user would assume the normal and routine characteristics of a particular item to be. We believe a user with “general knowledge” (paragraph 1.16) may have less knowledge than a “reasonably well-informed” (paragraph 4.15) user.

**Question 10:**

**Can this approach (or any approach that involves describing the objective for the judgments) help identify relevant disclosures? If so, what can be done to improve it? If not, is there a better alternative? What obstacles do you see, if any, to the approach described?**

**Response:**

As previously discussed, we do not believe the framework described in the Discussion Paper could be implemented in today’s regulatory and legal environment. Instead we believe the most practical way of moving forward would follow the approach we have outlined in our cover letter.

If the Board decides to move forward with its planned approach, we believe the Board should:

- ▶ Coordinate with the SEC, the PCAOB and other regulators (e.g., financial institution regulators) at the outset and consider what guidance could be issued on a combined basis to attempt to mitigate second-guessing.

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<sup>19</sup> Paragraph 4.5 of the Discussion Paper.

<sup>20</sup> Paragraph 4.18 of the Discussion Paper. The concept of “could” is also discussed in more detail in paragraph 4.22.

- ▶ Challenge and debate some of the fundamental principles underlying the framework, especially the strong reliance on the principle of prospects for net cash inflows to the entity and the lack of a clear boundary for financial statement note disclosure. See our response to Question 3 for more details.
- ▶ Provide a full discussion of materiality as it applies to note disclosure. See our response to Question 9 for more details.

**Question 11:**

**Reporting entities would need to document the reasons for their decisions about which disclosures to provide. How would reporting entities document the reasons for their disclosure decisions and how would auditors audit those decisions?**

**Response:**

Preparers would have to provide appropriate documentation to support their rationale for not making required disclosures. The level of documentation would depend on the criteria used to support non-disclosure (e.g., specified level of activities around a disclosure area, materiality). We also believe public companies would have to develop and test internal controls related to such an approach to comply with the Sarbanes-Oxley Act. Auditors would have to audit an entity's decisions on which required disclosures were not made for the purposes of the financial statement audit, as well as the entity's control system for the purposes of the internal control audit. We believe the costs (both internal and audit) could be significant to preparers.

Until the Board further develops the flexible disclosure approach, we are unable to provide a more specific response to how preparers would document their reasons for excluding disclosures. The same holds true for how auditors would audit those decisions. Before we can provide meaningful feedback on preparer documentation and auditor approach, we believe the Board needs to:

- ▶ Coordinate with regulators and other standard setters such as the SEC, PCAOB and AICPA to develop accounting, auditing and regulatory guidance on a combined basis and to set expectations regarding the documentation requirements.
- ▶ Provide a definition or purpose of what is to be included in the notes to the financial statements and identify a clear boundary for financial statement note disclosure.
- ▶ Provide a full discussion of materiality as it applies to note disclosure.

**Question 12:**

**Would any of the suggestions for format improve the effectiveness of disclosures in notes? If so, which ones? If not, why not?**

**Question 13:**

**What other possibilities should be considered?**

**Question 14:**

**Do any of the suggested methods of organizing notes to financial statements improve the effectiveness of disclosure?**

**Question 15:**

**Are there different ways in which information should be organized in notes to financial statements?**

**Response:**

It appears that the suggestions for formatting and organizing note disclosures included in the document are inconsistent with the concept of preparers exercising judgment to determine relevant disclosures. That is, we find it somewhat inconsistent that a document that proposes having preparers use judgment in determining which “required” disclosures are required does not permit preparers to use judgment as to where in the notes the disclosures appear and in what format (e.g., table versus narrative). For example, we believe that standardizing the order for notes<sup>21</sup> or requiring disclosures to be organized by the type of activity (e.g., operating, investing, financing)<sup>22</sup> appear to be reducing the judgment applied by preparers.

