

Disclosure effectiveness

Companies embrace
the call to action



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EY

Building a better
working world



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About the research

Our research surveyed 120 finance, accounting and financial reporting executives to gain an understanding of the actions, benefits and challenges facing them in the area of improving corporate disclosures. The research was conducted jointly by the Financial Executives Research Foundation (FERF) and Ernst & Young LLP (EY). The respondents were divided among major industry sectors. The survey was supplemented by in-depth interviews with investors, preparers, Audit Committee members, legal counsel and other key stakeholders to add further context and insights.



Foreword

Enhancing the effectiveness of corporate disclosures is of paramount importance to companies, investors, creditors, regulators and the capital markets at large. Capital markets changes along with technological advances in the past decade have altered how investors “consume” and analyze information. This has compelled many companies to take a fresh look at how effectively they “tell their story.” While the regulatory bodies examine ways to modernize the disclosure framework, companies are differentiating themselves by adapting to the shifting investor demands and expectations, voluntarily.

In October 2014, EY released a report titled, *Disclosure effectiveness: what can companies do now*.¹ This report examined the corporate disclosure environment and what the U.S. Securities and Exchange Commission (SEC) and global accounting standard setters were doing to improve disclosure effectiveness. It provided some leading practices and recommendations for companies to consider in order to

make their disclosures more meaningful for investors. While disclosure effectiveness has been top of mind for many, few could have predicted the progress leading companies have made by shifting their attention and focus to this important topic – a shift that, in many cases, has led to noticeable improvements in financial reporting.

Similarly, since the report’s launch, regulatory and accounting standard-setter efforts around disclosure improvements also have intensified. Notwithstanding the robustness of the US disclosure system, and the fact that it is has been held as a gold standard for many generations, corporate disclosures have become voluminous, difficult to understand and redundant and, in many cases, contain boilerplate language and obsolete information. In September 2015, the SEC issued its first formal request for comment on how it might enhance the effectiveness of disclosure requirements, specifically the requirements in Regulation S-X.

The SEC request for comment follows SEC Chair Mary Jo White’s announcement of a disclosure effectiveness initiative and comes on the heels of SEC staff speeches that have called registrants to action. Keith F. Higgins, Director, Division of Corporation Finance, declared, “There is a lot that you ... can do to improve the focus and navigability of disclosure documents in the absence of rule changes. You can step up your game right now.”²

But the SEC’s recent action represents an important turning point in the disclosure effectiveness initiative, which aims to put better disclosure into the hands of investors – the primary purpose of financial reporting. As Chair White states:

“We are interested in feedback from investors, companies, and other market participants to help us evaluate potential changes to Regulation S-X that would benefit both investors and companies.”³

¹ [http://www.ey.com/Publication/vwLUAssets/EY-disclosure-effectiveness-what-companies-can-do-now/\\$FILE/EY-disclosure-effectiveness-what-companies-can-do-now.pdf](http://www.ey.com/Publication/vwLUAssets/EY-disclosure-effectiveness-what-companies-can-do-now/$FILE/EY-disclosure-effectiveness-what-companies-can-do-now.pdf).

² Keith F. Higgins, “Disclosure Effectiveness: Remarks Before the American Bar Association Business Law Section Spring Meeting,” SEC, April 2014, <http://www.sec.gov/News/Speech/Detail/Speech/1370541479332>.

³ “SEC Publishes Request for Comment on Regulation S-X,” SEC, 25 September 2015, <http://www.sec.gov/news/pressrelease/2015-211.html>.



The SEC is also reviewing the disclosure requirements in Regulation S-K as part of its broader disclosure effectiveness initiative.⁴

Accounting standard setters, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) also have major initiatives underway to improve disclosures.

In September 2015, the FASB released proposed guidance on applying materiality to disclosures. The proposal aligns the accounting definition of materiality with the legal concept of materiality. The intent is to improve the effectiveness of disclosure by omitting immaterial information and focusing readers on material and relevant information. The FASB proposal aims to encourage companies to consider whether some, all or none of the requirements in a disclosure section are material. The proposal is part of the disclosure framework project the

FASB is undertaking to improve the effectiveness of disclosures in notes to financial statements.⁵ The IASB also has a number of projects underway as part of its own initiative to improve financial reporting disclosures.

With initiatives clearly underway and yet no official guidance provided to date, companies have stepped up their own disclosure effectiveness efforts, heeding the SEC's call to action. Many of these efforts are resulting in key benefits for their organizations and users of financial reports.

What actions are they taking? What are those key benefits? What challenges have they faced and overcome? How much progress has been made and what are the current plans to move forward? And what can regulators and accounting standard setters do to help?

The Financial Executives Research Foundation, in collaboration with EY, set out to answer those key questions

by surveying and interviewing finance and accounting executives from a wide range of industries.

Our study reveals that the vast majority of companies surveyed are improving their financial reports in measurable ways. We found that many executives have valuable advice to offer their colleagues about the process and key lessons learned along the way, and we share that with you in this report⁶. We believe that companies in any stage of the process of evaluating or improving their disclosure effectiveness will find the information in this report useful to them.

To supplement the findings of this report, we will be releasing a follow-up report that provides additional insights into specific actions that S&P 500 companies have taken in the last three years to improve their financial reporting and disclosures, including some leading practices.

⁴ "Report on Review of Disclosure Requirements in Regulation S-K," SEC, December 2013, <http://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf>.

⁵ Proposed ASU—Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material, Proposed amendment to FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting

⁶ Throughout this report, particularly in some interviews, the terms "financial reports" and "financial statements" may be used interchangeably.



Executive summary

A company's financial reporting is valuable to a wide variety of stakeholders, and financial reporting that reflects economic and business realities has never been more important. Financial reports help shape how investors formulate their decisions, thereby influencing where and how capital is deployed and enabling markets to function more efficiently.

Investors, creditors, analysts and other key stakeholders are now requiring much more insight into companies' performance, strategic direction, governance and exposure to risk, information that is often captured and synthesized through disclosures and financial reports.

Disclosures encompass the traditional and required channels of communication, such as annual, quarterly, proxy statements and earnings release filings, but also include information that may be provided via company websites, social media platforms and other modern channels.

Currently, the SEC is reviewing its disclosure requirements (in Regulations S-X and S-K) and continues to reach out to companies, investors and other market participants for recommendations on how to improve and modernize the disclosure regime and its EDGAR system. The SEC and accounting standard setters have a number of documents out for public comment that are aimed at promoting improved disclosures, a listing of which is provided in the appendix of this report. It is an opportune time for companies, investors and other market participants to proactively engage in this process and respond to those proposals by providing written feedback and contributing to the overall dialogue and the ultimate success of those initiatives.

With this we ask, how are companies staying ahead of the curve? Are they taking steps to embrace opportunities to communicate more effectively while satisfying increasing regulatory demands?

The answer is that more and more companies are recognizing that in the absence of clearly communicated financial information, key stakeholders, including activist investors, may draw their own and potentially flawed conclusions about their performance and strategic objectives. An effective disclosure process is the key to addressing such issues.

The Financial Executives Research Foundation, in collaboration with EY, conducted this study to identify how companies have begun to implement disclosure effectiveness initiatives and to learn how those efforts are progressing. During the research process, we:

- ▶ **Surveyed more than 120 executives** from various industries. We supplemented the results of the survey with interviews* of key stakeholders in the financial reporting process such as preparers, investors, audit committee members and legal counsel. A selection of their comments follows summaries of the survey results.
- ▶ Asked about their companies' **financial disclosure improvement initiatives progress to date, the benefits to improving their reports and processes, the biggest challenges and the key lessons learned.**
- ▶ Inquired about **what they're planning to do next** and what the regulators and accounting standard setters can do to support them.

*While the individuals we interviewed have deep knowledge and experience related to preparing, reading, and analyzing disclosures and the related requirements, the views expressed may not necessarily be representative of the broader views of the stakeholder groups they represent.

Here are the key findings from the survey and interviews

Nearly three-quarters (74%) of the companies surveyed are taking action to improve their financial reporting.

Most are primarily focusing on the annual (10-K) and quarterly (10-Q) financial reports, with some focusing on earnings releases and proxy statements. For some that have made more significant overall progress, the efforts started with the earnings release and proxy statement, followed by a focus on the annual and interim financial statements.

The predominant impetus for improvement has come from senior-level executives, who have questioned the clarity and readability of compliance-driven language.

This issue was particularly visible when senior-level executives were relatively new to the roles. Other catalysts for change to disclosure processes included:

- ▶ Companies who had conducted peer analysis and benchmarking studies were more aware of the need for improvement.
- ▶ More dramatic reporting changes require taking an innovative approach, which, companies admitted, could be better encouraged and rewarded under the current disclosure regime.

