



December 10, 2015

Russell G. Golden, Chairman
Financial Accounting Standards Board
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Submitted via electronic mail to director@fasb.org

**File Ref: 2015-300 Chapter 3: Qualitative Characteristics of Useful Financial Information
2015-310 Assessing Whether Disclosures are Material**

Dear Chairman Golden:

The Committee on Corporate Reporting (“CCR”) of Financial Executives International (“FEI”) appreciates the opportunity to comment on the FASB’s two proposals addressing the application of materiality to disclosures (the Proposals). We commend the Board for its efforts to address financial statement disclosure. CCR strongly supports these Proposals, which we view as an important and necessary first step in order to achieve the outcomes desired by financial statement users. We also believe that the development of relevant, entity-specific disclosures that are clear, understandable and relevant to investors will require complementary changes in the compliance model to facilitate innovation and continuous improvement among all reporting companies. The basis for our views is discussed further below.

FEI is a leading international organization of more than 10,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. CCR is a technical committee of FEI that reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. With approximately half of FEI’s membership from private companies, FEI also has a strong base of knowledge to draw upon with regard to the financial reporting needs and requirements of the private sector. This document represents the views of CCR and not necessarily the views of FEI or its members individually.

Our Position on the Proposals

CCR applauds the Board’s efforts to address the issues that exist with the effectiveness and usefulness of disclosures provided in today’s financial statements. We fully support the objective of clarifying the definition of materiality and confirming how the concept should be

applied to financial statement disclosures. We also support eliminating the language in the sub-sections of the Codification (e.g., “a reporting entity shall disclose, at a minimum, the following information...”). Although these clarifications do not represent a substantive change (since companies already were permitted to apply materiality in this way under existing GAAP), we believe that issuers are more likely to avail themselves of the opportunity to streamline their reports as a result.

However, CCR also believes that it is important for the FASB and other financial reporting stakeholders to evaluate the larger issue with financial reporting. Specifically, we believe that in addition to removing clutter from financial statements, we need to find ways to improve relevance and understandability of the disclosures that remain. With that objective in mind the remainder of this letter provides our views on broader objectives of the disclosure effectiveness initiatives at the FASB and the SEC.

Overview

CCR believes that financial statements have declined in relevance and usefulness as a tool for the average investor in evaluating financial performance. The continued growth in the size and complexity of reports is an important contributing factor, as many investors are unable to isolate and comprehend the material information in financial reports. We suspect that many resort to other sources of financial information that are not subject to the same regulation and oversight or make investment decisions with an incomplete understanding of the company’s performance, financial condition and future prospects.

CCR does not believe that the goal of disclosure effectiveness is simply to make financial reports shorter. We acknowledge that companies may need to add information in areas where existing standards do not specify disclosure requirements and to take the necessary steps to ensure that all of the disclosures that remain are clear and understandable.

CCR also believes that we need to more broadly consider the impact of our prescriptive approach to disclosures, which standardizes reporting in a way that may not fully or effectively describe the activities and performance of any company particularly well. That effort should naturally seek to change the compliance paradigm from primarily focusing on adherence to a disclosure checklist to thinking first about what is important and relevant for investors to know about their companies.

The reporting environment will significantly influence the depth and breadth of reporting changes we will see as these efforts move forward. CCR believes that key stakeholders (the FASB, SEC, and PCAOB) should evaluate how to remove impediments to this change and support mechanisms that facilitate continuous improvement in disclosures. These points are explained further below.

Importance of Disclosure Effectiveness

CCR believes that this initiative has the potential to significantly improve the relevance of financial reporting, as it seeks to address why financial reports have declined in utility among average investors and are no longer deemed to be an essential tool for them. The SEC tried once before in the mid-1990s to make progress in this area but that effort failed to gain momentum. We would observe that the length and complexity of financial reports have grown significantly since then – underscoring our concern that preservation of the status quo has only served to exacerbate the problem.

The Board's guidance indicates that the audience for financial reports is a person who is willing to make a reasonable effort to understand the information they contain. CCR believes that the volume of information provided in most financial reports has a deleterious effect on focus, understandability and utility. CCR agrees that this is a challenging problem and that the Board's proposals reinforce the ability of companies to streamline their financial reports by eliminating immaterial, irrelevant or redundant financial information. These types of changes represent the low hanging fruit on the road to improved reporting.

