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Susan M. Cospers
Technical Director
File Reference Number 2016-290
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Ms. Cospers:

I am pleased to have the opportunity to comment on the Board's Invitation to Comment: Agenda Consultation. I am a security analyst who reads and evaluates public company financial statements regularly. For much of my career, I have participated on committees and task forces whose goals were to provide input on proposed accounting and financial reporting standards.

Generally speaking, I am concerned less with inconsistencies in existing accounting standards and more with the way that accounting standards are being implemented, including efforts to simplify disclosures under the "disclosure effectiveness" initiative. We are, it seems, at the beginning of a new wave of change in public company financial reporting practices.

The most significant changes seem to be focused on the MD&A section of 10-K filings, but many companies are also planning to change their footnote disclosures. These changes will, of course, reduce the volume of disclosure. In many cases, however, cuts may be made to existing disclosures that may represent a departure from current disclosure standards.

The Board has encouraged such cuts, for example, by stating that it intends to eliminate minimum disclosure requirements because they "make it difficult to justify eliminating immaterial disclosures."¹ However, this change in policy would also raise the risk that material disclosures will be eliminated. Taken to an extreme, disclosure specifications can become "recommended disclosure practices" and cease to be standards.

Rather than open the door wide to any sort of change, the FASB, I believe, must continue to specify minimum disclosure requirements, even though revising minimum disclosure requirements on all accounting standards is obviously a huge task. Still, it is an effort that the FASB must take on if it wants to avoid the risk of losing material disclosures.

¹ See, for example, Proposed Accounting Standards Update, Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20), Change to the Disclosure Requirements for Defined Benefit Plans, page 2.

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Besides looming changes to disclosure practices, preparers face the challenge of implementing new complex accounting standards, like revenue recognition and leasing. There is also, I believe, a widespread sentiment that GAAP does not reflect substantive economic reality. (Some of this is reflected in the prevalence of non-GAAP metrics.) Consequently, the FASB should pause to assess the current state of implementation of accounting standards and their associated disclosures rather than take on a new slate of projects to change current standards.

Here are my responses to some of the specific questions that you raised in the ITC:

Question 0.1: Are there major financial reporting issues that are not considered in this ITC that should be addressed by the FASB before any of the issues discussed in the ITC are addressed? What are the considerations or criteria that you used to identify these issues? Please describe any of those issues and your perspective about how the FASB should resolve the issues.

As noted above, the major financial reporting issues for me relate to the implementation of accounting standards and disclosures. At the moment, I do not see any other issues that are not considered in the ITC that should be addressed by the FASB.

Question 0.2: What is your view about the priority of addressing the major financial reporting issues addressed in this ITC? In other words, is addressing one or more of the issues more critical than others? Please describe your assessment criteria and why you prioritized certain issues above others.

For the most part, I think that the major reporting issues addressed in this ITC are of low priority. The FASB should not be trying to fix anything that is not broken. Despite the concerns described in the ITC, I do not see the problems with the existing standards as significant enough to take priority over addressing the implementation concerns.

Question 1.1: Is the accounting for intangible assets (including research and development) a major financial reporting issue that the FASB should consider for improvement? Please explain.

I do not believe that the accounting for intangible assets is a major financial reporting issue that the FASB should consider for improvement.

The value of intangible assets is almost always determined by the earnings and cash flow generated by the company. The Campbell Soup brand has little value apart from the profits that are generated from sales of Campbell Soup and product line extensions.

Debt and equity analysts alike use tangible net worth (i.e. net worth excluding the carrying value of goodwill and intangible assets) because it provides an alternate measure of the value of a company's tangible net assets as a proxy for liquidation value in the event that the company's profitability declines (in which case, the goodwill and intangible assets would have little or no value). In essence, I tend to ignore the value of intangible assets (apart from company profits and cash flows) and I am certain that I am not the only analyst who does so.

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While some may complain about the differences in treatment between internally generated and acquired research and development costs, it is very difficult (as the ITC points out) to provide a direct link between internal R&D spending and value creation. Ignoring acquired R&D would just result in a corresponding increase in goodwill.

A case can be made that the cost of acquired R&D should be similar to the estimated cost of avoided internal R&D. There is therefore no harm in identifying this as an asset apart from goodwill in a business combination.

It also seems to me that it does not make sense to write-off acquired R&D immediately in a business combination, unless the Board is also willing to allow the same treatment for goodwill.

I would object to adopting a fair value approach for measuring intangible assets on an ongoing basis, since this would inflate (or deflate) profits without increasing (or decreasing) cash flows.

Question 2.1: Is the accounting for pensions and other postretirement benefit plans a major financial reporting issue that the FASB should consider for improvement? Please explain why.

Although the existing standard may not be perfect, I believe that it is sufficient, with the related disclosures, to provide me with a reasonable picture of the financial condition of a company's benefit plans and their collective impact on its financial results. It is unlikely, in my view, that the standard can be improved meaningfully. There will always be tradeoffs, such the increased volatility associated with the immediate recognition of gains and losses. I think that certain pension disclosures, such as the detailed schedule of fund investments, can be eliminated without significant loss of information to financial statement users.