- ▶ For many, embarking on a reporting change arose from an internal desire to continuously improve and provide more effective financial communications to investors and other users of financial statements.
- ▶ SEC and the FASB initiatives also appear to have prompted or catalyzed efforts to improve the readability and user-friendliness of the documents.

Areas that companies have improved the most in their annual reports (Form 10-K) include management discussion and analysis (MD&A), the business section, risk factors and certain footnotes to the financial statements.

Investors today are not just focused on headline performance numbers. Instead, they want information that will help them best assess performance, evaluate strategy and identify risk. Companies are responding to these shifting demands to varying degrees and are focusing on making their financial communications more streamlined, connected and understandable. We found the three key focus areas in companies' improvement efforts to be:

- ▶ Disclosing material information and eliminating immaterial information (80%)
- ▶ Reducing redundancies and using more cross-referencing (77%)

- ▶ Eliminating outdated information (70%)

Overall, respondents cited improving consistency across all external financial communications as their main objective.

Disclosure effectiveness is a cross-functional journey together.

Companies that have made meaningful improvements to their financial reports highlighted that it's important to engage those involved in the company's financial reporting process – senior-executives, controllers, heads of SEC reporting, investor relations, in-house and external counsel, and board members – right from the start. Interestingly, a majority of companies (52%) noted that while they do not have a formal dedicated group in charge of disclosure effectiveness, roles and responsibilities in the process have materialized organically. For example, respondents indicated that in many cases, the head of financial reporting is generally responsible for contributing ideas; financial reporting managers are responsible for executing those ideas; senior-level employees such as chief financial officers (CFOs), chief accounting officers (CAOs) and others are responsible for approving changes; and external independent auditors are responsible for reviewing the financial statements. In many cases, audit committees have played a considerable role by challenging whether the financial statements are sufficiently transparent and concise and have encouraged management to initiate improvements.

Many key benefits were identified by companies of various sizes and across industries.

Companies cited a number of key benefits to improving disclosures, including receiving favorable reactions from senior management, board members, investors and analysts who found the information easier to read and digest – allowing them to make more informed decisions. Some companies identified “best-in-class disclosures” that provide investors with a clear snapshot of the company “story” as a key benefit. Others cited enhanced clarity through an internal “de-risking” process that removes unnecessary information and clarifies the contents of the report and its connection to the strategy. Notably, companies also reported finding process efficiencies as a result of their efforts, with nearly 39% of respondents estimating they now save (or expect to save in the next year) at least one to three days in the preparation of their financial statements due to their company’s improvement efforts.

Investors interviewed highlighted that the quality and robustness of disclosures play a key factor in their decision-making, and also shared that they want to gain a better understanding of both financial and nonfinancial information often provided on company websites, including sustainability reports in some cases.

Regulator and accounting standard-setter support is needed to address some of the challenges with disclosure effectiveness.

Respondents identified that determining what is material and what is not for purposes of financial statements continues to pose a major challenge that ultimately increases disclosures. A few points we discovered in our interview process:

- ▶ Respondents stated it would be highly useful to have more guidance on materiality considerations in order to stem the tide of “disclosure overload,” a key concern continuously expressed by preparers and others.
- ▶ Many stated that it would be useful if the SEC or the FASB indicated that an omission of immaterial information was not an error in financial reporting.
- ▶ Some respondents also suggested that regulators should start highlighting and identifying “gold standard” disclosures by industry.

Since our survey, both the SEC and the FASB have issued proposals intended to make disclosures more meaningful (see appendix). It is unclear whether those proposals and the resulting actions will be sufficient to address all of our survey respondents’ concerns. Many preparers believe that a clear shift in mindset is necessary.

Other challenges that companies face with disclosure effectiveness include questions from external auditors; resistance internally from management; fear of an SEC comment letter; being too busy with addressing day-to-day matters; the time it takes to write concisely; addressing matters from existing or potential transactions; and legal counsel guidance that, at times, treats the financial statement as a legal document rather than a communication tool.

Many companies plan to continue the process they have been using to improve disclosures, but have become wiser about potential pitfalls.

Respondents pointed out the need to start disclosure effectiveness early and get broader buy-in, especially from the investor relations team. In addition, companies expressed the need to engage investors who have increasingly become more sophisticated, to better understand their needs and processes so they can deliver more transparent reports. As the business and regulatory environment changes, companies must plan ahead as they grow and strategies change; disclosures should similarly evolve so that financial communication remains synchronized and responsive to technological advances. Companies further noted that information from the past that might have been added as a result of, for example, an acquisition, an investor inquiry or a regulatory comment may no longer be relevant, so ongoing scrutiny is needed.

More changes are on the horizon across a broad spectrum of platforms, with a continued focus on MD&A and notes to financial statements.

Respondents indicated that over the next two years, they plan to continue to improve financial reporting across a broad spectrum of communication channels that include 10-Ks, 10-Qs, earnings releases, proxy statements and websites. Many are particularly interested in improving MD&A and financial statement notes, with accounting policies, fair value measurements, income taxes, pensions and stock-based compensation at the top of the list.

Moreover, some respondents indicated they plan to review their financial reports more holistically and consider ways to embed more infographics, charts, tables and other elements that can make financial reporting more visual and accessible to a variety of stakeholders. This trend is expected to accelerate as companies increasingly use financial reporting as a broad communication tool and not just a means to comply with regulations. Respondents also noted they are increasingly focusing on nonfinancial indicators of performance.

Sage advice for companies getting started.

Preparers, audit committee members and legal counsel offered a variety of suggestions for companies just getting started, including holding meetings with key constituents, leveraging disclosure committees, putting disclosure effectiveness on the Audit Committee agenda, ensuring the right tone and support is coming from the top, regularly reviewing disclosure documents for effectiveness, designing executive summaries in a way that drives quality in the rest of the document, and finding ways to avoid repetition.



Disclosure effectiveness action steps to consider listed on page 11

Where can a company start?

Respondents and interviewees offered a great deal of advice for companies just beginning their disclosure effectiveness initiatives. They suggested starting the process by holding meetings with key constituents, making the improvement process less episodic and more evolutionary, and reviewing technological offerings to help streamline the process and provide a more meaningful and contemporary presentation, including revamping the investor relations section on the company website.

Consistent with many of the ideas expressed by survey respondents, SEC Chief Accountant James Schnurr recently offered his thoughts⁷ on the audit committee role stating: “The audit committee plays a critical role in overseeing management’s preparation of reliable financial disclosure.” He then offered three specific things a company can do to start:

“First, I would encourage you to set the tone for the organization - one that expects effective disclosure and robust judgments on preparing it. Empower management and embrace efforts to focus on disclosure effectiveness. For some companies, this could entail, among other things, redesigning portions of the document to include tables and graphs, removing outdated disclosures when appropriate, and increasing the use of hyper-links and cross-references instead of repeating the same disclosure in multiple places.”

Next, actively participate in the dialogue, not only around the “volume” of disclosure but, more importantly, around the quality of those disclosures. Consider the various users of the financial statements and think about better ways to convey information to them. Effective disclosures are not static. Rather, what is important to investors may change over time. As facts and circumstances change, you may need to re-evaluate whether existing disclosures continue to be relevant and applicable to your current situation.

Finally, omitting immaterial financial statement disclosures will often require significant judgment. The accounting literature allows for appropriate, well-supported judgments around disclosure. Well-reasoned, practical judgments to omit immaterial disclosures should be grounded in the objectives and principles of the relevant guidance and companies should have appropriate processes and controls to evaluate those judgments. As part of its oversight, audit committees should encourage this dialogue. Developing appropriate processes to enhance disclosures - and judgments for deciding which disclosures can be omitted - naturally requires coordination with the audit committee. Being an active and willing participant in the process is a key step as we collectively work to achieve disclosure effectiveness.”

Involvement of key constituents

Some respondents and interviewees suggested that involving key constituents from an organization early dramatically helps facilitate the improvement process and improve efficiencies. One interviewee noted their process involves holding a meeting twice per quarter for quarterly reports and three times for the annual reports. The meeting includes the Finance VPs, CFO, Senior VPs and general counsel (internal and external). A team member explained: “This meeting is to first point out any changes from the prior filing or anything key from the quarter, but [it] also allows senior management ... to ask questions about the disclosure. ... We determined that if you hear a question more than once over multiple quarters, that’s when there may be something you need to fix.”

Another interviewee added, “Technology is also a good place to start. ... Some platforms allow you to provide an analysis of other information filed on EDGAR,” making benchmarking to peers easier and quicker.

Continuous improvement process

Other interviewees believe the process should be continuous. A director of SEC and financial reporting at a bank believes that companies should make the process of improving the financial statements and communication less

Companies can make significant improvements in their disclosures without any changes to the rules.