While suggestions for formatting note disclosures could make it easier to use the financial statements, we question whether the Board should spend time on this part of the project given the importance of other parts of this project and other projects on its agenda. We believe this could be better addressed by a task force of preparers, users, regulators and auditors, which could determine best practices. The task force also could consider the role that technology should play in the formatting and organization of the notes to make them most effective. Any outcomes that would change the form or content of financial statements and require standard setting or regulatory rule making (e.g., eliminating from the notes certain company or accounting policy information that typically does not change significantly between reporting periods) could be considered as necessary by the appropriate body.

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<sup>21</sup> Paragraph 5.20 of the Discussion Paper.

<sup>22</sup> Paragraph 5.32 of the Discussion Paper.

**Question 16:**

**Do you think that any of the possibilities in this chapter would improve the effectiveness of disclosures for interim financial statements?**

**Response:**

We agree that a framework for disclosures for interim financial statements should be developed. The current standard-setter approach seems to be in contrast to the premise<sup>23</sup> that only disclosures that materially update those in the prior annual financial statements should be required in interim financial statements and fails to recognize the time constraints on interim reporting. That is, the recent trend of requiring all or nearly all new annual disclosures in interim financial statements has resulted in additional, more complex interim disclosures and a loss of the balance between the timeliness and volume of information in interim disclosures. We do not believe that the possibilities in this chapter suggested for setting interim disclosure requirements would adequately address the need for a balance between the timeliness and volume of information in disclosures. For any interim framework to be successful, we believe it should reduce the volume of required interim disclosure. In developing the framework, we believe:

- ▶ The Board needs to coordinate with the SEC. Paragraph 6.1 states that this chapter applies to SEC registrants required to file Form 10-Q. We therefore believe it is important for the Board to involve the SEC in developing a framework for relevant interim disclosures and in considering what guidance could be issued on a combined basis.
- ▶ The Board should further consider the balance between volume and timeliness of information contained in notes of interim financial statements. Given the current interim reporting timetable for public companies, it is important to balance the volume and timeliness of information in interim disclosures. We believe the objective of interim reporting differs from the objective of annual reporting. Interim reporting is intended to provide users with the concise, timely information needed to understand events that have occurred since the previous year-end through the filing date that have had a material effect on the company. In developing a framework for determining relevant interim disclosures, we believe the Board should seek preparers' and users' views on the objectives of interim reporting and be specifically cognizant that increased disclosure is likely to come at the expense of timely reporting.
- ▶ The Board should include a discussion of materiality in developing a framework for interim disclosures. Similar to our views regarding materiality in the overall disclosure framework, we believe that materiality is a significant consideration for both preparers and users in determining relevant disclosures for interim reporting. We believe that a framework for interim disclosure that includes a discussion of materiality would be better aligned with the objective of interim reporting.

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<sup>23</sup> This premise is based on SEC Regulation S-X Rule 10-01(a)(5), which requires that the notes to the interim financial statements include disclosure of events that have occurred since the previous year-end through the filing date that have a material impact on the company.

**Question 17:**

**If you think that a framework for the Board's use in deciding on disclosure requirements for interim financial statements would improve the effectiveness of interim reporting, what factors should the Board consider when setting disclosure requirements for interim financial statements?**

**Response:**

The interim disclosure decision-making framework appears to be entity-focused. As written, the example principles (paragraph 6.17) and questions (paragraph 6.19) in the Discussion Paper should be considered from the perspective of the reporting entity. Accordingly, information about the reporting entity would be needed to assess these principles and answer these questions for them to be used to set interim disclosure requirements. As mentioned in our cover letter, we believe that some of the fundamental principles underlying the annual framework (e.g., the boundaries of the financial statements, users' understanding of future cash flow prospects) need to be challenged and debated as they apply to interim financial statements. As we state in our response to Question 16, we believe that interim reporting is intended to provide users with the concise, timely information needed to understand events that have occurred since the previous year-end through the filing date that have had a material effect on the company. Therefore, we believe the Board should not require any interim disclosures that would repeat disclosures made in the most recent annual financial statements unless a material change has occurred.

