Ms. Susan M. Cosper  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

14 July 2014


Dear Ms. Cosper:

We appreciate the opportunity to comment on the Proposed Statement of Financial Accounting Concepts, Chapter 8: Notes to Financial Statements (the Proposed Statement).

We support the objective of the Financial Accounting Standards Board (FASB or Board) in its disclosure framework project (Project) to improve disclosure effectiveness in the notes to the financial statements. We also generally support developing a framework that the Board would apply consistently when creating new disclosure requirements and when critically evaluating existing disclosure requirements. However, we are concerned that the framework set forth in the Proposed Statement would not make disclosures more effective but would instead perpetuate the significant expansion in disclosure that has occurred over the past few decades. We find this concerning, given the large volume of disclosure requirements that currently exists and that makes it difficult for users to find important information in the notes to the financial statements.

Disclosure overload

Disclosure overload continues to be a concern for investors and other stakeholders, and this concern likely contributed to constituents ranking this Project as the Board's most important priority in a 2013 survey conducted by the Financial Accounting Standards Advisory Council. Currently, required disclosures comprise several hundred pages of the Accounting Standards Codification (ASC), and the number of pages continues to grow with each new standard. Our recent study of 40 years of financial statements found that the average number of pages devoted to notes to the financial statements grew at a compound annual rate of 7.6%, with disclosures roughly doubling every 10 years.1 While we understand that reducing the volume of disclosures is not the Board’s primary objective in this Project, overload does have a direct effect on disclosure effectiveness. However, given the large volume of disclosures required today and the trend of continuing growth, we believe the Board should use this project as an opportunity to create a roadmap to address disclosure overload.

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1 See EY’s To the Point, Now is the time to address disclosure overload, where we described our study of 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 continues at historic rates. (We have attached this article as Appendix C.)
While we believe the concepts in the Proposed Statement are an improvement over those described in the Board’s 2012 Invitation to Comment, the proposed framework most likely would not reduce or streamline disclosures. We find the series of decision questions (Appendix A of the Proposed Statement) to be very broad in nature, and they appear to have been designed for the purpose of ensuring that all possible disclosures are considered. They also have the appearance of being reverse engineered from today’s disclosure requirements. We are concerned that they will continue to foster disclosure overload.

We understand that the Board needs to think broadly about what disclosures need to be made, but it must be equally focused on limiting the information to be disclosed. The Proposed Statement discusses ways in which the Board should limit the amount of information to be included in the notes, but the discussion of these limits does not go far enough. While we recognize the Board proposed that this limiting process would be done as part of developing and evaluating individual standards, we believe it must also be a fundamental part of the framework. We believe the framework would be far more effective if it incorporated a robust cost-benefit analysis that the Board would apply before creating any new disclosure requirements. A key part of this analysis would be an assessment of whether the new disclosures provide more important information than existing disclosures and, if so, whether less important disclosures could be eliminated to help users focus on the new information. This limiting process could be partially incorporated into decision questions that the Board would consider. We have provided some examples in Appendix B of this letter.

We also believe that limits on information to be included in the notes to the financial statements should include a discussion of materiality and how it should be applied to decisions about note disclosure. The Proposed Statement indicates that materiality decisions are to be made by each reporting entity but does not define the term. While we agree that each reporting entity needs to consider materiality based on its facts and circumstances, we believe guidelines for entities to follow in making materiality determinations for note disclosures are needed. Both quantitative and qualitative guidance would be helpful, but catchall concepts under which virtually any disclosure could be viewed as material should be avoided. By providing guidance on materiality, the Board would assume control of and responsibility for how those assessments affect disclosure. Providing guidance would also reduce the likelihood of second-guessing. We note that how materiality is applied to disclosures varies widely in practice. To elaborate, some believe it is appropriate to assess materiality for each element of a disclosure. For example, whether a purchase price basis difference must be disclosed for a material equity method investment is based on the materiality of the basis difference. Some say that if the equity method investment is material, then all required disclosure elements, including the basis difference, must be included in the notes, regardless of the size of the element. Others may simply evaluate the materiality of a given disclosure in relation to the financial statements as a whole.

