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Ronald W. Lott  
Research Director  
Financial Accounting Standards Board  
401 Merritt 7  
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Re: File Reference No. 2012-220

Dear Ron,

I am pleased to have the opportunity to comment on your discussion paper regarding possible changes to the disclosure framework. I am an independent security analyst who has followed accounting standards and financial reporting issues for nearly 20 years. In this position, I am an active user of financial statements for the purpose of evaluating the future prospects of publicly-traded companies and their securities (both stocks and bonds). I have long wished for improvements in financial reporting that would eliminate duplication and less relevant disclosures. However, I am also wary about cutting back on disclosures for fear that useful information might be lost.

**Any project to address disclosure practices should be comprehensive.** Although I understand that your proposal (and a companion proposal to be distributed in Europe by the EFRAG, the FRC and the ANC) covers only footnote disclosures, I believe that any effort to improve disclosure should be comprehensive and therefore should encompass items 1-6 in 10-K filings, the MD&A section, the financial statements and the footnotes. I recognize that the FASB only has jurisdiction over the financial statements and footnotes, so any such effort would have to involve the SEC and therefore add another layer of complexity to the process. Nevertheless, I do not believe that the Board can make meaningful strides in improving the relevancy of disclosures (and eliminating irrelevant or duplicative disclosures) unless its process addresses all of these disclosure venues.

For example, many companies make accounting policy disclosures in both the footnotes and the MD&A sections. The Board's proposal to address the footnote disclosures does not address the disclosures made in the MD&A section. Conceivably, then, any overarching framework that the Board creates for footnote disclosure may have to be revised if and when a more comprehensive effort is undertaken. This could potentially add significant costs to this project

Similarly, I have seen instances in certain industries, where some companies have made their detailed disclosures on a topic in the footnotes and others in the MD&A. The choices of where and how detailed each company makes its disclosures are relevant to the user. If the FASB addresses only one disclosure venue (i.e. the footnotes) without considering the others, it cannot conceptually cover disclosure completely. I am confident that preparers of financial statements consider all of the available sections in making their decisions about disclosing financial information. It seems to me that the FASB (and the SEC) should too.

**Disclosure policies should be targeted to the experienced user.** While I admit that the footnote disclosures are typically voluminous, the experienced user can usually cut through much of the clutter without too much wasted effort to find the information that he or she believes is relevant. Sometimes, certain disclosures that are less relevant today can become more important as business conditions change. I recognize that many types of disclosures can be improved and some can be eliminated or reduced without much of a loss. Still, I do not believe that standard setters should focus on the casual user as the primary consumer of footnote information; for in doing so, it is more likely that relevance would be compromised and the increasingly short-term focus of the user community may be reinforced.

With that overview, I will try to answer the questions that you put forth in your Invitation to Comment.

Question 1. The details of the 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 be supplemented to consider the needs of donors? How, if at all, should not-for-profit reporting entities modify their decision-making process for the needs of donors, when deciding which disclosures to include in notes to financial statements?

In my limited experience in looking at the financial statements of not-for-profit organizations, I have recognized that donors essentially want answers to two questions: Is the organization using its money effectively and is it using it efficiently? In most cases, the effective use of donor funds cannot be measured in a profit-and-loss statement. Here, the "MD&A" or its equivalent for a not-for-profit organization, should focus on both qualitative (i.e. how well did it meet its mission?) and quantitative (i.e. how many people did it serve?) measures. Efficiency is typically measured by the ratio of administrative costs to donations received. Organizations that use third-parties to raise funds should also disclose gross receipts and amounts paid to those third party fundraisers. Many of the footnotes for a for-profit enterprise do not apply to non-profits and so they are not included in non-profits' financial statements. Consequently, I do not believe that the Board's decision process should be supplemented to consider the needs of non-profit donors.

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?

I have not tested the decision questions in this chapter or the related indicated disclosures to be able to offer any examples of footnote disclosures that fall through the cracks of your framework. It would have been helpful if the Invitation to Comment included some specific examples of disclosures that the staff found that fell outside of this framework (as described in paragraph 2.20).

The Board proposes that the potential effect of any disclosure item on future net cash flows be the sole criteria for determining relevancy. There is no question that future net cash flows are important, indeed probably the most important criteria, but it should not be the sole criteria, in my view. First of all, this raises the issue of timing: when will an item affect cash flow? Often, the disclosure of a potential liability is more relevant and can have a dramatic impact on the value of an investment, even though the timing and ultimate amount of the actual cash flow may be uncertain. Similarly, there are certain footnote disclosures, such as the calculation of earnings per share or the issuance of convertible debt, which either do not affect cash flows at all or are relevant only because they represent potentially significant dilution to shareholders (and thus do not affect net cash flows).

