Topic **Disclosure – reducing complexity**

Overview

1. The purpose of this paper is to provide SAC with an overview of the FASB's Disclosure Framework project, including its objectives, current plans, and potential issues. A discussion by SAC of the project's objectives and work started by the FASB could assist SAC and the IASB in their consultations and consideration of whether to undertake a similar major project to make comprehensive improvements to the IFRS in the post 30 June 2011 period and reduce complexity in current required disclosures. It also could be helpful to the FASB if SAC has any input into prioritization of items in this project.

Disclosure Framework Project

2. On 8 July 2009, the FASB Chairman announced the addition of the Disclosure Framework project to the FASB's agenda and added that the project is "aimed at establishing an overarching framework intended to make financial statement disclosures more effective, coordinated, and less redundant" (News Release 07/08/09).

Dual Objectives to Respond to Constituent Requests

3. The project has dual objectives, which are to (a) establish an overarching framework intended to make financial statement disclosures more effective, coordinated, and less redundant, and (b) seek ways to better integrate information provided in financial statements, MD&A, and other parts of a company's public reporting package. The project is not intended to be additive

but rather to develop a framework for improved U.S. generally accepted accounting principles (GAAP).

4. The project and those objectives are intended to respond to constituents' recommendations for the development of a disclosure framework to better communicate information to investors and reduce redundancy and complexity, particularly the:

   (a) Proposal of the **Investors Technical Advisory Committee** (ITAC) (December 2007)

   (b) Recommendations (1.2 and 1.3) of the **SEC Advisory Committee on Improvements to Financial Reporting** (Pozen Committee report of August 2008)

   (c) Recommendations of the SEC staff in its Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 on Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers (the Report of June 2005, pages 113–115).

The History and Efforts Directed at Disclosure Concerns

5. The FASB has a long history of disclosure initiatives and projects that date back to 1974, when the AICPA's Accounting Standards Division began a study of the application of U.S. GAAP to smaller/closely held entities. Much of the FASB's non-project specific disclosure initiatives that followed might be broadly called efforts directed at *disclosure overload*, *disclosure effectiveness*, or *differential disclosures for small or nonpublic entities*.

6. In her 2007 article, *Required Disclosures in Financial Reporting*, former FASB member Katherine Schipper noted that:

   > . . . required disclosures are not well understood: we lack a comprehensive theory of mandatory disclosures; many questions remain as to how preparers, auditors, and users of financial reports view disclosures, particularly as compared to recognized items; and [FASB's] conceptual framework does not provide either a

> conceptual purpose for disclosures or criteria to support a sharp distinction between recognized and disclosed items. This last omission is particularly puzzling since standard setters make recognition versus disclosure distinctions in nearly every standard. [The Accounting Review, Vol. 82, No. 2, 2007, pp. 301 and 302.]

7. Her article acknowledges that concepts for required disclosures would be helpful to standard setters but suggests that developing such concepts in a non-context specific setting is likely to be easier said than done.

8. An objective of the IASB-FASB joint conceptual framework project is to improve on their existing conceptual frameworks, including filling in gaps or omissions. A later phase ultimately is to address presentation and disclosure matters but that phase is not staffed or likely to start until the Boards make further progress on the phases addressing the elements of financial statements and their definitions, recognition, derecognition, and measurement.

9. In its proposal, ITAC expressed the view that:

> …past attempts from various constituents to expand disclosure guidance have failed, because preparers typically do not include additional information if not required to do so. Accordingly, instead of expanding a particular disclosure standard, which may be inefficient and relatively slow . . . , we believe this shortfall should be addressed with a more encompassing separate and distinct principles-based standard. [page 4]

10. The Pozen Committee suggested that:

> The SEC and the FASB should work together to develop a disclosure framework to:
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> - Integrate 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. This would eliminate redundancies and provide a single source of disclosure guidance across all financial reporting standards.
>
> - Require disclosure of the principal assumptions, estimates, and sensitivity analyses that may impact a company's business, as well as a qualitative discussion of the key risks and uncertainties that could significantly change these amounts over time. This would encompass transactions

> recognized and measured in the financial statements, as well as events and uncertainties that are not recorded.

11. The earlier SEC Staff Report of June 2005 recommended the development of a disclosure framework and noted that:

> The disclosures in the notes to the financial statements are a critically important complement to the financial statements and are necessary to achieve transparency in financial reporting. Based on this Study, as well as experience with issuer filings, the Staff believes that disclosures can be improved . . . if issuers were to seek to achieve the goal of communicating with investors, rather than focusing principally on technical compliance with rules and regulations. [page 113]
>
> . . . insights generated by the development of . . . a disclosure framework might also lead to recommendations from the Staff regarding the Commission's regulatory disclosure requirements. Indeed, some of the objectives noted above, each of which is evident in the disclosure requirements for notes to the financial statements in some areas, are also objectives of MD&A or other regulatory disclosure requirements. As such, the Staff would be willing to work closely with the FASB in its development of a disclosure framework, in order to consider whether complementary changes to the Commission's disclosure requirements would generate further improvement as well as to ensure that disclosure is provided in the most appropriate location, whether it be in notes to the financial statements, MD&A or in some other location. [page 115]

The ITAC Proposal

12. The staff plan contemplates using the December 2007 ITAC proposal and Pozen Committee recommendations as a useful starting point for the development of a standards-level disclosure framework. Its research plan also calls for a review and consideration of (a) existing disclosure standards, including those of the IASB, (b) the work of the staff of the Canadian Standards Board on behalf of the IASB-FASB joint conceptual framework project, and the work of the IASB and others related to management commentary. At this time, however, it is not clear whether the FASB will invite comments on ITAC's proposal essentially "as is" or develop its preliminary views on key components of a proposed disclosure framework that would serve as the initial discussion document.