⁷ Remarks Before the UCI Audit Committee Summit, Oct. 23, 2015

Companies need to answer two critical questions in the summary: 'where have they been?' and 'where are they going?'

episodic and more evolutionary. He explained: "It's part of continuous improvement. So we'll file a 10-Q, and then a couple weeks later, we'll wait for others, we'll do some peer analysis, and we'll talk to each of the constituencies and create a game plan for the next quarter that we'll share with management before we get to it. And [that's our] standard operating procedure."

He also agrees that technology has helped. "You need a process where you can efficiently make changes on a timely basis and turn things around. If we go back 10 or 12 years, we would not be as responsive as we are today if we had not made the technological changes."

A corporate controller for a major bank said that his organization is also continually looking for ways to implement disclosure effectiveness efforts in future quarters. "We challenge new disclosures to make sure that they are generally disclosed once and not repeated within the document," he explained. "We continue disclosure effectiveness dialogue with key stakeholders in senior management, counsel (both internal and external), investor relations and external auditors."

Adding disclosure effectiveness to the agenda

Audit committee members interviewed also provided advice for other audit committee members and management on how to get started, suggesting that the Audit Committee put the disclosure effectiveness initiative on their agenda. Their advice to management teams is to take a fresh look at opportunities to improve – and don't fall into the trap of "more is better or easier."

An audit committee member of a financial institution said that "audit committees, boards, etc., are all very busy, so unless [disclosure effective initiatives] are on the agenda to-do list, it's not going to get done." He suggested that the finance team automate the reporting process as much as possible, to give the financial reporting team more time to work on producing quality disclosures.

Another audit committee member suggested that the Audit Committee should encourage management to "look hard at opportunities to improve the understandability and to streamline the financial reports whenever they can. Whether that results in an increase or decrease, I think that is an outcome rather than an objective. Obviously, until the SEC and the FASB can agree to reduce the overlapping and duplication of requirements, by and large, it's difficult for management to do that unilaterally. But companies should look for opportunities to be as crisp and succinct as possible throughout the documents."

Yet another agreed that senior management should regularly take a fresh look at the company's communications. "So, step back periodically, look at [your annual report] and say, *How can we become more effective?*"

Some legal counsel agreed with the suggestion that companies take a step back, look at their businesses and consider what's really important to investors. They argued that companies shouldn't take the "kitchen sink" approach for risk factors and should consider repetition and materiality. They also advised focusing on the manner of presentation.

Brink Dickerson, Securities and Transaction Attorney, had a number of suggestions. "Companies can make significant improvements in their disclosures without any changes to the rules," he stated. "Much of the focus so far has been in

eliminating repetitive disclosure – e.g., where something is disclosed in both the footnotes and the MD&A. While the low-hanging fruit in this area has been picked, there still are some opportunities for improvement simply by covering an item once and doing so in a manner that can serve multiple purposes. Litigation disclosure is a good example of this.

"Second, while it may sound silly, the tone that a company sets in the first paragraph or two of its MD&A – the so-called 'executive summary' – often drives the length and quality of the remainder of the disclosure. Companies need to answer two critical questions in the summary: 'where have they been?' and 'where are they going?' If they do that and then use that to set the tone for the remainder of their disclosure, it will be shorter and more informative.

"Third, companies can focus their disclosure on the tried and true approach of focusing on the words and the story rather than the numbers. Certainly some numbers are needed in order to provide context, but not as many as companies think. Companies need to focus on the salient message that they want to deliver and narrow the other matters – often just noise – that they cover."

Focus on what's really important to investors

Kimberley Anderson, a corporate governance and disclosure attorney, suggested starting with risk factors: "Read risk factors every year and decide if all of those risks listed are really applicable. ... Once an issuer has taken a red pen to its risk factors, I would focus on the business section. Is there too much historical detail? Can any of the information be cross-referenced? Can charts or tables convey information

faster and more clearly? Is the page too dense with text? Would a summary section (using bullet points and active voice) be useful for the reader? What are the top five things you want the reader to come away understanding about the most recent fiscal period – have those been communicated clearly or did they get lost in the text? If a reader has to turn to your press releases to understand your current concerns and priorities, then your disclosure documents should be reimagined.”

A former CAO of a privately held transportation company agreed that charts and tables are a good place to start in terms of focusing on what is helpful to the investor, stating “more tabular presentations will improve disclosure effectiveness.”

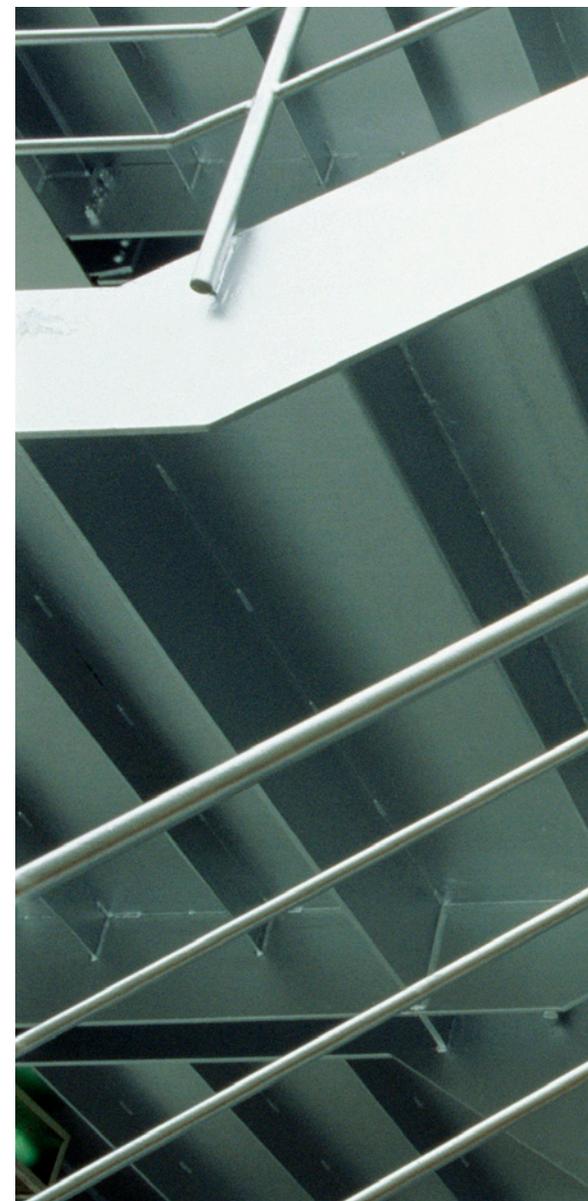
Consider your disclosure mindset

According to Mr. David Lynn, a securities advisor and disclosure attorney, repetition and materiality are key areas in which organizations can start improving their communications. Mr. Lynn thinks people should in some instances try to “get comfortable that they’re still in compliance with the rules if they provided the information in a way that’s not exactly repeating the same information over and over again.”

Mr. Lynn also offered that companies need to focus on materiality. He pointed out that the SEC staff has commented that securities laws don’t require companies “to disclose every piece of information that somebody might find interesting, and I think people tend to forget that because of the adoption of things like the conflict minerals

rules and rules along those lines that are not particularly useful disclosures for investors, in my point of view. And some companies I think need to sit down and ... perhaps ask, ‘is this material to investors?’ And if the conclusion is it’s not, then when permitted under the existing rules, you don’t have to talk about that, or [not to] the same level of detail.”

Mr. Lynn’s final suggestion for what companies can do without regulatory guidance is to focus on the general manner of presentation and wording of financial communications. Consider “whether things could be presented more clearly through tabular presentations or graphical presentations, using lists and bullet lists or things like that, instead of long paragraphs.” He also advocates more frequent use of “plain English.” He recommends, “maybe just refer back to the actual disclosure requirements, and particularly for something like MD&A, and read all of the interpretative gloss that the SEC and the staff has put on that disclosure requirement, and boil it down to what exactly a company should be talking about.”



Top 10 disclosure effectiveness actions to consider

1. Start early.

Starting as early as possible in the reporting cycle is important, as most changes require time to design, review, approve and implement.

2. Engage relevant stakeholders from the start.

Engage key stakeholders within the company, such as senior executives, controllers, heads of SEC reporting, investor relations, and in-house and external counsel, to ensure they understand the plan and provide relevant feedback.

3. Discuss your plans with the Audit Committee.

Increasingly, disclosure effectiveness is being added to the agenda. Discuss their views on matters they care about and share with them what other companies are doing to improve financial reporting.

4. Challenge yourself and ask “how can our disclosures be more effective for investors?”

Taking a fresh look at opportunities to make disclosures more understandable, meaningful and effective can help improve the alignment of your vision and strategy across all your communication channels – which ultimately can translate into greater market confidence.

5. Addressing “low-hanging fruit” may provide a good start toward building momentum.

Removing immaterial information, redundant disclosures and outdated information may provide a good start for disclosure improvement, but consider plans for more robust efforts, including holistic changes across all financial communication channels.