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?

The framework appears to be so complete that a strict interpretation of it could lead one to conclude that many, if not all, of the disclosures contained within the MD&A should also be included in the footnotes. For example, category b.(2) (from paragraph 2.10), which calls for the inclusion of information about "how the line items affect prospects for future cash flows" could apply to the sales, gross margin and operating income lines from the income statement. Questions L1, L4, L5, L6, L9 and L10 could be answered affirmatively for those three income statement line items, so it could conceivably require the preparer to include a discussion of gross margin and operating income trends in the footnotes. In my view, if the Board is not going address disclosures comprehensively (i.e. including the MD&A), the framework should at least spell out how footnote disclosures should differ from (or relate to) those included in the MD&A.

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?

I think that the Board should continue to exercise judgment, as it has in the past, to determine on a case-by-case basis when it is useful and important to have

consistency of disclosure (i.e. detailed requirements in each project) and when it is necessary, because of the differences in circumstances, to allow preparers to craft their own disclosures. It is hard to imagine that users would be better served by having 1,000 different varieties of pension disclosure. On the other hand, other disclosures, like derivatives, impairments and contingencies, are probably not so easily standardized. In these cases, disclosure requirements should be principles-based, with the Board continuing to prescribe the key items that at a minimum must be included in the disclosure, while letting the company determine the specific format and any supporting information.

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?

I think that the proposed decision process is too complex and not sufficiently refined to be successful. If the Board finds it to be a useful tool in deciding how to structure disclosure requirements on proposed standards, then by all means it should use it; but I would be surprised if many preparers think that it is a better alternative to existing practice.

Preparers have been using existing accounting standards and their own determinations of materiality to make their footnote disclosure decisions. I have come across instances where, for example, I thought that a detailed schedule of the "other liabilities" line item provided by one company offered little decision-useful information; but another company, which should have provided such a schedule because it had a big cash outflow in this line item in one reporting period, refused to do so.

The problem here, I believe, is not due to the lack of a comprehensive disclosure framework, but rather in the implementation of existing standards. Preparers generally know what information is useful to users in their footnote disclosures; but they will not disclose it, if they believe that it is not in their interests to do so, unless they are pushed to do so by the user community or forced by regulators, like the SEC.

In my view, the Board would be better served by offering a simpler, principles-based footnote disclosure proposal. Footnote disclosures should contain information that is useful to investors, creditors and other relevant stakeholders in their decision-making processes. They should help to explain a specific line item in greater detail to understand both how that line item may change over time and how it might affect future cash flows. They should help users better understand the interconnections between the income statement, balance sheet and statement of cash flows. They should mostly be based upon accounting standards promulgated by the FASB on key topics that are common to most preparers, including income taxes, pensions, inventories, long-term debt, earnings per share and others. Beyond that, they should cover line items or contingencies that have (or could have) a material impact on the financial statements.

Question 6: Would any of the possibilities in [Chapter 3] (see paragraphs 3.8 and 3.11) be a practical and effective way to establish flexible disclosure requirements?

As you propose in the Invitation to Comment, the best solution is likely not to be one where responsibility for disclosure selectivity rests either solely with the Board or solely with reporting entities, but rather one that is between the two extremes. As noted above, I think that there is great value in standardized disclosures, because they allow experienced users (as well as auditors) to evaluate the disclosures with greater efficiency, especially for those who analyze many different companies. At the same time, reporting entities should have the flexibility both to provide less disclosure (if the reported item is not material) or more disclosure (if the reported item is especially significant or sufficiently complex) in order to give users a better understanding.

I believe that it is also important for the Board to recognize that different users have different needs. In many cases, an analyst who is a generalist may overlook much of the detail in a particular disclosure and zero in on a few key metrics, such as whether a pension is fully funded or whether the discount rate has changed. In practice, these analysts may comprise the majority of users of the financial statements of a given reporting entity. On the other hand, analysts who are industry specialists typically appreciate detailed disclosures, because they provide insights which may be useful both in achieving a full understanding of a reporting entity's performance and also in evaluating that company's performance against its peers. Through their research, these industry analysts make the greatest contribution to the market's understanding of a company. For that reason, I believe that the Board should target its disclosure policy to those users who follow the reporting entity most closely.

Question 7: If more than one approach would be practical and effective, which would work best?

Question 8: Are there other possibilities that would work better than any of the ones discussed in this chapter?

