



November 30, 2012

Financial Accounting Standards Board  
Technical Director  
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Via Electronic Submission: [director@fasb.org](mailto:director@fasb.org), File Reference No. 2012-220

**Re: Invitation to Comment – Disclosure Framework**

Dear Ladies and Gentlemen:

Standard & Poor's Ratings Services appreciates the opportunity to provide the Financial Accounting Standards Board (FASB) our comments on the "Invitation to Comment–Disclosure Framework" (Invitation to Comment).

The views expressed in this letter represent those of Standard & Poor's Ratings Services and do not address, nor do we intend them to address, the views of any other subsidiary or division of Standard & Poor's Financial Services, LLC or of its parent, The McGraw-Hill Companies, Inc. We intend our comments to address the analytical needs and expectations of our credit analysts.<sup>1</sup>

**Capital Markets Greatly Need A Disclosure Framework**

In our view, financial reporting disclosures currently lack completeness, consistency, and clarity of information which can impede financial analysis. These issues result from incomplete, missing, and/or dispersed disclosures about a company's operations; financial statement line items such as components of the line items and explanations of period-to-period changes; and the nature and effect of other events and conditions that are relevant to the analysis of the company. Further, users require ease in accessing and using financial reporting information to facilitate financial analysis. For these reasons, we believe a comprehensive, uniformly applied disclosure framework is ever more important to analysis of financial reports. Global standard-setters are currently undertaking work on a disclosure framework, and we believe the FASB should be part of the global discussions with its own developed work to ensure the U.S. capital markets are represented and are an integral part of the emerging international financial reporting landscape.

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<sup>1</sup> The opinions stated herein are intended to represent Standard & Poor's Ratings Services' views. Our current ratings criteria are not affected by our comments on the Invitation to Comment.

### **Standard & Poor's Strongly Supports Efforts To Enhance Disclosures**

Standard & Poor's previously commented to the FASB – notably in our submission to the IASB and FASB Round Table on the global financial crisis<sup>2</sup> and in previous responses to the FASB on various accounting topics – that we support the development of a disclosure framework. In those comments, we indicated a disclosure framework should require that companies consistently disclose accounting policy selections and application; the related balances in the financial statements and account composition; the significant assumptions on which material account balances are based; the events that could cause these assumptions and balances to change; and an assessment of the probability or likelihood of such changes occurring. Disclosures should also better enable forward-looking analysis. Therefore, we strongly support the objective set out in the Invitation to Comment to improve disclosure effectiveness to enhance the relevance and usability of financial reports.

Current financial reporting does not give users sufficient insight about the financial performance, financial position, cash flow prospects, and risk exposures of a company, in our view. We believe the recommendations in the Invitation to Comment, requiring the development of a disclosure framework that promotes consistent decisions about disclosure requirements for notes to the financial statements, and the application of those requirements by companies, are long overdue. That said, to fully achieve the objective set out in the Invitation to Comment, we believe there is a need for a disclosure framework that has a broader focus than currently proposed.

The proposed scope of the project, as set out in the Invitation to Comment, is focused on the notes to the financial statements, within which there is a particular focus on disclosures that would assist users in evaluating future cash flow prospects. We believe this scope is too narrow for the development of a truly comprehensive disclosure framework. Users of financial reports consider all of the disclosures in financial reports, not just the notes to the financial statements. In addition, users want to better analyze and understand a company's financial position, financial performance, and risk exposures as well as its future cash flow prospects. For these reasons, we believe the FASB should work with the Securities and Exchange Commission (SEC) to develop a broader disclosure framework which encompasses all financial reporting disclosures. We also believe it is important to consider international consistency and convergence, because differences between U.S. Generally Accepted Accounting Principles (U.S. GAAP) and International Financial Reporting Standards (IFRS) impede the ability of users to compare peer companies across global capital markets.