**Interim disclosures**

We agree with the proposed concept that the framework for determining interim disclosures should align with the existing Securities and Exchange Commission (SEC) interim reporting framework and the guidance included in ASC 270, *Interim Reporting*. The Proposed Statement indicates that interim financial statements should be primarily viewed as an integral part of annual financial statements, and interim financial statements are essentially an update of the information included in the latest annual financial statements. However, the Proposed Statement goes on to discuss the types of information that should be included in notes to interim financial statements, and some of the items discussed seem more consistent with a discrete period approach (e.g., all fair value changes, contingent liabilities).
We recommend that the Board further develop the framework for interim reporting by more clearly following the guidance in ASC 270 and the SEC interim reporting framework. As part of this effort, we suggest that the Board consider defining interim reporting requirements within the respective accounting standards and clearly distinguishing between annual and interim disclosure requirements. For the most part, the current guidance indicates that disclosures are required for each period presented in the financial statements but does not distinguish between annual and interim reporting requirements. As a result, many companies default to providing the same disclosures for interim periods as they do for annual periods. We found that over the past two decades the average number of pages of notes to the interim financial statements had increased more than 750%.

**Project process/testing framework**

We believe that before the Board decision framework is issued, it should be tested in some disclosure areas by applying the decision questions included in Appendix A of the Proposed Statement to develop new disclosure requirements and to evaluate existing disclosure requirements. Furthermore, we recommend that the Board formalize a process of hosting workshops for financial statement users and preparers together to determine the effectiveness of the recommendations.

Also, to address disclosure overload now and in the future, we believe the Board should commit in the Proposed Statement to periodically performing a comprehensive review of existing disclosure requirements. To address shifting priorities, we believe the Board should consider disclosure requirements every five years or allow them to sunset, or disappear, if they are not reaffirmed by the Board. To facilitate such a review, the Board would have to maintain a tool listing all note disclosures in one place. Ideally, this list would be organized by the type of financial statements entities prepare (e.g., annual, interim, employee benefit plans, not-for-profits, public and private). We believe that any challenges the Board would face in preparing the list would provide insights the Board could use in crafting more effective disclosure requirements (e.g., the importance of specificity in setting scope, the multiple definitions of public companies in US GAAP today).

Finally, we believe the success of the Board's disclosure framework project depends on its decisions involving both the Board's and the entity's decision processes. We believe it would be beneficial for constituents to evaluate the proposed guidance for each of these processes simultaneously so they can better understand how one interacts with the other. This would require closer alignment of the timelines of these two parts of the project.

Ultimately, the effectiveness of the framework will depend on how the Board applies it. We understand the Board may be performing research on how it might apply the framework to certain individual standards. We encourage the Board to expose and gather feedback on one or more standards before finalizing the framework. This exercise should give the Board valuable insight into the effectiveness of the framework.

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Our responses to the specific questions posed in the Proposed Statement are set out in Appendix A of this letter.

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

Very truly yours,

Ernst & Young LLP
Appendix A - Responses to specific questions raised in the Proposed Statement of Financial Accounting Concepts, Chapter 8: Notes to Financial Statements (Proposed Statement)

**Question 1:** Should financial statements of employee benefit plans be excluded from the scope of this chapter of the conceptual framework?

No. While the disclosure requirements prescribed by ASC 96X are unique to employee benefit plans, each time the Board issues a new standard there should be a clearly communicated decision on whether the disclosure requirements apply to an employee benefit plan. We recommend that the decision questions in Appendix A of the Proposed Statement be expanded to include considerations that would identify disclosures relevant to an employee benefit plan.

We also recommend that the Board maintain (and preferably publish) an all-inclusive list of disclosure requirements for employee benefit plans. This list would assist preparers and financial statement users and facilitate the Board’s periodic comprehensive review of disclosure requirements.

**Question 2:** Do the concepts in this chapter related to not-for-profit entities address the informational needs of resource providers to those entities?

While users of many not-for-profit entities' financial statements are different from investors, lenders and other creditors of business entities, some not-for-profit entities are business-oriented. We suggest that the Proposed Statement make this distinction to clarify that users of financial statements of this type of not-for-profit entity generally have the same interests as users of financial statements of business entities.

We believe the Proposed Statement addresses the informational needs of resource providers to business-oriented not-for-profit entities. However, we do not believe the concepts in the Proposed Statement address all of the informational needs of resource providers to more traditional not-for-profit entities. While resource providers of a traditional not-for-profit entity may find information on prospects for cash flows to be useful in making certain decisions, this information will not always be sufficient to support a user’s assessment of services provided by a not-for-profit entity and its ability to continue providing those services. For example, some lenders to traditional not-for-profit entities extend loans that are not based on conventional lending criteria but instead are made to comply with or benefit from government-related programs, without expectation of a typical return on investment. As these lenders are not making decisions based on their assessment of prospects for cash flows, requiring them to make disclosures designed for profit-seeking entities would have little benefit and could distract users from more relevant disclosures.