**Question 18:**

**If you think that a framework for reporting entities' use in deciding on disclosures for interim financial statements would improve the effectiveness of interim reporting, what factors should reporting entities consider when providing disclosures for interim financial statements?**

**Response:**

The Board must coordinate its framework project with the SEC. SEC regulations require companies to disclose in the notes to interim financial statements events that have occurred between the previous year-end and the filing date that have a material effect on the reporting entity.<sup>24</sup> These regulations allow registrants to omit interim disclosures if they would effectively duplicate disclosures contained in the most recent annual report.

The SEC interim disclosure requirements are similar to the Board's suggestion in paragraph 6.23 of a reporting entity decision process for eliminating interim period disclosures when the changes from the prior period are consistent with investors' expectations. However, we believe reporting entities may struggle to execute such a decision process because the SEC interim disclosure requirements focus on materiality, whereas the Board's interim framework focuses on changes from users' baseline expectations (a term that would need to be more clearly defined to be operational). As we state in our responses to Questions 9 and 10, we believe that the Board should add a discussion of materiality to the framework. We believe that materiality is a significant consideration in determining relevant disclosures for both annual and interim reporting.

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<sup>24</sup> SEC Regulation S-X, Article 10-01(a)(5) requires that the notes to the interim financial statements include disclosure of events that have occurred since the previous year-end through the filing date that have a material impact on the company.

**Question 19:**

**What impediments do you see regarding the development of a framework for the Board, reporting entities, or both that addresses disclosure for interim financial statements?**

**Response:**

The development of an interim disclosure framework for the Board, reporting entities or both is an important part of the overall disclosure framework project that will take a significant amount of time to complete. While the Board already has a number of important, complex projects under way (e.g., Accounting for Financial Instruments, Revenue Recognition, Leases) we believe it should address interim disclosures because the current standard-setter approach to setting interim disclosure requirements is fundamentally redefining interim reporting on a standard-by-standard basis. The Board would need to consider the items we noted previously for annual disclosures. In addition, until the Board develops an interim disclosure framework, we believe that the Board should suspend its practice of requiring all or nearly all new annual disclosures in interim financial statements and resume following the approach in ASC 270 consistent with past practice and SEC regulation. Only disclosures that materially update those in the prior-year annual financial statements should be required.

**Question 20:**

**Would the change to the requirements described in paragraph 7.8 for disclosure of the summary of accounting policies improve the effectiveness of disclosure?**

**Response:**

We believe that a narrower requirement for the disclosure of accounting policies as described in Paragraph 7.8 would improve the effectiveness of disclosure. In cases where alternative accounting policies could be applied, we believe it is useful for the reader to understand the accounting for that line item. However, we do not believe disclosure effectiveness is improved by disclosing accounting policies in cases where alternative accounting policies do not exist. Paragraph 7.8 refers to question L10,<sup>25</sup> which, as written, would require disclosure of the magnitude of the effect of an accounting policy in certain situations (e.g., the method is unusual, results are counter to readers' expectations, the method dramatically affects the financial statements). It is unclear whether the Board's intent in those situations is to require preparers to quantify the effects of the selected accounting policy relative to the other acceptable alternative accounting policies. We believe this disclosure will often be challenging and may not be cost effective (e.g., preparers would incur costs to effectively account for the line item using multiple methods, such as weighted average and first-in, first-out (FIFO) inventory costing methods).

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<sup>25</sup> Question L10 asks whether there are acceptable alternative accounting policies or methods that might have been applied to this line item. It provides the following information to be considered for disclosure: (a) the accounting policy or method applied and (b) the magnitude of the effect if the accounting method is unusual, if results produced are counter to what a reader might otherwise expect (for example, last-in, first-out inventory costing), or if the method otherwise dramatically affects the financial statements (full cost versus successful efforts).

In the discussion of a narrower requirement for disclosure of accounting policies, Paragraph 7.8 also refers to question L11,<sup>26</sup> which we do not believe would improve disclosure effectiveness because it is too broad. Given that ASC Topics are not written to address each type of transaction that occurs in practice, we believe the requirement of question L11 would result in a “catch-all” disclosure of various transactions.