6. Consider content and presentation of information.

In addition to improving the content of information, consider ways to improve the presentation of information through greater use of bullet points, tables, charts, graphics and infographics. Communicate rather than simply disclose.

7. Don’t be afraid to consult.

Consider proactive communication with key stakeholders, including the SEC and your external auditors, so they understand the rationale for any changes made.

8. Optimize the use of technology.

Investors are adapting to technological advances in how they consume information used in decision-making. Consider opportunities to leverage new technologies to enhance the content and messaging provided on your website and, specifically, investor relations page.

9. Remember that disclosure effectiveness is a continuous process.

Financial reporting improvements are a continuous process, as reporting should constantly adapt to changes in the business, regulatory environment, accounting rules and technology.

10. Set the right tone at the top.

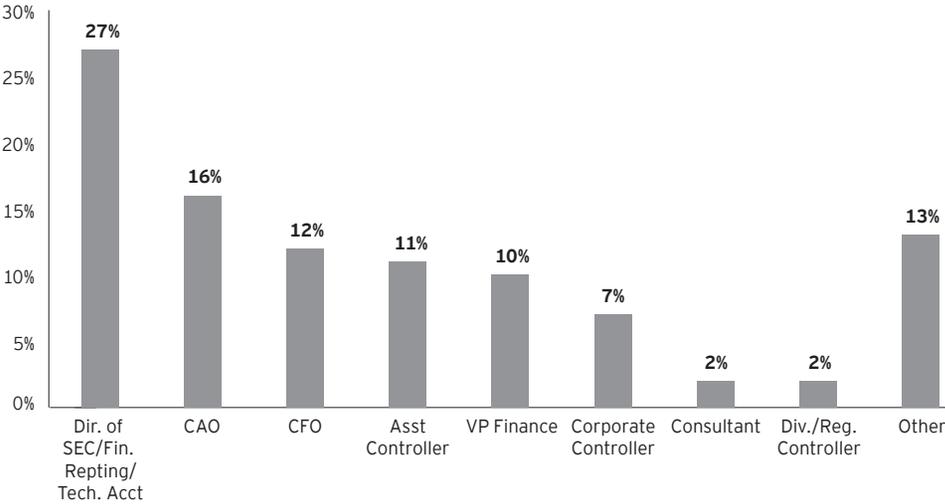
Empower management and proactively support efforts to focus on disclosure effectiveness.

Characteristics of respondents

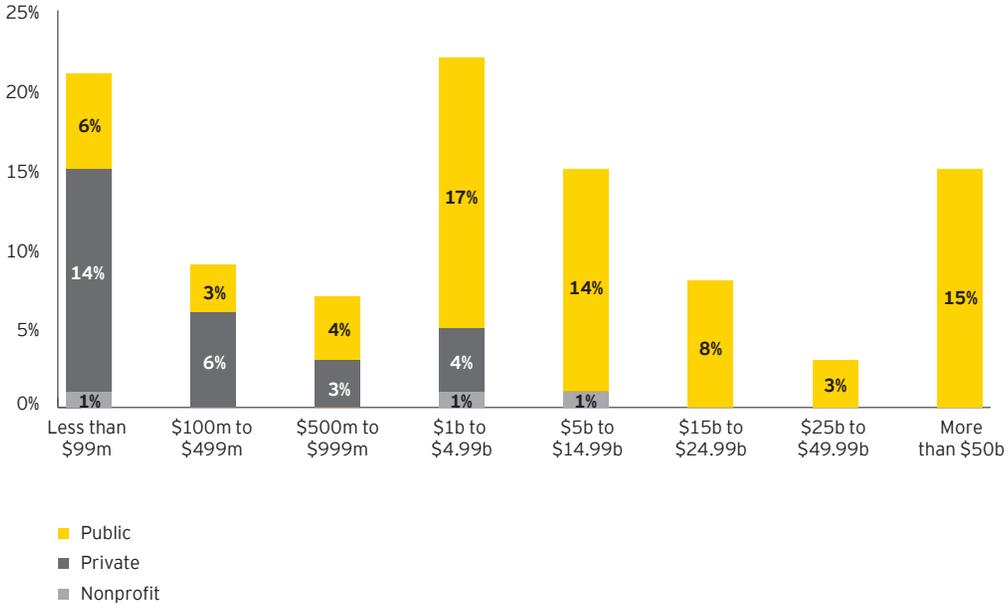
From May to August 2015, FERF and EY conducted a survey of predominantly US corporations, receiving more than 120 responses. The respondents were key participants in the financial reporting process. CFOs, CAOs, controllers and directors of SEC reporting made up the bulk of the respondent pool.

Annual revenues of respondents' companies range from less than \$5 million to more than \$50 billion, with 63% representing \$1 billion and above. Respondents' organizations include public and private companies.

Respondent titles

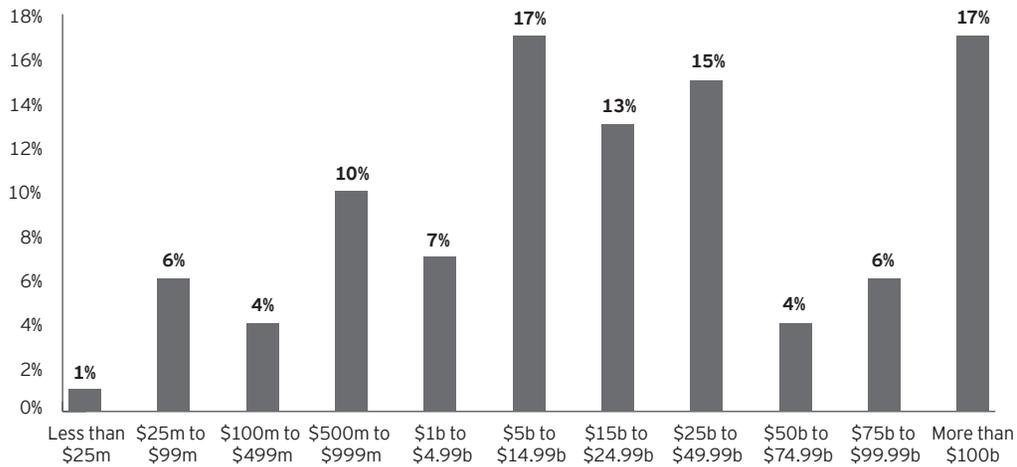


Respondent revenues

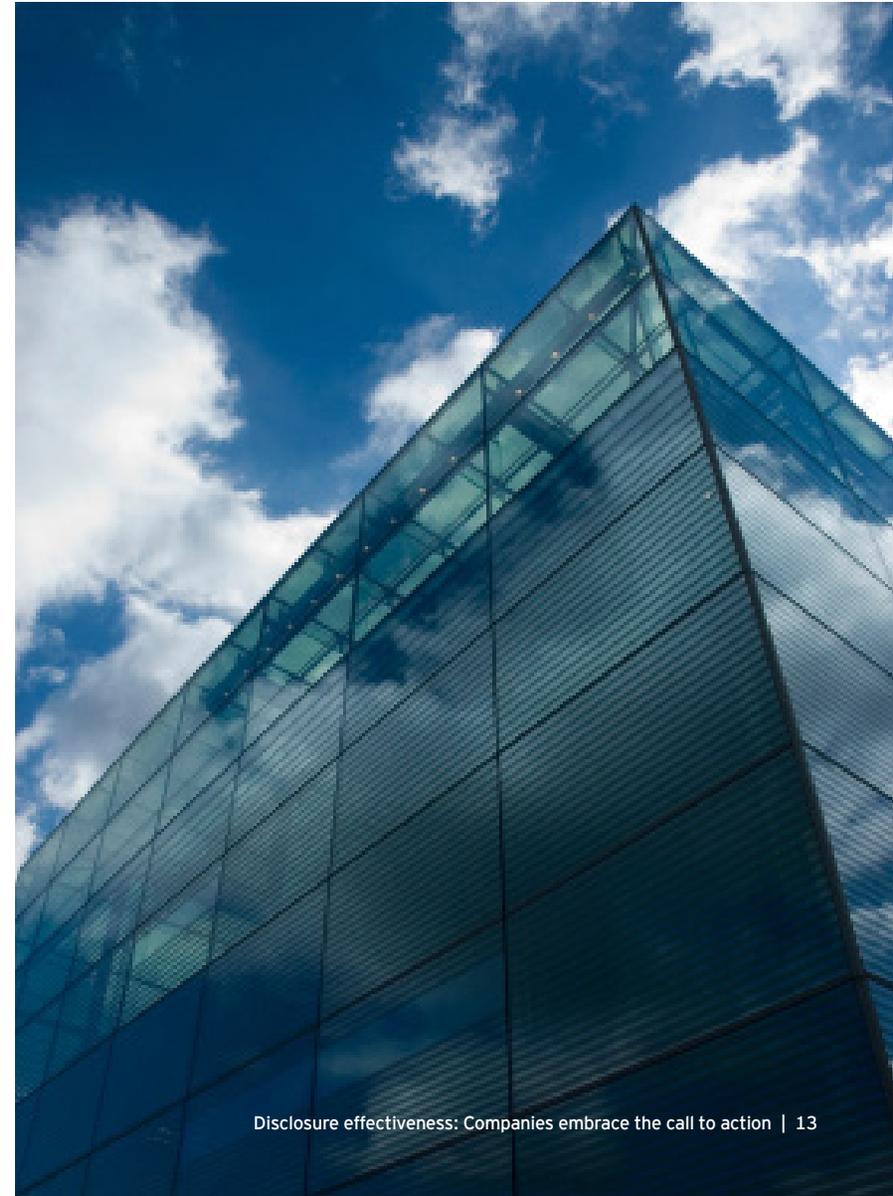


Market capitalization for public company respondents as of May 2015 covered a broad range, with \$5 billion-\$14.99 billion and more than \$100 billion strongly represented, and more than 55% of respondents with market cap larger than \$15 billion.