The Proposed Statement indicates that in making decisions regarding the types of information to disclose in the financial statements, the Board should consider the various types of resource providers and their purpose for using the financial statements. We believe that diligent application of this principle could appropriately result in a determination that certain disclosures about transactions similar to those entered into by business entities may have little relevance to users of financial statements of traditional not-for-profit entities (e.g., fair value of investments that are not recognized at fair value). On the other hand, other disclosures (e.g., the nature of any donor restrictions on cash flows and liquidity) may be more relevant to those users.
We recommend that the decision questions in Appendix A of the Proposed Statement be expanded to include considerations that would identify disclosures relevant to the efficiency and effectiveness of a not-for-profit entity in providing services and its ability to continue to provide those services. For example, Question L4\(^2\) would not necessarily identify a disclosure about how a not-for-profit entity might be able to use its resources. We recommend expanding this question to include the consideration of whether the line item includes components of different natures that could affect the cash flows available to the entity to fulfill its mission. In the list of examples included in Question L4, we recommend that the Board add an example that would say: “For not-for-profit entities, expenses related to program or administrative functions.”

In addition, each time the Board issues a new standard there should be a clearly communicated decision on whether the disclosure requirements apply to not-for-profit entities. We also would recommend that the Board maintain (and preferably publish) an all-inclusive list of disclosure requirements for not-for-profit entities. This list would assist preparers and financial statement users and facilitate the Board’s periodic comprehensive review of disclosure requirements.

**Question 3:** Do the concepts in this chapter encompass the information appropriate for disclosures in notes to financial statements that would assist resource providers in their decision making? Are there concepts that should be added or removed?

In determining what information should be required in the notes to the financial statements, the proposed framework emphasizes information that is necessary to assess entities’ prospects for future cash flows. While the objective of financial reporting is to provide financial information about the reporting entity that is useful to users in making decisions based on their expectations about returns from their investments, it appears to disproportionately focus on “matters that can affect an entity’s cash flows.” While information about an entity’s future cash flows may, in some cases, be based on information in the notes, we believe the primary purpose of the notes should be to provide explanatory information about amounts reported in the financial statement or that may be reported in future periods based on events that have already transpired (e.g., contingencies).

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\(^2\) Question L4 asks whether the line item includes components of different natures that could affect prospects for net cash flows differently. There are many examples of line items that contain different components, and not all of those components would necessarily affect prospects for cash flows in the same manner. Some examples include the following: (a) a portfolio of financial instruments of different types; (b) inventories of different types of products or of raw materials, work in process or finished goods; (c) revenues from different products or services whose sales are not correlated; (d) real estate that includes apartment buildings, malls and office buildings; (e) revenue related to a business acquired through a business combination; and (f) property, plant and equipment acquired in exchange for debt. The following are examples of indications that components affect prospects for cash flows differently: (a) different frequency or timing of occurrence, (b) different probabilities of repeating, (c) responses to different variables or different responses to the same variables, and (d) different rates of return expected.
**Question 4:** Are there additional concepts needed to identify information that is unsuitable for requirement by the Board in notes to financial statements even though that information would be consistent with the purpose of the notes?

We understand that the Board needs to think broadly about what disclosures need to be made, but it must be equally focused on limiting information to be disclosed. The Proposed Statement discusses ways in which the Board should limit the amount of information to be included in the notes, but the discussion does not go far enough. While we recognize that the proposed limits would be applied as the Board develops new standards, we believe limits also must be a fundamental part of the framework. We believe the framework would be far more effective if it incorporated a robust cost-benefit analysis that the Board would apply before creating any new disclosure requirements. Such an analysis would include an assessment of whether the new disclosures would distract users from other important financial information and, if so, whether less important disclosures can be eliminated to help users focus on the most important information. The limiting process could be incorporated into decision questions that the Board would consider. We have provided some examples in Appendix B of this letter.

We also believe that the limitations on information to be included in the notes to the financial statements should include a discussion of materiality and how it should be applied to decisions about note disclosure. The Proposed Statement indicates that materiality decisions are to be made by each reporting entity and does not define the term. While we agree that each reporting entity needs to consider materiality based on its facts and circumstances, we believe guidelines for entities to follow in making materiality determinations for note disclosures are needed. Both quantitative and qualitative guidance would be helpful, but catchall concepts under which virtually any disclosure could be viewed as material should be avoided. By providing guidance on materiality, the Board would assume control of and responsibility for how those assessments affect note disclosures. Providing guidance also would reduce the second-guessing that some believe contributes to the current state of disclosures.