We believe a disclosure framework that promotes a tiered disclosure regime could be helpful to analysis. Such a regime could consist of three tiers of disclosure: Tier 1: a disclosure set principally composed of roll-forwards and disaggregation of line items in the primary financial statements; Tier 2: disclosures based on existing U.S. GAAP; and Tier 3: additional disclosures necessary to achieve a fair presentation of the company. Within that, we believe Tier 1 disclosures should include tabular

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<sup>2</sup> Details of our submission to the IASB and FASB for their Round Table on the global financial crisis held Nov. 14, 2008, can be found on the IASB Web site ([http://www.ifrs.org/Current-Projects/IASB-Projects/Round-tables-on-global-financial-crisis/Documents/submissions\\_for\\_London\\_roundtables.pdf](http://www.ifrs.org/Current-Projects/IASB-Projects/Round-tables-on-global-financial-crisis/Documents/submissions_for_London_roundtables.pdf)).

disclosures that disaggregate financial statement line items and provide period-to-period roll-forwards for key financial statement line items. We elaborate on these tiers later.

### **Need For A Comprehensive Disclosure Framework That Can Quickly Deliver Key Enhancements**

While we recognize a disclosure framework likely will require much analysis and input from capital market constituents to develop fully, we strongly believe there is an opportunity for the FASB to achieve more immediate enhancements in the format and organization of the notes to the financial statements. In our view, such enhancements should encompass the Tier 1 disclosures mentioned above, as well as greater consistency in the way notes are organized and referenced. These are much needed, and should be a first milestone in the project. In our view, the FASB should reach this milestone in a defined, short period.

We elaborate on the aforementioned comments, as well as other matters raised in the Invitation to Comment, in the remainder of this letter.

### **Proposed Scope Is Limited**

In analyzing a company's financial performance, financial position, cash flow prospects, and risk exposures, users consider financial reporting information in the financial report as a whole, including information contained in the Management's Discussion and Analysis (MD&A) section and information presented in the primary financial statements and the notes thereto. Yet users face unnecessary hurdles in their analysis when topics are presented, discussed, and quantified in multiple places and ways within financial reports.

### ***There is a need to consider all financial reporting disclosures in financial reports***

Currently, some financial reporting disclosure requirements are set by the FASB (for notes to the financial statements) and, for public companies, some are set by the SEC (including for MD&A). Disclosure requirements have been established by either the FASB or the SEC based on differing objectives and at different times. This results in overlaps and gaps in disclosure, as well as substantially similar information provided in different formats or locations in the same financial report. In addition, financial statement disclosures are currently set by the FASB one project at a time, which causes further disparities in the level of disclosures across different topics. In our view, these factors complicate and obscure information provided to users and thus limit disclosure effectiveness.

MD&A and note separation evolved primarily because of separate FASB and SEC requirements and the perceived need to separate audited information from unaudited information. Yet from a user's perspective, it is difficult to justify the placement and organization of financial reporting being based primarily on which body has mandated the relevant requirements. Further, we do not believe there are significant obstacles or conceptual justifications to prevent companies from organizing and presenting all relevant information for a specific topic in one place in financial reports, with appropriate headings and designations to clearly distinguish audited and unaudited information. This should help reduce analytical efforts in piecing together related information contained in different places in financial reports (or elsewhere).

For these reasons, we believe the current scope of the disclosure framework project--focused only on the notes to the financial statements, rather than financial reports as a whole--is incomplete. We believe a disclosure framework project is best developed in the context of the full financial report, e.g., the MD&A, primary financial statements, and the notes.

We further believe that:

- The FASB should work with the SEC in developing the disclosure framework. We note that this has been a key recommendation of the Advisory Committee on Improvements to Financial Reporting. We agree with their view that there is a need for a disclosure framework that “integrate[s] existing SEC and FASB disclosure requirements into a cohesive whole to ensure meaningful communication and logical presentation of disclosures, based on consistent objectives and principles...[to] eliminate redundancies and provide a single source of disclosure guidance across all financial reporting standards”.<sup>3</sup>
- The FASB should take forward its work on its Financial Statement Presentation (FSP) project in developing a disclosure framework.

The purpose of the FSP project was to establish a standard that would guide the organization and presentation of information in the financial statements. The results of the FSP project would have directly affected how management communicates financial statement information to users of financial statements. Clearly, the goals of the two projects (Disclosure Framework and FSP) are integral elements of financial reporting, therefore we believe they should not be developed in isolation, and ideally should be worked on jointly. The staff draft of the FSP project proposed ordering the primary financial statements by categories (Business, Financing, Tax, Discontinued Operations and Other), and the notes in a similar way. In our view, this approach has merit, and we recognize that such an approach would ultimately affect the format and organization of the notes.