Public company market caps



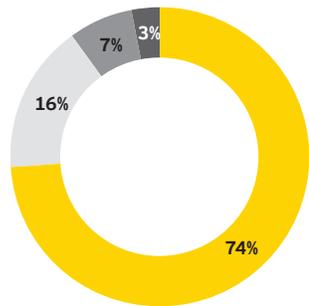
Survey respondents covered a wide range of sectors, including manufacturing, life sciences, health care, pharmaceuticals, electronics, technology, software and services, and professional services.



What are companies doing to enhance their disclosures?

Nearly three quarters (74%) of responding companies (both public and private) across a broad spectrum of industries are taking action to improve their financial statement disclosures, with many citing management team influence, SEC disclosure effectiveness initiatives and FASB/IASB efforts to improve disclosures as the catalysts for change.

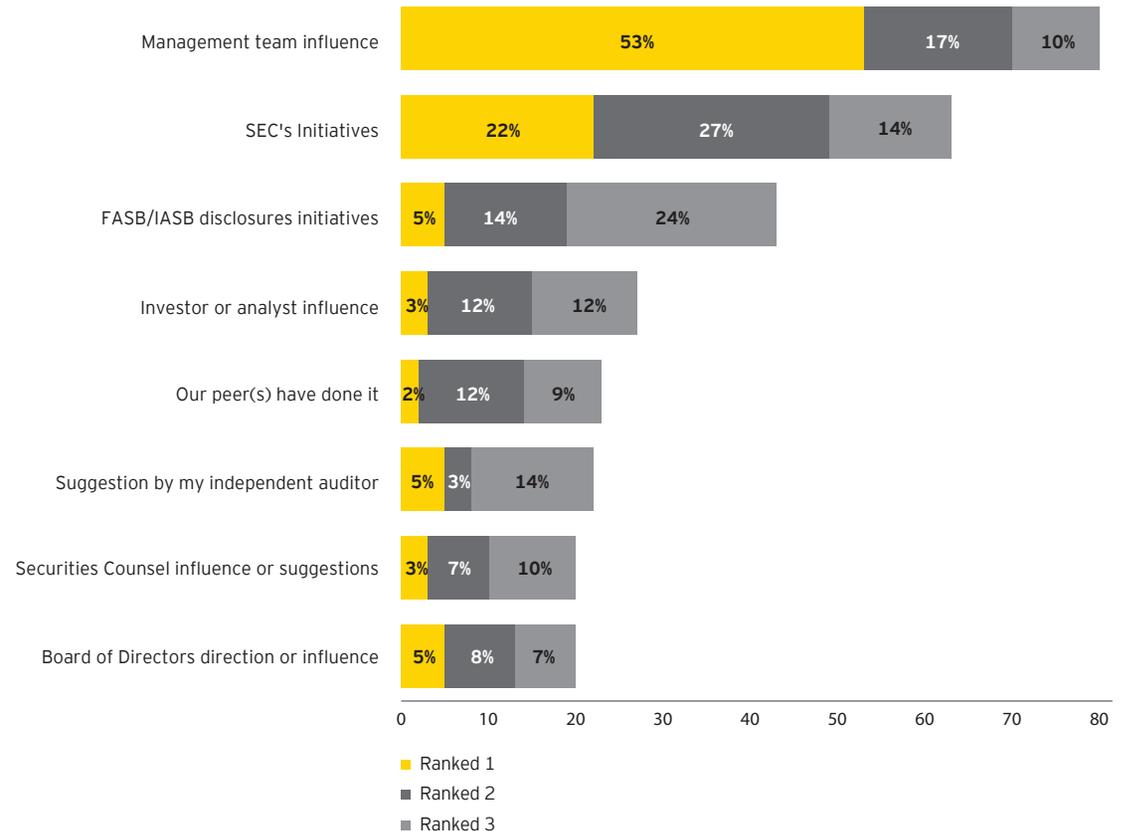
Have companies undertaken efforts to improve their financial statements and communications?



- Yes we have taken action to improve our financial statements and have incorporated the changes into our filed statements.
- We have not considered improving our financial statements.
- We have considered taking action to improve our financial statements but decided not to make any changes at this time.
- We have considered taking action to improve our financial statements and plan to make changes to our upcoming financial statements.

Major reasons for making the change?

(Ranked 1-3, with 1 being the main reason – respondents were to select all that applied)





How can we make these disclosures more understandable?

We asked about the reasons companies launched disclosure effectiveness efforts. Many of these initiatives resulted from comments by senior executives, board members, investors, peer analyses, or simply from an internal desire to provide more effective financial communications to investors.

During our interviews, a financial reporting team of an electronics company suggested that their initiative started because of a comment received from their CFO related to the length and complexity of a derivative footnote and why there were things repeated. One member vividly recalls, “The CFO asked, ‘what did the long, complex blob of information mean?’” This comment led to an initiative for the team to rethink the purpose and effectiveness of their disclosures and ask, “How can we make these disclosures more understandable? It started with the derivatives footnote, and then moved to the commitments and contingencies [footnote] and now is continuing with deleting redundant information and more cross-referencing to full disclosures.” This concerted effort led to a shift in thinking in the organization about ways to make disclosures more clear and informative. Another key for this company is to benchmark against peers: “Anytime we are updating a footnote, anytime we are making major changes or minor changes to our footnote, we are looking at several peers and key competitors before we decide on our final form.”

Similarly, a director of SEC reporting and technical accounting of a diversified industrials company shared that this “management-driven” initiative around disclosure effectiveness has always been the goal of his group, and they have always aimed to have concise financial information that communicates effectively. The director’s team is aware, he said, that sometimes “less is more.” They also review peer groups to identify improvements in reporting each period. However, they don’t just use peers from the same industry. They draw from a variety of industries by including companies with board members they have in common.

Peer analysis certainly plays an important role in disclosure effectiveness efforts according to a director of SEC financial reporting of a large bank. He explained that their initiatives started from the management team’s efforts to compare and contrast their financial statements to the financial statements of their peers. From this analysis, the management team “determined the best practices and analyzed whether those differences are value-add.”

Still, others noted that sometimes making more dramatic reporting changes requires taking an innovative approach, particularly when there is little variability in disclosures across a peer group. Interviewees admitted, however, that disclosure innovation could be better encouraged and rewarded under the current disclosure regime.

Another approach to the initiative that was echoed by several respondents was to consider investor feedback as the basis for the disclosure effectiveness project. A lack of clear and transparent disclosures sometimes results in sub-optimal investor and analyst views, which in turn manifests itself through adverse market valuations and cost of capital. One former CFO of a financial services company shared, “We received feedback from our analysts and used that feedback in trying to understand what their questions are and how we could communicate more effectively.”

Why are some companies taking no action?

For the small minority of companies that have not undertaken efforts to improve their financial reporting, the top three reasons cited were: (1) the financial statements already provide reasonable presentation of the company’s financial standing and performance; (2) investors will not benefit significantly from efforts to improve financial reporting; and (3) the benefits of those reporting improvements do not justify the costs.

Many companies are increasingly supplementing their financial reporting results with a range of non-generally accepted accounting principles (GAAP) performance measures and therefore feel they are “telling the story” about their recurring results through that lens. In addition to the more typically used EBITDA and adjusted earnings before interest, taxes depreciation and amortization (EBITDA) metrics, companies reported increasing use of organic sales/revenues, core sales, earnings excluding derivatives and earnings excluding foreign currency effects.

We received feedback from our analysts and used that feedback in trying to understand what their questions are and how we could communicate more effectively.