As a general practice, the FASB should set a minimum disclosure requirement. The format for that disclosure should be detailed and standardized, where practicable, to promote efficiency both in preparation and in use. Reporting entities should be encouraged to provide more disclosure, if they believe that it is relevant and necessary.

At the same time, the FASB might set a threshold for the minimum requirement for certain types of footnote disclosure. So, for example, the Board might decide to allow reporting entities to skip the detailed minimum disclosure requirement for pensions, if their Accumulated Benefit Obligation is less than 5% of their total capital (to pick a number). In that case, those entities may choose to provide the less prescriptive (and more free form) disclosures as envisioned in paragraphs 3.15 to 3.17.

So my 3-Tier Disclosure Plan would be as follows

Tier 1: For reporting entities that do not meet the minimum threshold requirements, the disclosure policies as set forth in paragraphs 3.15 to 3.17

Tier 2: The minimum, detailed and standardized disclosure requirement.

Tier 3: The minimum requirement plus expanded disclosures for those reporting entities who believe that such expanded disclosures are both relevant and necessary.

Question 9: This chapter attempts to provide a benchmark for judgments about disclosure relevance by clarifying the objective for the judgment. Is the description of the approach clear enough to be understandable? If not, what points are unclear?

As noted in my response to Question 2 above, I object to the assumption that the guiding principle for relevancy should be based upon a particular item's impact on future net cash flows. Net cash flows are important, but they are not the only relevant criteria. I believe, for example, that net income and (tangible) net worth are also quite important to investors and creditors. If the Board truly believes that net cash flows are the only relevant criteria, then perhaps it should initiate a project to propose eliminating the statement of comprehensive income from financial statements.

While the discussion in this chapter (Chapter 4) does acknowledge both the relevancy of other criteria (but only in so far as they have an effect on future cash flows) and also considers the problem of timing on the determination of relevancy, I still believe that it would be a mistake to base the criteria for relevancy solely on net cash flows. Conceivably, for example, financial statement preparers could take the position that impairment charges do not warrant detailed disclosures because they do not impact future net cash flows. The same might be said for other items that have a material impact on current net income or (tangible) net worth, but may not affect future cash flows.

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?

Other than the objection noted in my answer to Question 9 above, I can think of no material omission or anything that I can add to the approach described in Chapter 4 for identifying relevant disclosures. I do think that the approach is comprehensive and may therefore lead auditors and compliance professionals to opt on the side of retaining existing disclosures, rather than cutting back to improve disclosure effectiveness.

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?

I do not believe that reporting entities would necessarily need to document the reasons for their disclosure decisions. Obviously, many may choose to do so, especially in instances that might be considered controversial or to defend against potential lawsuits in the event that investors or creditors suffer significant losses that some of them might have avoided, if the disclosures were more complete. If entities feel that they have to document their decisions to provide less disclosure, then their lawyers will probably advise them to make the more extensive disclosure to avoid legal risk. In practice, the decision to document disclosure decisions should probably be limited to those situations where disclosures are potentially quite complex or where there are trade-offs between informing stakeholders and preserving competitive advantages.

Beyond that, the mechanics of how reporting entities would document their disclosure decisions and how auditors would audit them is best answered by those constituencies.

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?

Most of the suggestions included in the first part of Chapter 5 are simply common sense. Reporting entities are already very much aware of how to make their disclosures more readable and useful or how to obfuscate.

I do note, however, that U.S. reporting entities generally do much less in the way of cross referencing than their European counterparts. Such cross referencing is extremely helpful in understanding the interconnections between the income statement, balance sheet and statement of cash flows. Any initiative to promote more cross referencing would improve both the usefulness and ease of use of financial statements considerably.

Question 14: Do any of the suggested methods of organizing notes to financial statement improve the effectiveness of disclosure?

I believe that any potential role for the Board in determining or suggesting methods of organizing notes should take a back seat to the other proposals for improving footnote disclosure. It is sometimes the case that certain footnote disclosures are difficult to find and may be organized in a way that is not considered optimal. Yet, I think that this is more of a problem for generalists, who are looking at the reporting entity's financials for the first time. Any analyst who has more than one year of

experience in analyzing a particular company's footnote disclosures will generally know where to look to find the information that he or she needs quickly.

I am sure that some improvements could be made to the organization of footnotes, but these should be considered only after the desired level of quality and relevance in individual footnote disclosures is achieved. Even then, reporting entities should have the final say on organization because sometimes their choices can provide useful insights into the way that the reporting company is managed. The Board should not prescribe, but rather only recommend an organizational structure to footnote disclosure.

Question 15: Are there different ways in which information should be organized in notes to financial statements?

