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Thank you for that kind introduction, Joe [McCafferty, deputy editor, *Compliance Week*].

It's a pleasure to be with you today in Washington, with so many kindred spirits who like to play by the rules. Being in a position to actually write the accounting rules is a dream come true for someone like me—an accountant and an English major—although I am reminded on a daily basis that I only get one vote! And that is why the remarks I make today reflect my own personal views and do not represent an official position of the FASB.

In preparing today's remarks, I read a *Compliance Week* blog by Bruce Carton about what could be called "the study to end all studies," which was conducted by the Government Accountability Office. Mr. Carton wrote that:

> …the Pentagon found itself so overrun with studies in 2010 that it ordered a study to determine how much it cost to produce all of the various studies. At some point, the GAO decided it needed to study the Pentagon's study, giving the world perhaps its first-ever study of a study of studies.[1]

[1] Bruce Carton, "At the SEC, Investigations About Investigators Who Investigate Other Investigators," *Compliance Week*, May 16, 2012.

I [also] got a chuckle out of that quote, because it is a great example of the old adage, "truth is stranger than fiction." But more importantly, this piece brought to mind two major issues that now confront the FASB: disclosure overload and cost-benefit analysis.

Let me start with the issue of disclosure overload, which is one of the most common concerns that I hear from all types of stakeholders, from investors to auditors of micro-companies all the way up to the C-suite at major companies. Many of those stakeholders tell me that financial reports are just too long—and, as a result, that they have become much less effective tools for communicating with investors. Yet investors continue to say they want more information, particularly when there is a business downturn or failure. Often the information that these investors want is available in the financial statements—but it is hidden in plain sight.

How did we get to this point? I'll start by looking in the mirror and admitting that, over the years, the FASB has taken an ad hoc approach to disclosure. In areas in which you might expect significant disclosures, such as a company's revenue, there are very few GAAP requirements. Yet, in other areas, we have gone into great detail, requiring very specific information about a cost accrual that might be relatively insignificant, in the grand scheme of things.

Over time, the FASB also has taken an ad hoc approach to establishing disclosure requirements in interim reports. Until recently, companies were required to disclose only significant changes from their last annual reports. But in recent years, in response to strong investor feedback and input, the FASB generally has required that new disclosures be provided both annually and quarterly. Preparers tell us that it is increasingly difficult to provide the expanded disclosures within the accelerated regulatory filing deadlines. Finding the right balance between the investor's needs and the preparer's constraints is a recurring issue in our discussions.

Another issue contributing to "overload" is that, in some areas, FASB requirements overlap with SEC requirements. Sometimes that's because the FASB information is historical and the SEC requirement is forward looking. I don't know if most investors appreciate that distinction, or the legal safe harbor afforded to forward looking information in MD&A. And, of course, that doesn't help explain the concerns that we hear from private companies and nonprofit organizations, which are not subject to SEC requirements.

We also hear that a contributing factor is the "checklist" mentality of some companies and their auditors. To a group of compliance professionals, that might sound like a compliment. But it can be a real problem. When immaterial or unimportant information is given as much prominence in financial reports as important information, investors find it much more difficult to identify the information that provides insights into the trends, risks, and prospects of the company.

Speaking of materiality, many people struggle with how to apply the concept of materiality to disclosure items. If an item is material in a financial statement, must every prescribed disclosure about it be provided, even if some of *that* information is immaterial? On the other hand, can a preparer afford to omit immaterial information when they are likely to spend more time explaining to an auditor, investor, or regulator why it was omitted? I call this phenomenon "defensive disclosure." While I understand why companies do it, I think it contributes greatly to disclosure overload and ineffectiveness.

Disclosure overload is clearly a problem—and there is plenty of blame to go around. But the most important question to ask about disclosure overload is, "what are we doing about it?"

For some months now, the FASB has been working to develop a disclosure framework that we believe will improve the quality of the information being disclosed and will make financial statements more understandable for investors and other users.

Let me emphasize that the purpose of this project is to improve disclosure *effectiveness*, not to single-mindedly reduce disclosure volume. In the coming weeks, we will issue for public comment a Discussion Paper that will address three different areas that could affect disclosures, both in the present and the future.