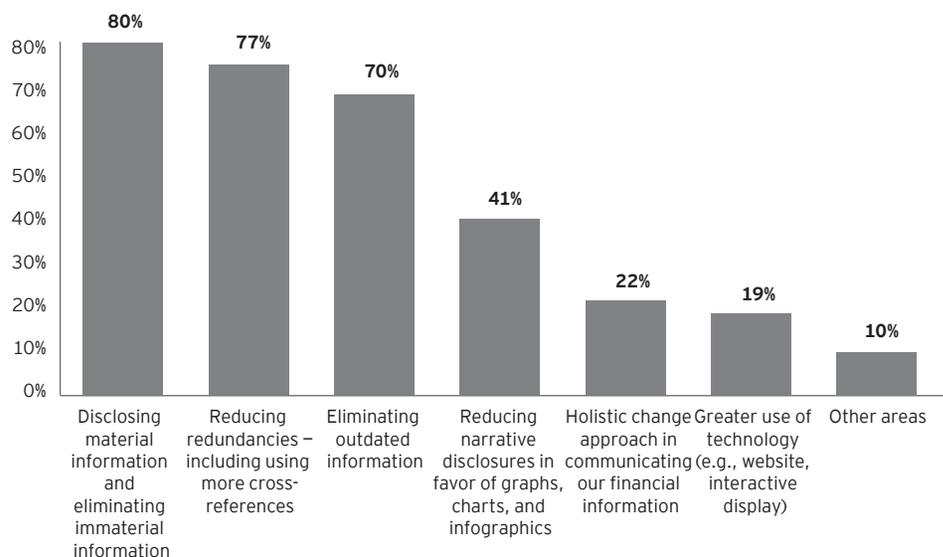
Three key focus areas in companies' improvement efforts

Respondents indicated that their company's financial statement improvements efforts have primarily centered in three main areas: (1) disclosing material information and eliminating immaterial information (80%); (2) reducing redundancies by using more cross-referencing (77%); and (3) eliminating outdated information (70%).

Other areas of focus include taking a "fresh look," as some respondents describe, at opportunities to enhance the presentation of their financial statements by reducing narrative disclosure in favor of tables, graphs, charts and infographics (41%).

Companies continue to focus on ways to make their disclosures comprehensive, accessible and contemporary in order to promote understandability. The attention to these areas was similar for private and public companies. Of particular interest, 22% of the respondent companies are exploring a holistic change in their financial communications.

Areas of focus (respondents could select all that applied)



I think a message from the audit committee carries a lot of weight. If management and the financial reporting team know they have the support of the audit committee, they are likely to be more proactive with proposed changes.

The key focus areas also align with areas that boards of directors and audit committees are concerned about.

An audit committee member of a financial services firm suggested: "On my boards, we have several financial experts, who are very committed to good financial reporting. The disclosures have remained fairly consistent for several years, but with the recent awareness of disclosure overload, we encouraged management to take a look to address any redundancies and delete immaterial information. I think a message from the audit committee carries a lot of weight. If management and the financial reporting team know they have the support of the audit committee, they are likely to be more proactive with proposed changes."

Another audit committee member serving on various companies' boards agreed. He said, "As for duplication in the report, we challenge senior management to see whether or not there is some way to be a little bit more concise." He also shared that his audit committee encourages the company to "comply with disclosure requirements but also focus hard on communicating in as clear and unambiguous a fashion as they can to investors and users of financial statements." He further explained, "We read the financials in draft form, and if things are opaque or difficult to understand or not presented in the fashion that enhances the understandability, we, as the audit committee, will provide our comments to senior management."

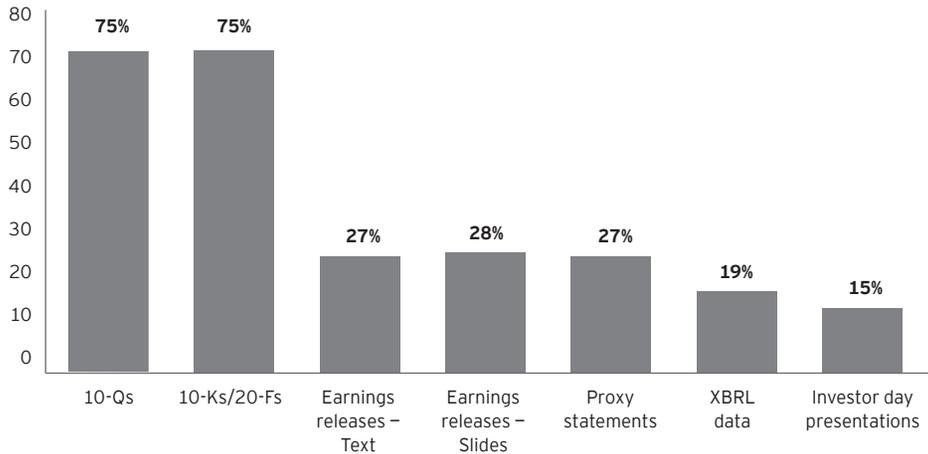
An audit committee member of a large financial institution said encouraging companies to streamline financial statements is important. "It's particularly important to push back on information [that auditors and others] request of the management team." The committee member explained: "This ... resulted in a 10-Q being approximately 20 pages shorter than the 10-Q for the corresponding quarter in the prior year. Since the general counsel or the corporate secretary, or both, attend the audit committee meetings, they also weigh in on changes to the financial statements."

As expected, many of the companies that made significant changes to their financial statements said they reviewed the changes with the Audit Committee prior to finalizing them. In some instances, the more dramatic changes also involved proactive discussions with a company's SEC filing review team, which many recommended as a good practice.

Companies focusing on annual (10-K) and quarterly (10-Q) reports, but starting small

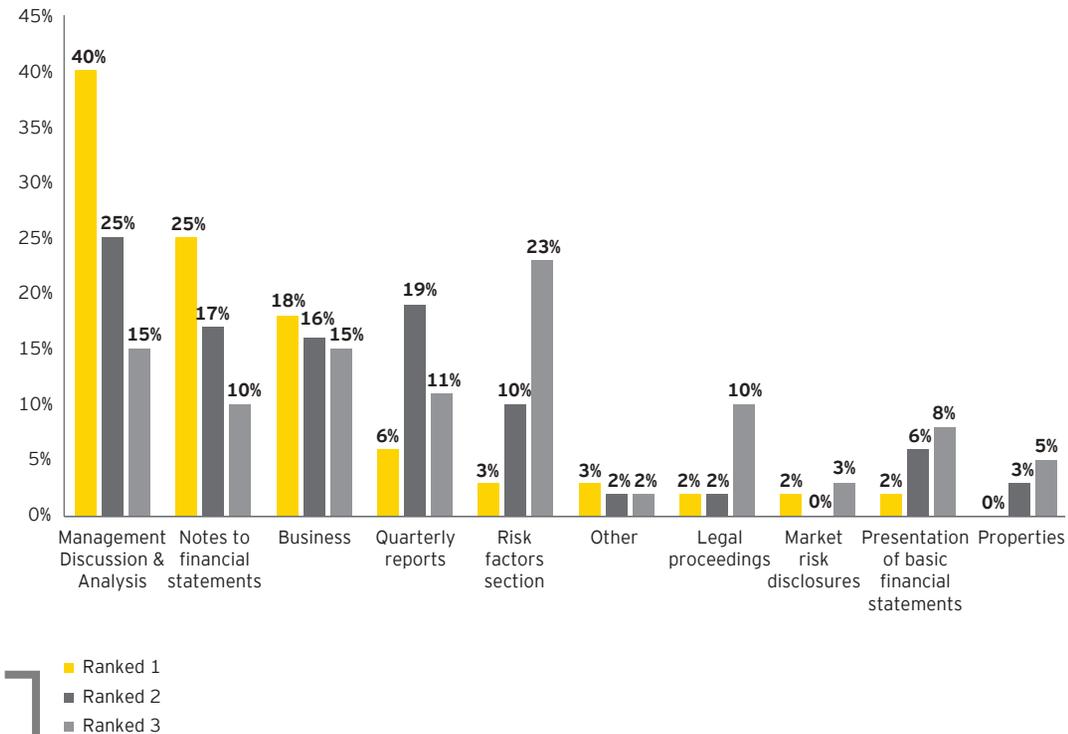
Most companies that have taken steps to improve their financial reporting are focusing on their annual and quarterly reports. However, some are also focusing on making meaningful changes to their earnings releases and proxy statements. In some instances, the efforts have evolved from first making incremental improvements to the earnings release and proxy statements, followed by more robust changes to their financial reports, including MD&A and financial statements.