I would be wary of changing the ways in which information is organized in the footnotes. Existing groupings, such as derivatives or fair value disclosures, typically offer a more complete picture of the line items that are affected. Changing the groupings to mix the disclosures across topics, as suggested in paragraph 5.31, would make it more difficult to perform any analysis. Allowing the groupings and order to change from period to period would add another layer of complexity that would seriously compromise analyst productivity.

Question 16: Do you think that any of the possibilities in this chapter would improve the effectiveness of disclosures for interim financial statements?

While I can think of many examples where I wish that reporting entities would provide better (or more expanded) footnote disclosures, I generally do not have a problem with existing interim footnote disclosure practices. To me, the annual disclosures are most important and I do not think that it is reasonable to expect reporting entities to provide the same detailed footnote disclosures in their interim financial statements. I would be reluctant to add an additional burden on preparers for interim reporting and prefer that any efforts undertaken by the FASB to improve footnote disclosure focus on the annual reports. That said, I would guess that companies implicitly follow a framework roughly similar to that proposed in Chapter 6, guided by requirements already contained within existing accounting standards, for deciding upon their interim footnote disclosures. It would surprise me if implementing the framework proposed in that chapter would improve the effectiveness of disclosures for interim financial statements.

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?

I do not think that a framework for the Board's use would improve the effectiveness of interim reporting.

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 disclosure requirements for interim financial statements?

I do not think that designing a framework for the reporting entity's use would improve the effectiveness of interim reporting.

Question 19: What impediments do you see regarding the development of a framework for the Board, reporting entities, or both that addresses disclosures for interim financial statements?

The two biggest that come to mind are: (1) the additional cost burden placed upon reporting entities for this effort. (I believe that such costs would outweigh any potential benefits to financial statement users.); and (2) this vague notion of using the trend to determine whether disclosures are needed. Trends can quite often be in the eye of the beholder. If the Board proceeds along this route, it will, in my opinion, have to conduct extensive testing to determine whether the use of trends as a disclosure determinant identifies all of the relevant disclosures. In the end, the Board may have to find another more objective standard for determining which footnote disclosures are necessary for interim financial statements.

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?

As I understand it, the existing requirement calls for reporting entities to describe only certain current accounting policies that are material to the financial statements (for example, revenue recognition policy). It also requires reporting entities to list newly adopted accounting standards and state whether the new standard will have a material impact on their financial statements when adopted. Many of the latter type of disclosure seem mostly to be irrelevant and take up too much space.

If I am reading paragraph 7.8 correctly, you are proposing to replace this existing requirement with a narrower requirement contained in Questions L10 and L11 of the Invitation to Comment, which essentially would require disclosures of only those policies (a) for which alternative policies exist (and if so, to quantify the impact of the alternative policies) and (b) that "are not addressed by directly applicable reporting requirements" or "are not clearly analogous to other transactions or events for which there is applicable guidance."

I am concerned that the two proposed criteria are too narrow (and so would cause some useful policy disclosures to be dropped) and also that it would impose an additional burden upon the reporting entity that may not be cost justified. I think that some policy disclosures are useful, because they disclose specific parameters used by the reporting entity, even though there is only one acceptable method to use.

Ronald W. Lott, Research Director, FASB  
Invitation to Comment: Disclosure Framework  
October 18, 2012

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Many reporting entities now include in their MD&A section a list of their “most significant” accounting policies. This disclosure is often helpful and is not always replicated in the footnotes. Ideally, they should be merged to avoid the duplication. Under your criteria for L10 and L11, it is possible that some of these disclosures could be dropped, which would reduce disclosure effectiveness.

Question 21? Should the summary of accounting policies include information about industry-specific accounting policies?

If such policies are significant (i.e. have a material impact on the financial statements), they should be disclosed.

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?

Reporting entities currently operate under a disclosure framework, which, though not codified, is nevertheless still effective. Rather than work on establishing a new overarching footnote disclosure framework, the Board should adopt a principles-based framework (as I have outlined in my response to Question 5 above).

At the same time, the Board would better serve financial statement users by embarking on a project to consider the effectiveness of existing disclosure practices on key footnote topics. (Derivatives, Share-Based Compensation and Pensions are three that come to mind.) I think, for example, that the Board would quickly find that derivatives disclosures are ineffective both in the information that they convey and in what they fail to disclose. By making specific changes to existing disclosure practices that reduce the volume of disclosure and improve their relevance, the Board could, I believe, address more effectively many of the problems that gave rise to this Invitation to Comment.

Thank you for the opportunity to share my opinions with you on this very important topic. If you have any questions or want additional information about any of the responses that I have given in this comment letter, please contact me directly.

Sincerely,



Stephen P. Percoco