**Question 21:**

**Should the summary of accounting policies include information about industry-specific accounting policies?**

**Response:**

As described in paragraph 1.16, the framework presumes that financial statement users are knowledgeable about certain types of information, such as general business risks, general economic conditions, US GAAP and SEC reporting requirements, among other things. Paragraphs 7.7 and 7.8 refer to question L10, which would require disclosure of an accounting policy when acceptable alternative accounting policies may be applied to a specific line item. We believe industry-specific accounting policy information should be disclosed if that information falls outside of the expectation of users' general knowledge (paragraph 1.16) and there are acceptable alternative accounting policies available that would result in disclosure in accordance with question L10. For example, in the oil and gas industry we believe an accounting policy disclosure of the use of either the full cost or successful efforts accounting method would meet the criteria described in question L10. Otherwise, we believe industry-specific accounting policy disclosures would not be necessary because users would be presumed to be knowledgeable about such information. We believe that this approach to industry-specific accounting policies would be consistent with one of the objectives of principles-based accounting,<sup>27</sup> as stated by the Board, whereby accounting standards only address significant matters<sup>28</sup> and professional judgment must be applied in situations that are not directly addressed.

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<sup>26</sup> Question L11 asks whether the line item include balances or the effects of transactions or events that either are not addressed by directly applicable reporting requirements or are not clearly analogous to other transactions or events for which there is applicable guidance. It provides the following information to be considered for disclosure: (a) nature of the transactions or events and the method of accounting applied to them, (b) if applicable, uncertainties related to recognition or measurement or both and (c) any unique or highly unusual aspect of the transaction or event that would affect an assessment of the entity's prospects for future cash flows.

<sup>27</sup> In *The FASB Report*, dated 27 November 2002, the Board stated, “A principles-based approach would not eliminate the need for interpretive and implementation guidance. However, the Board believes that an objective of that approach should be to provide interpretive and implementation guidance that focuses only on significant matters addressed in the standards, thereby increasing the need to apply professional judgment in the situations not addressed.” FASB Chairman Robert H. Herz further stated, “While rules are sometimes unavoidable and the guidance should be sufficient to enable proper implementation of the principles, the intent is not to try to provide specific guidance or rules for every possible situation. Rather, if in doubt, the reader is directed back to the principles.”

<sup>28</sup> In *The FASB Report*, dated 27 November 2002, the Board stated, “To achieve an objective of providing interpretive and implementation guidance that focuses only on significant matters addressed in the standards, the Board and other standard-setting bodies would need to resist pressures to provide interpretive and implementation guidance addressing all possible applications of the standards. In that regard, the Board would need to establish guidelines sufficient to identify situations in which interpretive and implementation guidance in accounting standards is appropriate.”

**Question 22:**

**Are there other required disclosures that could be modified or eliminated in the short term that would result in a significant reduction in the volume of notes to financial statements?**

**Response:**

As we state in our cover letter, we believe existing requirements should be reduced first for disclosure to be effective. We believe that the historical process of establishing disclosure requirements on a project-by-project basis has led to a piecemeal approach to financial statement disclosure. As a result, we do not believe it is possible to significantly reduce the volume of disclosures in notes by reviewing required disclosures in isolation (i.e., on an individual ASC Topic or a project-by-project basis) for requirements that could be modified or eliminated because each disclosure requirement may seem to provide the user with some decision-useful information. We believe that the Board should establish a limited number of overarching disclosure objectives that recognize there are inherent limits to the amount of effective disclosure that can be made in the notes to the financial statements. The overarching disclosure objectives should also seek to prioritize disclosures that are relevant to the financial statements taken as a whole. We believe that the Board could then use these objectives to perform a comprehensive top-down review of all disclosures. We urge the Board to make this review and the reduction of disclosure a priority, and to limit new disclosure requirements until the project is completed.

No. 2012-18  
21 June 2012

# To the Point

FASB – proposed guidance

## Now is the time to address disclosure overload

The FASB is developing a disclosure framework to improve the effectiveness of disclosures, which have quadrupled over the past two decades.