First, the framework will help the Board establish consistent disclosure requirements that focus on what is most important to most users.

Second, the framework will explain how the reporting entity should evaluate which disclosures are needed under different circumstances at different times—in other words, it will lead to a more dynamic approach to providing disclosure.

That would include determining when it is appropriate to *exclude* particular disclosures. More specifically, there appears to be an opportunity for entities with limited exposures in particular areas to reduce the volume of their notes, such as a small, frozen pension plan that is still the subject of pages and pages of disclosure. Eliminating the "clutter" of immaterial disclosures in cases like that can help users find and focus on more important information.

Third, the framework will explore ways to emphasize the more "newsworthy" information and ways to make it easier for users to find the information that they are most interested in. For example, would the notes be more helpful if the information most likely to influence a user's decisions were emphasized in some way, for instance, through a better ordering of the disclosures? We understand that some companies organize some of their notes in the order in which the disclosures became effective. Surely, there is a more logical order than that! Additionally, tying the financial statements to the notes and vice versa also could facilitate a user's analysis of the information.

The Discussion Paper also will invite comments on the approach to interim disclosures and how to evaluate materiality in the context of disclosures.

I know that some people would like to start slashing disclosures right now to deal with the wide perception of overload—the so-called "red pen" approach. However, at a recent resource group meeting, we received broad support for establishing a framework for disclosure first, so that there is a rationale for deleting or modifying existing disclosures and potentially adding new disclosures in the future. We also plan to hold interactive forums to generate interest and awareness in the framework during the comment period.

Once we have confirmation on the basic elements of the disclosure framework, we plan to undertake a review of existing disclosure requirements. Because one of the known issues is perceived overlap between the GAAP footnotes and MD&A, we plan to work cooperatively with the SEC staff. In fact, the topic of disclosure effectiveness is being contemplated for an upcoming meeting of the Financial Reporting Series, a roundtable including representatives of the SEC, the FASB, and the PCAOB, as well as participants from the financial reporting community.

In our current deliberations of pending standards, we are trying to think strategically about disclosure requirements based on the key principles underlying the draft framework. For example, on the revenue recognition proposal, we heard very diverse views from preparers (who said the disclosure requirements were excessive) and investors (who strongly supported the proposed disclosures). We plan to hold a special workshop this Fall that will include both preparers and users to work through the proposed requirements and to try to provide the information that users are seeking, but perhaps with greater focus and efficiency.

We believe that our Disclosure Framework project will lay the groundwork for a robust discussion about how we can all work together to make the financial statements a more effective communication tool, and we look forward to your comments and suggestions when the Discussion Paper is released in the next few weeks.

Now let me turn to the second issue that is top of mind at the FASB—the analysis of costs and benefits in standard setting—and some recent calls for us to extend that analysis into the economic effects of the standards that we set.

I'd like to begin with a few words about what the FASB means when we talk about the costs, benefits, and consequences of accounting standards.

First, we recognize that financial reporting can have economic consequences.

One consequence is the economic growth that is fostered by efficient markets and confident investors who have the information they need to wisely deploy their resources.

Another is the lower cost of capital that results from credible and consistent financial information.

Yet another is greater corporate accountability that results from financial reporting that is transparent to investors.

All of those positive consequences flow from informed decision making on the part of investors, creditors, and other users who need information that is relevant, complete, and neutral to discriminate between alternative investment opportunities—that is, they need financial statements that tell it like it is.

But information comes at a cost—the cost of preparing and using that information. When the FASB says it won't issue a standard unless the benefits justify the costs, we mean the following: We issue standards if the improvements in the quality of the reporting are expected to justify the costs of preparing and using the information.

For the FASB, cost-benefit analysis is not a discrete exercise that we ask our staff to undertake at the end of the process. From my perspective, the entire FASB process is one big cost-benefit analysis. That is, every step of our due process procedures is an effort to gather information about the benefits of a potential change in accounting; namely, to identify the most faithful way to present information about a transaction or economic condition so that investors and other users of financial statements can make well-informed decisions.