Looking at the issue more broadly, CCR believes that financial reports have declined in relevance because they are geared for more sophisticated users. We note that investor commentary during the standard setting process tends to come mainly from investor advocates and large institutional investors rather than individual investors and buy-side portfolio managers. Those investors typically have the staff and resources to parse and analyze the large quantity of data in today's reports, which offers them a competitive advantage over smaller investors. These firms also have an inherent conflict of interest, as they seek to earn revenue by providing investment advice and managing money for retail investors.

That may explain why some investor representatives have indicated that they do not see a problem with the current state of disclosure. At a recent forum on this topic, one institutional investor expressed his view that no one reads financial reports anymore and that he personally had not read one in more than four years.¹ We suspect that he was not suggesting that his firm does not use the information in financial reports but rather that he has resources at his firm to perform the work of isolating the important information on his behalf, making his personal review of the document unnecessary. Such commentary obscures the concerns we see among average investors and other individuals that try to read financial statements. One senior analyst at a top credit rating firm recently observed that there are typically a handful of sentences in a Form 10-K that are critically important to his analysis. His fear is that he will miss one or more of them due to the sheer volume of disclosures.

Importance of Disclosures to the Capital Markets

We do not believe that the concentration of financial knowledge and insight among a sophisticated subset of investors with resources should be the goal of our disclosure model. Financial information is powerful and capital markets perform their function more effectively and efficiently when it is shared among all investors on a level playing field. Regulation FD helps maintain an element of fairness in our markets by preventing selective disclosure of material information to more sophisticated market participants. The goal of this initiative should be to address the other end of the spectrum: the circumstance in which material information is publicly available to all but is hidden in plain sight.

Retail investors continue to be an important source of capital for our markets but lack the time and resources to cull the information that is material to their investment decisions. One could take a caveat emptor position on this issue – a view that is only reasonable when all other aspects of the investment decision are true and fair. CCR is of the view that 300-page financial reports are not equally useful for sophisticated institutional investment firms as compared with individual investors. Accordingly, successful efforts to streamline financial reports should benefit all investors while also reducing the competitive advantage that elite investors enjoy today. In so doing, we believe our capital markets will become more effective as individuals and institutions invest based on equal access to material financial information.

¹ Forum on Disclosure Effectiveness, Pace University, December 1, 2014

Our Position on Disclosure Effectiveness

CCR believes that we should strive to create financial reports that are readable, understandable and useful for the average investor. The clarifications in the Board's proposals with respect to materiality are an important and necessary first step. However, we do not believe that these steps alone will accomplish the broader goal.

CCR believes that there is a significant amount of less than useful information being disclosed today. While some portion of that information may be omitted under the Proposals, we are concerned that much will remain that should have been eliminated. This type of information may be quantitatively significant while the disclosure itself is neither relevant nor useful, and is therefore qualitatively immaterial. This will be an important area where judgment will need to be applied and the position of regulatory stakeholders will play an important role.

In addition, CCR believes that these efforts should not simply streamline disclosures, but also make the disclosures that remain more understandable and useful. It is our view that many of the required disclosures are highly technical (in an accounting sense) and may not be readily understood by otherwise financially literate investors. When coupled with the often-complex accounting requirements, the information reported often can exceed the comprehension of the average investor who is not expected to be an accountant.

If these efforts are successful, financial reporting resources will be freed from the work associated with the omitted information and can be redeployed to explore disclosures that are not specified in the current disclosure set. This process will need to involve all relevant parties including senior management, the auditors and the audit committee of the board of directors, and will benefit from broad dissemination of disclosure improvement ideas and presentation best practices, discussed further in the next section.

A major consideration affecting these efforts is the impact of our prescriptive approach to disclosure. The current disclosure set consists of thousands of individual items in hundreds of categories that appear to cover the waterfront of investor needs. And yet, they do not. Rather, they reflect the cumulative result of the projects and priorities of more than three decades of standard setting without the benefit of a broad framework that adapts and scales to meet the needs of investors in companies of all sizes and in all industries. The strength of our checklist system of disclosure is that it precisely defines what is to be presented. That is also its most significant weakness, as it implicitly defines what will not be disclosed as well.

We are not suggesting that the disclosure set established by US GAAP should be abandoned. Rather, we need to recognize its inherent limitations and adapt our paradigm to be directed at ensuring that investors get the information they need. We believe that the focus needs to shift from doing all things right (a pure checklist approach) to doing all the right things (an objectives-based approach that is focused on the needs of investors). We also need to recognize that issuers have natural incentives to maintain the status quo and must be willing to accept greater risks and incur additional costs to effect real change in reporting. This suggests that the regulatory environment will need to evolve in tandem to support and accelerate these efforts.