### What you need to know

- ▶ Over the past 20 years, the average number of pages in annual reports devoted to footnotes and Management's Discussion and Analysis has quadrupled, according to our research.
- ▶ If the rate of increase continues, companies will devote more than 500 pages in annual reports to footnotes and Management's Discussion and Analysis by 2032. We don't see how this volume of disclosure would be helpful to financial statement users.
- ▶ The FASB is developing a disclosure framework aimed at improving the overall effectiveness of financial statement disclosures.
- ▶ This issue affects all stakeholders. Companies should consider providing comments to the FASB as it works on this important initiative.

### Overview

Almost 20 years ago, Ernst & Young's then-chairman predicted that if trends in disclosures over the previous two decades continued, the result would be a "paper glut" of "frightening" proportions by 2012. Based on our review of the 2011 annual reports of companies in the 1994 study that served as the basis for that prediction, it has largely come to pass.

The average number of pages of notes to the financial statements rose to 69 in 2011 annual reports, just shy of the 1994 projection of 72 pages by 2012. The average number of pages of Management's Discussion and Analysis (MD&A)<sup>1</sup> in 2011 annual reports, meanwhile, has already reached the projection of 48 pages by 2012. Reports for 2012 will undoubtedly contain more footnotes, due to additional fair value disclosures required this year.

We updated the study of the reports of large well-known companies amid growing concern about growth in disclosures – and the potential for a big increase if the Financial Accounting Standards Board (FASB) moves forward with the contemplated disclosures outlined in the various joint projects under development with the International Accounting Standards Board.

At the same time, the FASB and regulators at the Securities and Exchange Commission (SEC) are looking for ways to increase the effectiveness of disclosures. In a recent speech, FASB Chairman Leslie Seidman said “disclosure overload” is one of the most common concerns she hears about from investors and other stakeholders. Although investors continue to ask for more information, she noted that the information investors want is often “hidden in plain sight.”

### Key considerations

In the 1994 study, we reviewed the 1972, 1982 and 1992 annual reports of 25 large, well-known companies, including AT&T, Bank of America, Coca-Cola, Ford, General Electric, IBM, Procter & Gamble, Wells Fargo and Xerox. We set out to compare the number of pages these companies devoted to the notes to the financial statements and to MD&A.

The results showed steady increases. From 1972 to 1992, the number of pages devoted to footnotes increased 325%. For MD&A, the increase was 300%. Projecting those growth rates through 2012, Ray J. Groves, our then-chairman, predicted a glut of disclosures by 2012.<sup>2</sup>

We recently updated the results for 20 of the companies in the study and compared them with the earlier predictions. (Our population decreased because 5 of the original 25 no longer file separate annual reports.)

Describing required footnote disclosures currently takes approximately 400 pages in the FASB’s Accounting Standards Codification.

	Average number of pages					
	Actual				Projected (per 1994 study)	Projected (per 2012 study)
	1972	1982	1992	2011	2012	2032
<b>Footnotes</b>	4	9	17	69	72	320
Cumulative percentage change		125%	325%	1625%	1700%	7900%
Compound annual growth rate				7.6%	7.5%	7.6%
<b>MD&amp;A</b>	3	7	12	48	48	214
Cumulative percentage change		133%	300%	1500%	1500%	7033%
Compound annual growth rate				7.4%	7.2%	7.4%

### How we see it

If the rate of increase continues, financial statement footnote disclosures and MD&A will take up more than 500 pages in annual reports by 2032. While this may seem unlikely, we note that the 1994 projections were also considered unrealistic at that time.

One of the drivers behind the increase is the sheer volume of required disclosures. The Accounting Standards Codification currently takes approximately 400 pages to describe disclosure requirements. The number of required disclosures is poised to

jump again with proposals in the joint projects under development, coupled with the disclosures the FASB is considering about liquidity and interest rate risk.

There are many reasons for the increase. Businesses have become more complex, and some of the added requirements are aimed at addressing that complexity. Other requirements were introduced to address perceived abuses. Because disclosures are often addressed on an issue-by-issue basis, standard setters rarely eliminate existing requirements when they add new ones.