***The primary focus on cash flow prospects is too narrow***

The Invitation to Comment states “...investment and credit decisions depend directly or indirectly on prospects for cash flows from the equity or credit instruments”. In our view, the Invitation to Comment places primary emphasis on disclosures around potential future cash flows. We agree the predictive value of financial reporting is of great importance in financial analysis, but believe focusing primarily on cash flows is not an appropriate approach in developing a disclosure framework. In our view, the Invitation to Comment does not give sufficient explicit emphasis to developing disclosures that provide better information not just about cash flows but also about a company’s financial position, financial performance, and risk exposures.

**Decision Questions Should Be Enhanced And Applied Primarily By The FASB**

The Invitation to Comment suggests a series of decision questions could be relevant in identifying what information should be disclosed in the notes to the financial statements. We favor the approach outlined in the Invitation to Comment for the FASB to apply the decision questions. While companies may find the decision

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<sup>3</sup> Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission, Aug. 1, 2008.

questions useful in formulating their Tier 3 disclosures--and should be free to do so--if companies apply the decision questions independently (i.e., for all disclosures), we believe financial reporting consistency and comparability would diminish, primarily because preparers would have varied views on the application of the decision questions. Such an approach may also increase the risk of management bias in disclosures over time. As the standard-setter, it is the FASB that should continue to promulgate required disclosures, not companies.

We found several shortfalls--or areas that warrant further clarity--in the decision questions. Specifically:

- Understanding a company's risk exposures and risk appetite is a fundamental element in analyzing a company's financial position, financial performance, and future cash flow prospects. The decision questions do not go far enough in addressing risk disclosure, including, for example, risks related to measurement uncertainties; market sensitive exposures; and existing or changing risks that a company is willing to accept.
- The decision questions fall short in asking whether a disclosure will better enable an understanding of the interrelatedness of line items in the primary financial statements. Disclosures that properly reflect such interrelatedness would better highlight the connection across a company's earnings, cash flows, and balance sheet exposures.
- The decision questions are intended to limit note disclosures to information that is not already apparent from financial statements or readily available. This may cause less disclosure if it is inappropriately applied or understood too expansively by companies; we therefore believe the FASB should consider deleting the "readily available from public sources..." criteria in paragraph 2.14 b. from the Invitation to Comment.

### **A Flexible, Tiered Approach To Disclosures Could Help To Make Disclosures More Relevant To Users**

We recognize that the volume of financial reporting has increased significantly, but believe incomplete or missing disclosures are a much greater threat to the usefulness of financial reporting than is disclosure overload. Moreover, a disclosure framework that focuses on principles which address the problem of incomplete or missing disclosures--rather than on reducing disclosure volume--would likely result in disclosures that are better focused on areas that are relevant to users and thus reduce the level of redundant disclosures. We therefore subscribe to a disclosure framework that consists of three tiers, as described below:

- Tier 1: A disclosure set principally composed of roll-forwards and disaggregation of line items in the primary financial statements. In particular, Tier 1 disclosures should include:
  - Tabular roll-forward disclosures for every balance sheet line item. These disclosures should be based on the proposals set out in the July 2010 Staff Draft of the Financial Statement Presentation project, which proposed roll-forwards that analyzed changes between those arising from cash flows; recurring routine non-cash transactions; nonrecurring and nonroutine noncash transactions; accounting allowances and allocations; and remeasurements. The quantitative information in these tables should be

supported by qualitative disclosures that explain significant or unusual movements revealed by the tables. This will help users more confidently identify and understand movements in balances that are of interest for their analyses.

- Tabular disclosures that disaggregate each balance-sheet and income statement line item that management judges to be relevant for users' understanding of that line item, supported by qualitative disclosures to support that understanding. For example, where a company has complex or significant accruals, providing a disaggregation of the balance into its different elements, and providing narrative that explains the basis for accrual of each element, helps users to better assess the company's financial position and risk exposures.

We believe Tier 1 disclosures are an essential foundation for disclosures because management's determinations of materiality and relevance in the context of disclosures may differ from that of users. Tier 1 disclosures would serve as a simple and effective way for users to confirm the existence (or absence) of balances, transactions or events which may affect their assessment and analysis of a company.