**Question 5:** Do the decision questions in Appendix A identify the information appropriate for the Board to consider requiring for disclosure when setting standards related to line items and other past events and current circumstances and conditions that can assist resource providers in their decision making?

The decision questions are very broad in nature and appear to have been designed for the purpose of ensuring that all possible disclosures are considered and also have the appearance of being reverse engineered from today’s disclosure requirements. We are concerned that they will continue to foster disclosure overload. We understand that the Board needs to think broadly about what disclosures need to be made, but it must be equally focused on limiting information to be disclosed.

**Question 6:** Does the discussion in paragraphs D43-50 identify the information appropriate for the Board to consider when setting standards related to information about the reporting entity?

Paragraphs D43-D50 primarily address topics for which disclosure requirements currently exist (e.g., related party transactions, segments, consolidation). It is unclear how the Board will use this information when setting standards related to information about the reporting entity in the future. Furthermore, limits on this type of disclosure (e.g., how to evaluate whether to disclose information of strategic advantage that, if disclosed, would harm the entity) are not discussed.
**Question 7:** Will the concepts related to future-oriented information (paragraphs D22-D31) result in disclosures that are appropriate for the notes? If not, what types of information should be included in or excluded from consideration for disclosure in the notes?

We support the concepts related to disclosure of future-oriented information. We believe the Proposed Statement adequately sets limits on the types of information to be included in notes to financial statements related to future-oriented information.

**Question 8:** Do the concepts in this chapter appropriately distinguish the types of information that are appropriate for the notes from the analysis management provides in other communications?

The information to be considered for disclosure for certain decision questions in Appendix A may be more appropriate to include outside of the financial statements (e.g., Management’s Discussion and Analysis). For example, the qualitative information to be considered for disclosure in item b. of Question L2 relates to risk factors that may be more appropriately included in Management’s Discussion and Analysis. Also, the information to be considered in items e. and f. of Question L2 involves a high level of estimation uncertainty that may not be easily audited.

**Question 9:** Are the concepts related to disclosure requirements for interim periods (paragraphs D60-D71) appropriate? If not, are there concepts that should be added or removed?

As noted in the cover letter, we agree with the Proposed Statement’s concept that the framework for determining interim disclosures should align with the existing SEC interim reporting framework and the guidance included in ASC 270, *Interim Reporting*. The Proposed Statement indicates that interim financial statements should be primarily viewed as an integral part of annual financial statements, and interim financial statements are essentially an update of the information included in the latest annual financial statements. However, the Proposed Statement goes on to discuss the types of information that should be included in notes to interim financial statements, and some of the items discussed seem more consistent with a discrete period approach (e.g., all fair value changes, contingent liabilities).

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3 Question L2 asks whether the line item represents any of the following: (a) financial instruments issued or held by the entity, (b) other contracts or legally binding contracts, or (c) other binding arrangements. It provides the following information to be considered for disclosure: (a) terms (obligations and rights) needed for the assessment of prospects for cash flows (some examples are amounts of timing of payments and receipts, interest rates, and the nature and timing of other required performance, call or put options, and penalty or bonus clauses); (b) if the item is an asset, the risk of counterparty nonperformance (credit risk or failure to deliver other assets or services) at the date of the financial statements; (c) the potential effect on the financial statements of the reporting entity of counterparty nonperformance; (d) the potential effect on the financial statements of the reporting entity of the entity’s nonperformance; (e) the estimated amounts and timing of future cash flows that are contractually required but whose amounts and/or timing are not contractually specified; (f) the estimated amounts and timing of future cash flows that are not contractually specified but that are anticipated or otherwise probable (for example, on the basis of past history or economic incentives); and (g) terms needed for assessment of prospects for cash flows of claims against the entity related to equity instruments issued by the entity. Some examples are the number of shares outstanding, the number of share options outstanding, dividend and liquidation preferences, conversion or exercise prices, participation rights, and unusual voting rights.
We recommend that the Board further develop the framework for interim reporting that would more clearly follow the guidance in ASC 270 and the SEC interim reporting framework. In addition, each time the Board issues a new standard, there should be a clearly communicated decision on whether the disclosure requirements apply to interim financial statements (e.g., apply in all cases, apply only if a significant change from the annual financial statements, do not apply). Given that we believe interim financial statements are an integral part of the annual financial statements, we support a significant change model as promulgated in the SEC interim reporting framework.

We also recommend that the Board maintain (and preferably publish) an all-inclusive list of disclosure requirements for interim financial statements. This list would assist preparers and financial statement users and facilitate the Board's periodic comprehensive review of disclosure requirements.