The FASB's due process also involves collecting information about the costs of providing that new or different information. That includes the cost of understanding the requirements, developing systems to collect and process new information, the cost of training people, and the cost of auditing the information. The assessment of costs and benefits is an unavoidably subjective evaluation, because until investors have experience using that new information, our understanding of benefits is based on what they tell us they need and how they will use the information. Likewise, until a company has actually adopted a new standard, our understanding of costs is based on imprecise estimates, even in a well-constructed and broad-based field test.

Nonetheless, throughout the process, we use a variety of techniques to gather robust data about both the expected benefits and the expected costs. That data includes academic research about how investors are using or adjusting information, meetings with preparers, auditors, users, and regulators, comment letters, surveys, roundtables, and meetings with our numerous advisory groups. We also conduct many forms of field work, during which we ask companies to consider possible alternatives and comment on the relative costs and the faithfulness of presenting the information in particular ways.

I want to emphasize that the FASB is constantly evaluating ways to improve its processes. For example, in the last few years, we have experimented with a few new techniques, including an electronic feedback form on Exposure Drafts, investor road shows to gather more information about what users need, and workshops to discuss specific provisions with preparers, users, and auditors. Tomorrow, we are having a discussion with our advisory council, FASAC, to talk about the Board's current approach to evaluating costs, benefits, and consequences as part of our ongoing initiative to update and improve our procedures in this specific area.

I also should mention that the FAF is now conducting reviews of the effectiveness of selected standards that have been in effect for a few years, which provides useful information about how the actual costs and benefits of a standard compare with the Board's expectations, as well as helpful suggestions about how to improve our processes.

So, that's what we mean by "cost-benefit" analysis. But, recently, some have called on the FASB to move beyond that paradigm and study the broader impact of proposed accounting standards on the economy. They suggest that particular companies or an industry will be especially harmed, and to do so would not be in the public interest. I'd like to spend a few minutes discussing some of the concerns that I have about that approach.

The role of financial reporting in the economy is to provide information that is useful in making business and economic decisions, not to determine what those decisions should be. While new accounting standards may change the way companies report their financial condition, the standards do not create or change the underlying condition itself.

Do we expect accounting information to have consequences or economic effects? Absolutely. Is that a bad thing? Let me use an analogy to explore that question.

A barometer, as you all know, is a scientific instrument used to measure the pressure in the atmosphere. An accurate reading of atmospheric pressure can help predict the weather. The tool—the barometer—has an effect on behavior if someone reads it, predicts rain, and buys an umbrella **or** reads it, predicts sunshine, and goes out without an umbrella. The barometer does not guarantee anything, but it can be useful in making informed predictions and decisions if it is neutral and accurate.

But suppose we all would prefer that it be sunny every day, and we asked the makers of barometers to recalibrate the barometer so that every day, the barometer readings would predict sunshine. What would be the effects of that? Well, some people would wake up happy at the start of every day. But, probably many would be annoyed at the end of the days that it actually rained. Some might be harmed on the days that it stormed because they didn't take adequate precautions. And so it is with financial reporting. Standard setters can't make it sunny or make it rain; the best we can do is provide a neutral tool so others can make informed decisions based on the likelihood of sun or rain.

The desire to have the Board consider economic consequences is not new—in fact, I borrowed the barometer analogy from a speech given by Oscar Gellein, a former FASB member—in 1978. But from the earliest days of standard setting, the history books show repeated episodes of concern about economic consequences, including replacement cost accounting in the 40's, deferred tax credits in the 50's, convertible debt in the 60's, oil and gas accounting in the 70's, and employee benefits in the 80's, 90's, and the new millennium.

To dive a little deeper into this topic, let me use an example from the '80s that many of you are probably familiar with, and that is other postemployment benefits or OPEB. It is actually a timely issue for our sister organization, the Governmental Accounting Standards Board, which is currently addressing pension accounting for state and local governments.