- Tier 2: Disclosures based on existing requirements and recommendations set out in U.S. GAAP and applicable only if relevant and material. We believe the FASB should use the decision questions when promulgating new and changing disclosure requirements going forward. Ideally, the FASB would also re-visit existing disclosure requirements to ensure information outlined in paragraph 2.10 of the Invitation to Comment is reflected in U.S. GAAP; however, we recognize the practical limitations of the FASB taking this on.
- Tier 3: Disclosures that go beyond those set out in Tiers 1 and 2 but are necessary, on the basis of relevance and materiality, for users to properly understand the financial performance, financial position, cash flow prospects, and risks of the entity. Such disclosures would, by definition, go beyond the specific disclosure requirements set out in U.S. GAAP. As such, to formulate the disclosures, companies should follow the principles embedded in the FASB's decision questions, taking into account relevance and materiality.

***Relevance and materiality concepts should be elevated in U.S. GAAP***

Regarding the application of relevance and materiality in the disclosure framework, we strongly believe these concepts are well defined in the FASB's Conceptual Framework, specifically in the "Statement of Financial Accounting Concepts No. 8, Chapter 1, The Objective of General Purpose Financial Reporting, and Chapter 3, Qualitative Characteristics of Useful Financial Information" (CON 8). We believe companies already have the flexibility to disclose more information than currently required, and the flexibility to avoid immaterial disclosures, yet complete and transparent disclosure is rarely achieved consistently. This may reflect an approach to disclosure that gives greater weight to compliance with the letter rather than the spirit of disclosure requirements. Preparers may take the view that it is safer and less burdensome to include boilerplate or immaterial disclosures, rather than have to explain to users why the disclosure is not relevant and has been excluded. If so, a cultural change in the approach to disclosure is likely to be as necessary as a

disclosure framework. We believe including the relevance and materiality concepts within U.S. GAAP more explicitly (rather than its current placement in CON 8), thereby elevating its application, and mandating companies to provide relevant Tier 3 information, could help to promote such change. This could reduce--if not eliminate--compliance-driven disclosures.

### **More Immediate Milestones Within The Longer-Term Project Are Needed**

The disclosure framework project is in an early discussion stage and, given the nature of the topic and the need for appropriate scoping, it is likely to be long term, but that should not prevent the FASB from seizing the opportunity to achieve immediate and much-needed improvements to disclosures. We particularly see an immediate opportunity to make the format and organization of notes to the financial statements more relevant and logical. This should be a first milestone in the financial reporting disclosure framework project. We also believe the Tier 1 disclosures described earlier should be included in the first milestone of the disclosure framework project. The Board can, and should, make a clear commitment to reach this first milestone in a defined, short period.

In using the term ‘improvements’ in the context of format and organization, we mean notes to the financial statements that:

- provide more relevant information to users;
- are easier to navigate; and
- better facilitate meaningful comparisons across companies, including comparisons that highlight differences between companies that are attributable to different business models and risks.

### ***Format of notes***

We believe notes to the financial statements should provide relevant, company-specific information. Disclosures that are simply extracts from accounting standards, or contain generic wording (such as the example in paragraph 5.4 of the Invitation to Comment) do not provide useful information to users. As noted earlier in this letter, it may be that these boilerplate disclosures are simply there to “check the box” in meeting standard-setter requirements.

Quantitative information, in a tabular format, contributes to greater clarity in presentation and a greater level of standardization in similar disclosures across companies. We believe there is a world of difference between many pages of tabular disclosure and the same information being disclosed in narrative form. The former is far more conducive to allowing users to identify and focus on areas of interest to them; the latter makes this process more uncertain and difficult. Hence, volume is much less of a concern for tabular disclosures, and we believe that tabular formats should be the default preference for quantitative information.

### ***Organization of notes***

We agree that the order of the notes to the financial statements should be consistent across companies, because this would help users to more easily navigate through financial reports of different companies. In this regard, the suggestion set out in paragraph 5.22 of the Invitation to Comment could be a suitable logical order, although we believe it is more logical and useful for accounting policies to be included in the note to which the policy relates. Over time, this should also lead to

more concise, relevant accounting policy disclosures. We do not support the notion that accounting policies should be moved outside of financial reports (for example to a Web site location), because accounting policy disclosures that are concise and relevant to the company are an important element of understanding financial reports. It is not clear how transferring accounting policy disclosures elsewhere would effectively address the issue of boilerplate or generic disclosures, which we believe is a particularly egregious issue for accounting policy disclosures.