**Question 10:** If no disclosure guidance for a transaction, event, or line item is specified in U.S. GAAP, how will an entity consider the nonauthoritative guidance in this chapter?

We generally do not believe that entities will consider the nonauthoritative guidance in this chapter in determining the disclosures needed for a transaction, event or line item.
Appendix B — Questions for limiting disclosures

Below are example questions we recommend be added to the series of decision questions included in Appendix A of the Proposed Statement. These questions address the limits on information that are discussed in the Proposed Statement.

► **Is the objective of the proposed disclosure already accomplished by another disclosure? If so, which disclosure best accomplishes the objective?**

The proposed disclosure should be compared with all existing financial statement disclosures, and a determination should be made as to whether any existing disclosures meet the same objective, in whole or in part. If there are any such disclosures, all should be evaluated and only the disclosure that best meets the objective should be made. All other disclosures should be eliminated.

► **Does the proposed disclosure provide more important financial information than existing disclosure requirements? If so, are there less important disclosure requirements that can be removed?**

When adding new disclosure requirements, the Board should assess whether the new disclosure would provide more important information than existing disclosures. If so, the Board should consider whether less important disclosures could be eliminated to help users focus on the new information.

► **What are the benefits and costs of the proposed disclosure? Do the benefits of the proposed disclosure exceed the costs?**

The Board should ask financial statement users in the comment letter process for new standards to clearly articulate the benefits they believe will be achieved by a proposed disclosure. The Board should then evaluate those benefits to determine whether they are appropriate and consistent with its expectations.

The Board should also ask financial statement preparers in the comment letter process to clearly articulate the costs of obtaining the information to make the disclosure. The Board should then evaluate those costs to determine whether they are appropriate and consistent with its expectations. The Board should then compare those costs to the benefits to determine whether the benefits exceed the costs. If the Board believes that the benefits do exceed the costs, it should articulate an explanation of that evaluation in the final standard.

► **Does the proposed disclosure, when added to all other required disclosures, make the overall financial statement disclosure package more effective?**

This question assumes that the Board maintains a list of all required financial statement disclosures. The Board should then consider whether any proposed disclosures would make the entire disclosure package more effective. This would include the Board considering whether the disclosure is additive or excessive, and whether it makes it more difficult for users to find information or overlook important information. The Board should formalize the principles and a tipping point analysis to be used for determining when a disclosure becomes excessive and should be eliminated.
Is the proposed disclosure written in such a way that if it is not material, an entity will not be required to make the disclosure?

This question assumes that the Board develops materiality guidelines specifically for entities to apply to note disclosures. The Board would need to determine that each additional proposed disclosure is written in such a way that entities could apply the materiality guidelines to it and not make the disclosure if it is not material.

Does the disclosure require a description of generally accepted accounting principles, such that a user should already be aware of the disclosure?

Users should be aware of generally accepted accounting principles. If a proposed disclosure requires a description of generally accepted accounting principles or the mathematics underlying a generally accepted principle (e.g., the Black-Scholes option pricing model), it should not be required.

Does the disclosure require information about general economic, political, business or other conditions that users should be aware of?

Users should have a working knowledge of general economic, political, business and other conditions that are specific to the entity. If a proposed disclosure requires this information, it should not be made.

Does the proposed disclosure contain information that is susceptible to being reasonably audited under generally acceptable auditing standards?

If the nature of a proposed disclosure is such that it is not susceptible to being audited under generally accepted auditing standards, it should not be required. This would generally mean that the proposed disclosure is not specific enough or contains forecast information that should not be included in notes to the financial statements. Other limitations could include whether the auditor would have the expertise to evaluate the information.

Could the proposed disclosure cause potential harm to the entity and its interest holders?

For example, if a proposed disclosure requires an entity to disclose a trade secret or a source of its competitive advantage, disclosure would not be appropriate. We note that under IFRS, this concept has been applied in developing the guidance for contingencies.

Does the proposed information to be disclosed consist of budget or forecast information?

Financial statements are intended to be a description and explanation of the historical performance of the entity. While budget or forecast information might be useful to financial statement users, notes to financial statements are not intended to be the means of communicating such information. As such, if a proposed disclosure contains such information, it should not be made. There may be other methods of presenting such information, but it should be outside of the notes to the financial statements (e.g., regulatory filings of SEC registrants).
To the Point
FASB – proposed guidance

Now is the time to address disclosure overload

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) 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.\(^2\)

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.)

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**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.” 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 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 much information would affect 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:

1 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.
3 Project update page on the FASB’s website.