Documents that were improved as part of initiatives



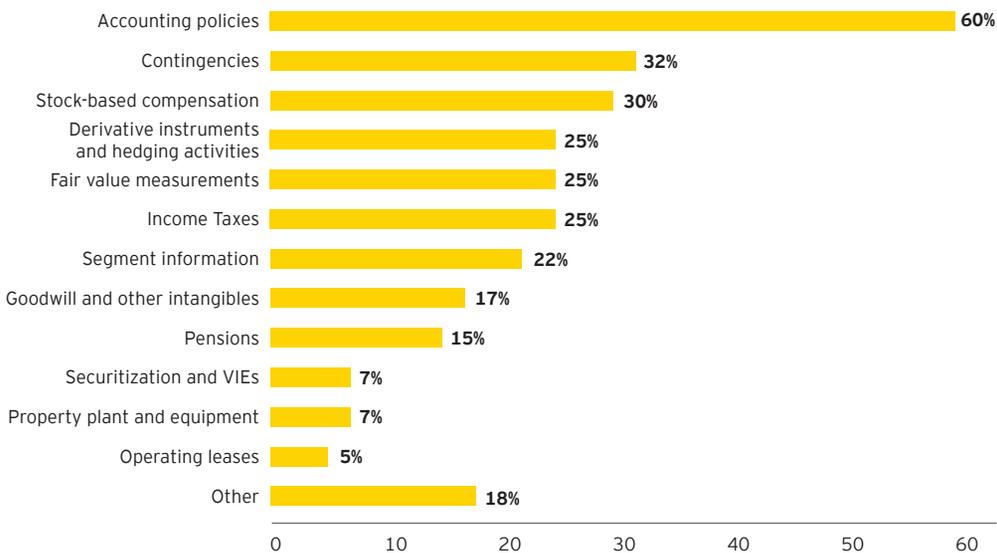
Respondents cited MD&A (40%), notes to the financial statements (25%) and business items (18%) as the three areas that have been improved the most. For those identifying financial statement footnote disclosures, accounting policies footnotes (60%) was the most cited by far and at nearly double the rate of the next two footnote categories: contingencies (32%) and stock-based compensation (30%).

Part of SEC report that improved the most (respondents could select all that applied and ranked the top 3, with 1 being the most improved; and 3 being least)



We read the financials in draft form, and if things are opaque or difficult to understand or not presented in the fashion that enhances the understandability, we, as the audit committee, will provide our comments to senior management.

Notes to the financial statements that improved the most (respondents could select all that applied)



Disclosure effectiveness is a collective effort

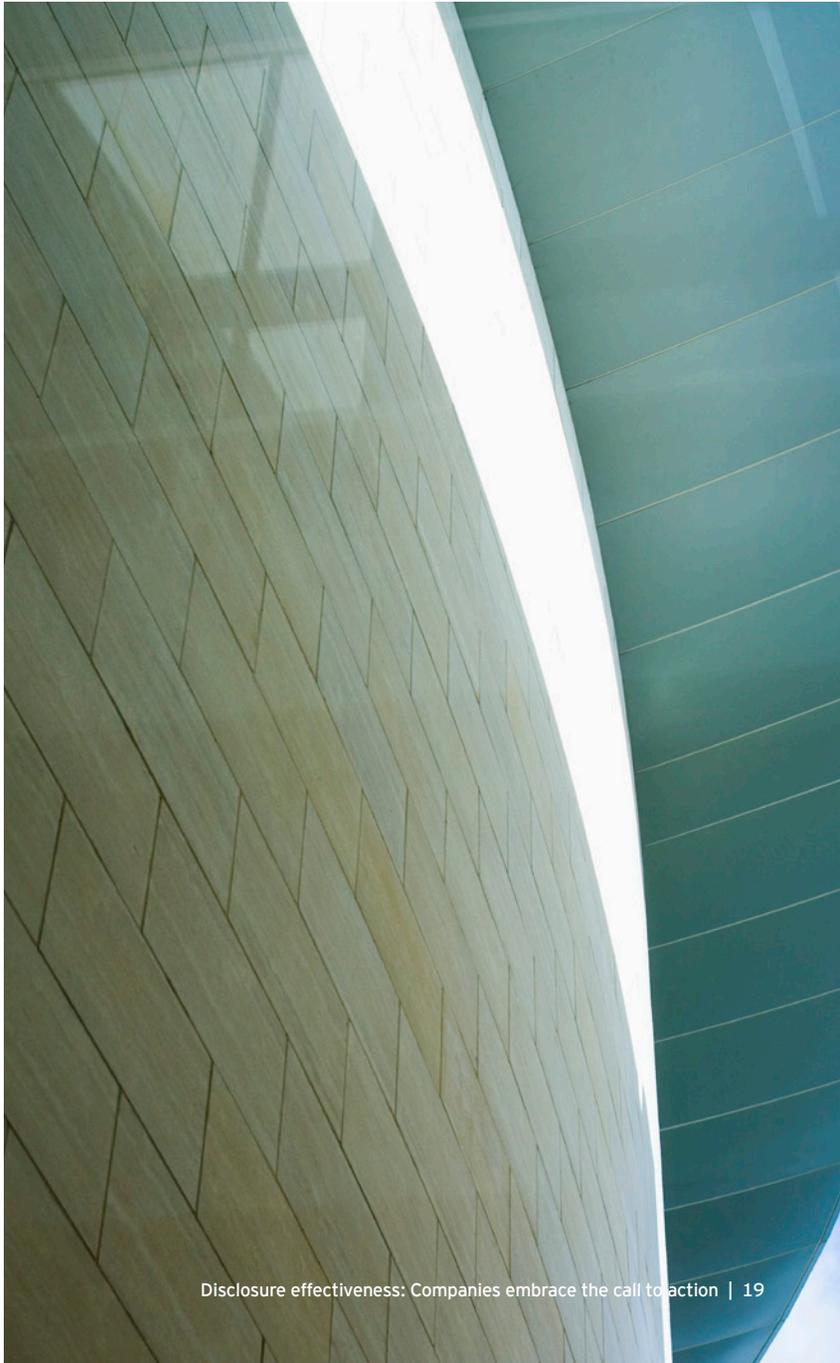
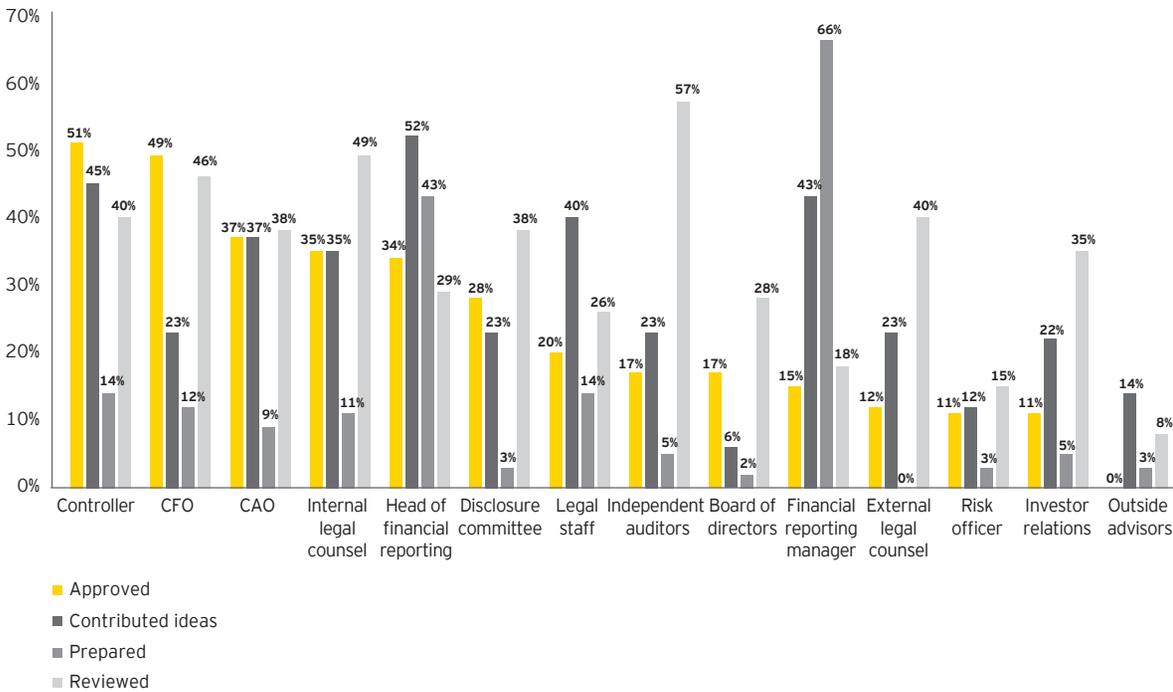
More than half of the respondents indicated they do not have formal dedicated groups in charge of disclosure improvement efforts. However, a third of companies do. Many of those companies indicated that they use disclosure committees to a great extent in order to help senior management assess potential changes (see the FERF/EY report titled, *Unlocking the potential of disclosure committees*, published in 2014). Those with only informal committees involve members such as CFOs, the controllership functions, directors of SEC reporting, directors of financial planning and analysis, and in-house counsel.