The FASB added the project to its agenda because of growing concerns that material, long-term retiree healthcare obligations were being incurred in corporate America, but they were not visible in the financial statements because they were accounted for on a "pay-as-you-go" basis. The consequence was that the balance sheets of companies that provided OPEB benefits looked the same as those that did not, despite the significant difference in their long-term obligations.

Board members concluded that OPEB plans were a form of deferred compensation—a promise to provide future healthcare or other benefits in return for current service. So they proposed that companies should be required to use accrual accounting—to report a liability measured as the actuarially determined estimate of the present value of the promises that had been made, using assumptions about interest rates, future medical costs, service periods, etc. Opposition to the proposal was widespread and forceful. It resulted in a *Business Week* headline, "First thing we do is kill all the accountants,"[2] and articles asking "What's a 'fas-bee' and why is it terrorizing American's largest companies—and their retirees?"[3]

Companies and even some investors raised concerns about the subjectivity of the measurements, and the potential for significant negative effects on the earnings and equity of companies in certain sectors. People raised concerns about the potential consequences of those reporting changes—in particular, that employees might lose some or all of their benefits as companies adjusted their plans to mitigate those reporting effects. Others raised concerns about the potential for Congress to use the new information to consider changes in the tax deductibility of advance funding, and possible legislative action about the level of funding that should be mandated.

The Basis for Conclusions of Statement 106[4] describes the journey that the Board went through to understand the benefits of accrual accounting, the costs of providing that information, and its assessment of the asserted consequences. The Board conducted a field test to gather detailed information about the costs of implementing the proposal, and many changes were made to the Exposure Draft

[2] James R. Norman and Susan Garland, "First Thing We Do Is Kill All The Accountants," *Business Week*, Issue 3069, September 12, 1988.
[3] Ian Johnson, "Taking Retirees Into Account: New Rule Forces Companies to Report Cost of Health Care," *Baltimore Sun*, January 17, 1993.
[4] FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*.

to reduce those costs, including a permitted phase-in of the transition obligation. The Board also carefully evaluated the concerns that had been raised about economic consequences, and concluded that they were the result of the promises that had been made, not the principles used to account for them.

The implementation of Statement 106 did, in fact, result in some of the predicted consequences—several companies reported material charges to equity and reduced earnings. The standard required that companies study and understand the terms of their plans. Companies learned that their plans were expensive, and some companies admitted that they had not previously been measuring the cost of the promises they had been making. Some decided to adjust the forms of benefits being promised to retirees. Gary Kabureck of Xerox was quoted at the time as saying, "FASB did the world a favor by making us deal with the costs sooner rather than later….you find out a lot of data about your medical costs. It's time well spent."[5]

The FASB's reason for changing OPEB accounting was not to influence in any way the nature or amount of retiree benefits that companies provided. The reason for the change was to provide investors with much needed information about significant obligations. But it is clear that the benefits of better information provided by the standard caused management and investors to think about this form of compensation in a different way.

As a result of Statement 106, the barometer indicated that OPEB storms were brewing. That information was credible, and the actions taken in response were

[5] Stephanie Overman, "Wake-up Call on Retiree Health Costs," Society for Human Resource Management, *HR News,* November 1992.

based on better information about where and what the problems were. In my opinion, that is the hallmark of a good accounting standard.

I'll leave you to think about the consequences if we had *not* moved forward with the standard, or instead had recalibrated the barometer to predict more sunny days: would the economic issues facing those companies and our capital markets today be better or worse than the adjustments that actually took place based on the new information?

Some have suggested that we undertake studies of the adverse consequences that our proposals might have for certain employees, or companies, or sectors of the economy. Some think that the potential for adverse consequences is a reason to not improve reporting. We don't share that view. We think investors, creditors, donors, and other users, including policy makers, need relevant and unbiased information on which to base their decisions. They need a good barometer, even if it sometimes predicts rain. To do otherwise would be to put the special interests of a few ahead of the broader public interest in unbiased financial information.

In closing, let me thank you for your attention, and encourage you to stay involved in the standard-setting process. We welcome your thoughts on the issues I have mentioned today, as well as the many specific financial reporting issues that we are striving to improve.