13. ITAC proposed that the framework be separated into three significant areas. The areas would consist of the following:

    (a) General—outlining the basis for presentation for a particular account/line item (similar to information currently provided under significant accounting policies)

    (b) Composition—disaggregation of the contents of a particular line item including a roll-forward analysis of the changes in the line item when appropriate

    (c) Assumptions and Uncertainties—an analysis of the principal assumptions, estimates, sensitivity analyses, and a qualitative discussion of risks and uncertainties as well as the potential of the amounts to change over time.

14. Representatives of ITAC presented and discussed their proposal at the March 2008 meeting of the Financial Accounting Standards Advisory Council (FASAC). (Their presentation materials are available from the FASB's website (FASAC meeting handout March 18, 2008, see Attachments B and B-1). Pages 7 and 8 of the minutes of that meeting provide a summary of the discussion and also are available from the website.) Mr. Neri Bukspan, a member of SAC and of the ITAC working group that developed the proposal participated in the FASAC discussion. He will be available at the SAC meeting to provide further insights as to the benefits that ITAC believes will result from its proposed disclosure framework.

Recent Activities of the FASB and its Project Staff

15. The project staff has begun initial research on disclosure effectiveness and redundancy, including a review of past studies and the reports. It is also discussing with the SEC staff how matters of mutual interest might be addressed, such as disclosures non-GAAP key performance indicators, forward-looking statements, and other items included in the MD&A.

16. The FASB project staff also is assisting the joint financial statement presentation (FSP) team in addressing respondent’s suggestions and concerns about the disclosure requirements proposed by the IASB/FASB Discussion Paper, *Preliminary Views on Financial Statement Presentation*. In that effort the staffs of both project teams are utilizing the second area of the ITAC proposal (paragraph 13(b)) in developing a recommendation that the Boards require a roll-forward for all *significant* line items of the statement of financial position that would reconcile and provide an analysis of the changes in the line item for the period.

17. The staff is also suggesting that the recommended roll-forward analysis be included in the proposed FSP standard and forthcoming joint Exposure Draft in lieu of the reconciliation schedule that was proposed by (Chapter 4 of) the *Preliminary Views*. The Boards will be discussing those recommendations at their October 26-28 joint meeting. The staff will provide an update at the November SAC meeting.

18. FASB members and project staff have also been engaging in discussions with FASAC, the CFA Institute, and other constituents as part of the Board’s ongoing outreach and liaison activities. Those issues include whether the scope of the Boards’ considerations and commitment of resources should extend to non-GAAP metrics, forward-looking information and MD&A that has traditionally been dealt with by the SEC. That is, for example, whether the boundaries of financial reporting to be considered by the Board should be limited to only information about transactions and other events and circumstances that have occurred during the reporting period and that exist at the end of the period, and thus, can generally be subjected to audit. Also, if the scope of the FASB’s project is extended, whether the contemplated disclosure framework should apply to all entities or only public entities.

19. In the U.S. financial reporting environment, it is generally acknowledged that objectives-oriented or more principles-based standards could help reduce complexity and redundancy within and between GAAP standards and regulatory

requirements, including those related to MD&A reporting by public registrants. However, achieving a reduction in complexity and redundancy in the U.S. will require proactively addressing the institutional, cultural, and behavioral issues, through continued collaboration and coordination between the SEC, the FASB, and the PCAOB, and the active involvement and assistance of other key parties in the financial reporting system. That kind of US-focused effort, however, does not preclude collaboration and coordination with the IASB and other national standard setters that have a common interest in developing a disclosure framework.

Other Matters for Consideration

20. Unlike the IASB, the FASB has not addressed management commentary (best practices or standards) and does not have an equivalent to the IASB's IFRS for SMEs.

21. Prior to adding the disclosure framework project to the FASB's agenda, the staff and Chairman consulted with the IASB Chairman and IASB members about conducting a disclosure framework project jointly. At the time, the IASB's other priorities and limited resources inhibited their ability to participate as partners in a joint project but that door remains open. Presently, the IASB staff is actively monitoring the disclosure framework project.

22. The FASB staff is also discussing with the Chairman of the national standard-setters (NSS) whether one of their members might wish to participate by committing a full-time staff as an international fellow, or otherwise designating a member or two to participate as a project consultant/resource group member.

Questions to SAC members
Question 1: Do you think there is a need for an international disclosure framework? **If yes, how do you see this fitting into your thinking about agenda priorities?**