Ms. Seidman acknowledged in her recent speech that this ad hoc approach has caused challenges. While US GAAP currently requires few disclosures about revenue, she noted that it requires detailed disclosures about cost accruals that “might be relatively insignificant, in the grand scheme of things.”

Because there is no overall disclosure framework (or any form of sunset review), it is difficult to determine which disclosures would be most useful to investors. For example, we believe the proposed disclosures in the revenue recognition project would create a “disclosure checklist” mentality that would distract from the FASB’s objective unless the FASB clarifies that not all of them are required for each annual reporting period.

The tremendous increase in disclosures is not restricted to annual reporting. Interim disclosure requirements have also increased significantly in recent years. That’s because most of the new disclosures must be made for both interim and annual periods. As part of our updated study, we reviewed interim financial statements for periods ended 31 March 2012 and 31 March 1994 for the 20 companies in our population. We found that the average number of pages of MD&A in interim periods had nearly tripled, to 29 pages from 10 pages, while the notes to the financial statements increased more than 750%, to 35 pages from 4 pages.

### **FASB disclosure framework project**

The FASB plans to issue an Invitation to Comment on its disclosure framework project sometime soon. The primary focus of the project is “to improve the effectiveness of disclosures in notes to financial statements by clearly communicating the information that is most important to users of each entity’s financial statements.”<sup>3</sup> Reducing the volume of footnotes is not the goal, but focusing on important information could provide an opportunity to address the volume of disclosures.

As part of the project, the FASB hopes to develop a decision process that it would apply in establishing new disclosure requirements. The FASB also hopes to develop a separate decision process to help companies determine which disclosures they are required to provide. A company’s evaluation would be based on the effect the information would have on a user’s assessment of its future cash flows.

After the disclosure framework is developed, the FASB plans to reconsider existing disclosure requirements in light of the framework. In the meantime, the Board plans to use the draft framework when developing new disclosure requirements for pending standards.

### **How we see it**

We urge the FASB to make this project a priority and to limit new disclosure requirements until the project is completed. The FASB should determine what information financial statement users need that they aren’t currently getting and

We believe disclosure overload should be addressed expeditiously.

what information they are getting that is less useful. Investors' needs must be weighed against the costs of providing disclosures as well as the likelihood that important disclosures can be lost in a sea of required, but less useful, information.

We believe the FASB should develop a procedure to routinely review existing requirements. Users' information needs may change over time, and it is important to consider whether existing disclosures continue to be relevant. The FASB should consider disclosure requirements every five years or allow them to sunset – or disappear – if they are not reaffirmed by the FASB.

We also have significant reservations about the FASB's plan to develop a decision process for companies that is based on how such information would effect a user's assessment of a company's future cash flows.

### **SEC staff effort to improve disclosures**

The SEC staff, at the 27 March 2012 Center for Audit Quality SEC Regulations Committee Joint Meeting, indicated that it is identifying ways to improve existing disclosures. The staff plans to identify and eliminate redundant and out-of-date disclosure requirements after reviewing:

- ▶ Duplicative SEC disclosure requirements
- ▶ SEC disclosure requirements that duplicate US GAAP requirements
- ▶ Disclosures that are repetitive in practice due to misapplication of the existing rules or interrelatedness of various parts of a filing

### **How we see it**

The SEC staff's plan to identify and eliminate redundancies is a step in the right direction. It is also important for the SEC staff and the Public Company Accounting Oversight Board to be involved in developing the FASB's disclosure framework, in particular the part that involves judgment about which disclosures a company should include in its financial statements. The success of this part of the project depends on preparers being able to exclude certain disclosures without fear of being second-guessed.

### **Endnotes:**

- <sup>1</sup> Includes information required in Item 7, *Management's Discussion and Analysis of Financial Conditions and Results of Operations*, and Item 7A, *Quantitative and Qualitative Disclosures About Market Risk*, of Form 10-K.
- <sup>2</sup> Ray J. Groves, "Here's the Annual Report. Got a Few Hours?" *The Wall Street Journal*, 4 August 1994.
- <sup>3</sup> Project update page on the [FASB's website](#).

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SCORE No. BB2367

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