The Path Forward

The disclosure initiatives at the FASB and SEC will require a coordinated effort among other key stakeholders to implement a principles-based approach to regulating disclosure and for all financial reporting participants to think about the objectives of disclosure differently. There are

encouraging signs in remarks and actions by the Staff and Commissioners of the SEC that this is top of mind. We note that in Europe, the market regulators have taken the extraordinary step of making a public statement that stresses “the need for concise and clear disclosures focused on the relevant facts that are specific to the entity and that are necessary to understand its financial performance and position.”²

CCR believes our new paradigm for compliance should embrace the preparers’ use of reasoned judgment, following high quality processes to evaluate disclosures, and engagement with investors and audit committees in reaching their conclusions. We also believe that those who review disclosures should support and potentially facilitate sharing of financial reporting best practices. The prescribed disclosure set should be viewed as an important resource to be used along with other sources, such as investor outreach and industry best practices, in developing an effective financial report. A checklist, by itself, should not be viewed as the absolute measure of disclosure compliance.

FEI stands ready to help facilitate improvements in financial reporting by working with other market participants in recognizing and promoting innovations in disclosure. Towards that end, FEI’s Financial Executives Research Foundation (FERF), together with Ernst and Young, recently published a research report on disclosure effectiveness, which highlights a number of key themes that support this approach.³ We intend to update our research at regular intervals to identify key trends and techniques used by companies to make their disclosures more effective. Some of the key conclusions in our initial report include:

- Nearly 75% of surveyed companies are taking actions to improve their disclosures
- The most important source of support for undertaking these improvements is senior management of the company
- Innovation is a critical element to obtaining dramatic improvements in reporting
- Peer analysis is a very important step in the improvement process
- Embarking on such initiatives frequently arose from an internal desire to continuously improve and provide more effective disclosure to investors

CCR observes that improving disclosures is fundamentally an issuer and investor driven exercise. While the efforts undertaken voluntarily by companies are still in the early stages, we believe that under the right conditions and with appropriate changes to the way in which disclosures are regulated, there is potential to achieve significant improvements in a much shorter time frame than would be possible through formal standard setting/rulemaking.

We note that in its Public Statement, the ESMA has committed to review and highlight best practices for other issuers to learn from. This is a commendable step and one that has the potential to accelerate the rate of improvement. However, without a change in the compliance paradigm we discuss above, these best practices may yield less than the desired outcomes given the prescriptive nature of our disclosure requirements. We may see improvement at the margins but not the kind that will change investor views about the relevance and usefulness of financial reports.

² “Improving the quality of disclosures in the financial statements”, Public Statement by the European Securities and Market Authority, October 27, 2015

³ A copy of the full research report can be obtained at <http://bit.ly/DisclosureEffectiveness>.

December 10, 2015

Conclusion

CCR strongly supports the Boards efforts to help issuers eliminate immaterial information by formalizing and reinforcing the capabilities they already have available to them to make these changes. We also support the efforts of the SEC to provide guidance that will improve the effectiveness of other elements of issuers' public filings.

We also urge the Board to move forward with its work on interim reporting by aligning its financial statement disclosure requirements with existing SEC guidance. CCR believes that interim financial statements are an integral part of the annual filings and that the latter should serve as the comprehensive baseline. Accordingly, interim financial statement disclosures should primarily focus on important changes from the last annual set of financial statements. Our current reporting timelines are based on this notion, while our disclosure obligations have evolved to an interim set of requirements that more closely parallel the annual set. We believe that this work is consistent with the broader efforts on disclosure effectiveness and that proposals in this area will be very beneficial for both issuers and investors.

CCR recognizes that there is a wide swath between information that is material and what is considered clearly immaterial that must be carefully evaluated in the reporting process. As public companies, we understand that it is our responsibility to ensure that financial reports reflect information, both the positive and negative, that is important for investors in assessing past performance and future prospects. We believe that this is an area where senior management, disclosure committees, independent auditors and audit committees should continue to focus and find ways to improve upon. The changes proposed by the FASB coupled with efforts to enhance the regulatory environment governing disclosures offer the best opportunity to achieve the broader goals of the disclosure effectiveness work that is underway.

The Committee appreciates the opportunity to share our views on the Proposals. We welcome the opportunity to discuss our response and the findings of our Research Foundation with the Board at a future date. Please contact Lorraine Malonza at (973) 765-1047 with any questions.

Sincerely,

Richard Levy

Richard Levy
Chairman, Committee on Corporate Reporting
Financial Executives International