Question 3.1: Is the accounting for distinguishing liabilities from equity a major financial reporting issue that the FASB should consider for improvement? Please explain why. In making your assessment, what criteria were used (for example, is the issue not sufficiently addressed in current GAAP, or is it addressed in a way that makes compliance costly or creates diversity in practice because the guidance is conceptually or economically flawed)?

Distinguishing liabilities from equity is an issue that has never presented me with a problem or dilemma during my career. It has only come up in cases, such as convertible notes, that have both a debt and equity component. In those cases, my approach is to treat the convertible debt as debt – because that has been the way the bankruptcy courts would treat it – until it is either converted into equity or is sufficiently in the money to virtually guarantee convertibility at some time in the near future. I have never felt the need or the desire to break a convertible debt instrument into debt and equity components for analytical purposes.

I recognize that this issue is more complex than I have described here. I have not taken the time to fully understand all of the potential issues behind the various types of hybrid instruments. I recognize that consistency in accounting for all types of hybrid instruments is a worthy goal. However, since I have rarely faced this issue over the years, it is difficult for me to recommend that it should be a priority project for the FASB. Similarly, it would be inappropriate for me to recommend an alternate approach, such as targeted improvements on

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certain hybrid instruments, because I believe that I do not currently have the depth of experience on this issue to know whether such an approach is optimal.

Question 4.1: Is income statement presentation a major financial reporting issue that the FASB should consider for improvement? Please explain why. In making your assessment, what criteria were used?

For the most part, I do not believe that income statement presentation is a major financial reporting issue that the FASB should consider for improvement. I believe that companies should have the flexibility to determine a presentation that works for them (i.e. that they feel is consistent with the way that they manage the business). It is often the case that the presentation choices that a company makes can convey useful information, especially if it differs from its competitors.

There can be value in noting the way different companies within the same industry define operating income. The occasional company that chooses not to define operating income conveys information to financial statement users that is useful.

With some companies, for example, income from equity method investments may not be considered a component of operating income, but with others, when such income is significant, it may rightfully be considered as part of operating income.

The separation of operating from financing activities within the income statement would also force companies to include the amortization of that capitalized interest as a financing activity. That is good in theory, but such allocations may be arbitrary and subjective.

Instead of forcing a new income statement format on preparers, it would be more useful to me to require detailed disclosure on components of key line items, such as depreciation and amortization expense and interest expense. This would make it easier for me to make appropriate adjustments, for example, in cases where the amortization of capitalized financing costs is included in depreciation and amortization.

Question 4.7: Is segment disclosure a major financial reporting issue that the FASB should consider for improvement? In making your assessment, what criteria were used?

Although I too would like to see more granularity and additional line item disclosures for business segments, I do not support making changes to the standard at this time. The notion of chief operating decision-maker is a sound theoretical concept, in my mind, even if companies hide behind it to achieve greater aggregation in their business segment reporting. Since companies may alter performance figures through intersegment transactions and corporate cost allocations, I do not think that it is possible to force better disclosure on preparers. Achieving meaningful improvement in segment disclosures will require the support of the preparer community, which seems unlikely at this time.

Question 4.11: Is the presentation of other comprehensive income a major financial reporting issue that the FASB should consider for improvement? In making your assessment, what criteria were used?

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I am not a big fan of the current presentation of other comprehensive income, but I agree that the presentation is necessary under this hybrid model of reporting (fair) value changes in certain categories of assets and liabilities. Reclassification adjustments are a potential source of earnings manipulation, so minimizing them is a worthwhile goal. From a practical point of view, however, such changes to the accounting standard must be considered for each category of OCI, which is best done case-by-case over time.

Question 4.15: Is the presentation of cash flows a major financial reporting issue that the FASB should consider for improvement? In making your assessment, what criteria were used?

Question 4.16: Do you recommend that the FASB retain or reconsider the three-category structure and the definitions of operating, investing, and financing activities within the statement of cash flows?

I do not believe that presentation of cash flows is a major financial reporting issue. Consequently, I believe that the FASB should retain the three category structure and existing definitions of operating, investing and financing activities.

As noted above, I think footnote disclosure of the components of depreciation and amortization expense, as well as interest expense, would be useful.

I would like to see disclosure of cash paid for interest and taxes become mandatory on a quarterly basis. It would be useful to see reconciliations between cash paid for interest and interest expense as well as cash paid for taxes and income tax expense.

I personally consider restricted cash and certain investments, such as short-term marketable securities, as a form of cash, so I typically pull these items out of investing activities in my analysis of the cash flow statement.

Many bank analysts do not view the present format of the cash flow statement as useful for financial institutions. However, I am hard pressed to offer a meaningful alternative, since any delineation of loans and securities between operating and investing activities may be arbitrary.

I have tried here to convey my general impressions on the FASB's agenda based upon my direct experience as a user of financial statements, even though I may not be fully up to speed on all of the topics covered in this Agenda Consultation. My comments do convey my general belief that the current standards and financial statement presentations are sufficient to meet my needs. As discussed above, I think that the Board should focus on implementation issues. I would welcome the opportunity to expand upon the comments and recommendations that I have made here at one of your upcoming roundtables.

Sincerely,



Stephen P. Percoco