We believe companies should be required to provide cross-references in their financial reports. Providing relevant cross-references across notes to the financial statements, and from individual line items in the primary financial statements to the relevant disclosures in the notes, would be a helpful development in navigating through many pages of financial information. In some cases, it may also be appropriate to provide references to more detailed information available elsewhere (such as a company's Web site), although we strongly believe annual financial reports should remain standalone documents (and interim financial reports should provide relevant and timely updates to those reports, as elaborated later in this letter).

In the longer term, there likely will be a need to enhance format and organization in later milestones in the project, including any changes in financial statement presentation (such as those proposed in the FSP project). They also include changes in the format and organization of the financial report as a whole. As noted earlier, we believe that, in the longer term, combining current MD&A disclosures with current note disclosures would provide more cohesive financial reports for users. These are important milestones but, given the longer timeframe necessary to achieve them, we do not believe the first milestone should be delayed or avoided.

### **Interim Reporting Should Update Annual Information**

While interim reports should be considered in developing a comprehensive disclosure framework, annual financial reports are the most comprehensive, reliable public sources of financial information about public companies. Other reports, including interim reports, are important, but supplementary to annual financial reports. We also believe improvements in annual financial reports will permeate to interim reports relatively quickly.

Interim reports should provide relevant and timely updates of company information contained in the annual financial reports. We support the Invitation to Comment paragraph 6.2 which states, "The SEC requirements and the requirements in the Codification are based on the premise that an interim period is not a discrete reporting period but an integral part of the next annual reporting period". We believe companies should be required to present in interim reports primary financial statements (not condensed) and our recommended Tier 1 disclosures (consisting primarily of supporting tabular note disclosures, such as roll-forwards, as described earlier). Such information would form the basic information set for users to understand, or at least question further, significant or unexpected movements in balances or transactions.

### **International Consistency And Convergence Should Be Considered**

We encourage the FASB to develop a disclosure framework jointly with the International Accounting Standards Board (IASB). The IASB has recently reactivated its own conceptual framework project with a consultative group which may be

comprised of national standard setters (including the FASB). In our view, working independently on a disclosure framework project would not further convergence between IFRS and U.S. GAAP and can create meaningful distinctions in financial information reported globally. Because we rate companies globally, comparability in accounting and financial reporting is important to our peer and trend analysis. The global capital markets require a comprehensive and a converged solution in this critical area.

The IASB plans to issue a single discussion paper addressing elements of the financial statements, measurement, reporting entity, presentation and disclosure--potentially a broader scope than FASB's Invitation to Comment--during the first half of 2013 with a proposed end date of September 2015. The IASB learned that capital markets believe comments can be more effectively developed when addressing the broader implications and the interconnectedness of issues pertaining to all of these aspects in one paper. We believe the FASB discussion paper is limited in scope in various aspects as previously addressed and we would support a comprehensive approach towards developing the disclosure framework in a defined timeframe.

### **The Private Company Financial Reporting Disclosure Framework Should Be Comparable**

The Invitation to Comment states there is a separate effort underway to develop a framework for evaluating financial reporting issues for private companies. We aim to retrieve from private company financial reports comparable information that we obtain from the financial reports of public companies in order to uniformly apply our ratings criteria. We strive for consistent, comparable financial information to better enable our peer analysis of private companies. Therefore, in our view, the disclosure framework developed for private companies should reflect principles similar to those applied in the development of the disclosure framework for public companies.

The MD&A in public company financial reports is useful to credit analysis on an annual and interim reporting basis. The MD&A provides a discussion of liquidity, capital resources, results of operations, and other information necessary to understand a company's financial condition, changes in financial condition and results of operations that is not required under U.S. GAAP. It would be helpful to our analysis if private company financial reports provided comparable relevant information.

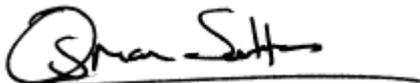
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We thank you for the opportunity to provide our comments, and we would be pleased to discuss our views with Members of the FASB or your staff. If you have any questions or require additional information, please contact the undersigned.

Very truly yours,



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