What best describes the state of your disclosure improvement efforts?



Still, the survey results revealed that informal “roles and responsibilities” have materialized at many companies. For example, respondents indicated that often financial reporting managers are responsible for preparing the improved financial statements; the head of financial reporting is responsible for contributing ideas; senior financial executives are responsible for approving changes; and the external, independent auditors are responsible for reviewing the financial statements.

Participation in the disclosure improvement initiative



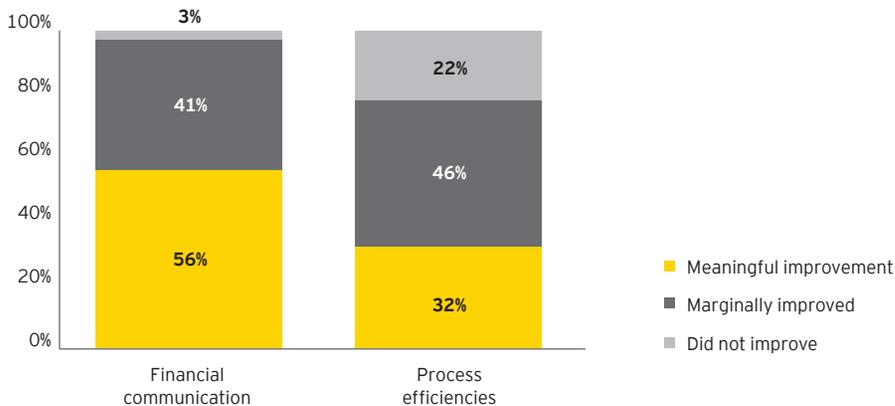
What are the benefits?

Many respondents believe there are key benefits to improving financial reporting, including receiving favorable reactions from senior management, board members, investors and analysts who found the information easier to read and digest, allowing them to make more informed decisions.

While some companies expressed a general desire to improve the quality and usability of their reported documents, others expressed having best-in-class disclosures that provide investors with a clear snapshot of the company “story” as a key benefit. Still other respondents cited an opportunity to enhance clarity through an internal “de-risking” process that removed unnecessary information, clarifying the contents of the report and its connection to strategy.

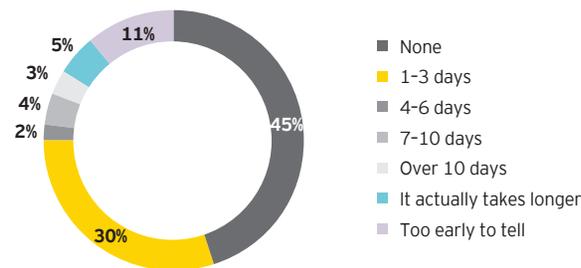
Moreover, our survey findings indicate that companies have gained both financial communication and process efficiencies as a result of their efforts, with respondents indicating meaningful or marginal improvements of 97% and 78%, respectively, in those areas.

Impact on disclosure improvement efforts for companies



Delving deeper into the process efficiency gains, nearly 39% of respondents estimate they now save (or expect to save in the next year) at least one to three days in the preparation of their financial statements due to their improvement efforts, of which 9% have indicated a savings of 4 days or more. Approximately 11% of respondents stated that it is still too early in the process to assess benefits, which reflects the sentiment that much of the progress that’s being made is still very fresh.

Days saved of improvement



Interviews with various investors reveal that they believe the changes they’ve observed are positive and they are supportive of the changes. While they are encouraged by the improvements, they would like to see more expansive changes – and for more companies to initiate actions around disclosure effectiveness.

In many cases, investors said they want to know more – sometimes much more – about how a company conducts its business. They want more insight into companies’ performance, strategic direction, and how they manage and mitigate risks. As they look to deploy their capital and make conclusions about the companies they want to invest in, they are studying the information that is available to them in disclosures.

Investors believe increased transparency instills market confidence and builds trust. In addition to reading financial reports, many investors are increasingly looking at other information, such as sustainability reports and information on company websites, which sometimes offer an in-depth view of various aspects of a company.



Nearly 39% of respondents estimate they now save (or expect to save in the next year) at least one to three days in the preparation of their financial statements due to their improvement efforts.

‘Noticeable improvements’ for some cases

Fred Cannon, Executive Vice President Global Director of Research and Chief Equity Strategist at Keefe, Bruyette & Woods (dealing primarily with financial services), feels there has been noticeable improvement in financial statements in the past several years. “Since the end of the financial crisis and its immediate aftermath, I think we have consistently seen improved financial disclosures from most financial companies,” Mr. Cannon said. “I think that’s been spurred on by regulators largely, but also by companies themselves to ensure that they, as best they can, clearly define their exposures. What the financial crisis underscored was that analysts and investors need to focus on balance sheets and not income statements for financial firms. And so I think that’s really occurred over the last ... three to five years. ... However, I have not seen any move toward simplification.”

Mr. Cannon also believes that companies are supplying additional analysis and presentation around the time of earnings press releases: “These have tended to become very important enhancements that investors have seen as result of regulatory and GAAP disclosure requirements.”

As it relates to transparency and good disclosures, Mr. Cannon explained, “An important part of our ability to recommend the stock to investors may be ... the quality and robustness of their disclosures, and if the quality of their disclosures is not adequate, they may be avoided.”

A senior analyst with experience covering both financial and nonfinancial services companies echoed the importance of disclosures: “The quality of disclosures matters for the price of the stock. If companies have clearer disclosures, you can make better investment decisions. If the company has poor disclosures, investors demand a premium in their investment return and require a discount in what they are willing to pay because of the uncertainty.”

She pointed out noticeable improvements in reporting, specifically in the MD&A section. “For a while, there seemed to be a lot of boilerplate information; however, now it seems that there is unique information.” She believes that the MD&A is still ripe for improvement and companies can go further to discuss how certain events will impact performance going forward.

Aeisha Mastagni, Portfolio Manager at CalSTRs within the Corporate Governance unit, has also seen notable changes in financial communications. “Companies are getting better at putting more information on their websites,” she said. They are also “learning to package this information into more ... plain English.” In addition, Ms. Mastagni has observed a rise in the number of sustainability reports – a welcome development: “As an investor that owns a whole market, things that affect risk as much as return are important to us. We have also seen a rise in companies disclosing their political contributions as well as lobbying efforts, and understanding what the board’s process is for overseeing those types of activities is very helpful.”

She adds: “In our organization, we strive to add value to the portfolios while minimizing risk, and therefore we cannot manage what is not disclosed or what companies are not talking about – more disclosure is always going to help us. But this does mean communicating with a level of priority of information about what is most relevant – as nobody will read through 200 pages. Important pieces are usually extracted out. We are normally more engaged with organizations that have poor financial communications because we are trying to improve their disclosures and transparency.”

For a while, there seemed to be a lot of boilerplate information; however, now it seems that there is unique information.



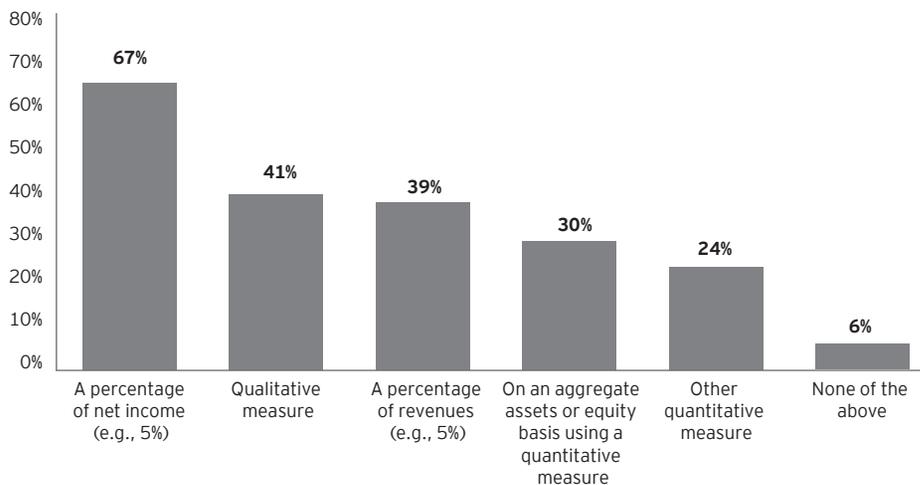
The quality of disclosures matters for the price of the stock. If companies have clearer disclosures, you can make better investment decisions. If the company has poor disclosures, investors demand a premium in their investment return and require a discount in what they are willing to pay because of the uncertainty.

What are the challenges?

Survey respondents identified that materiality considerations (i.e., determining what to include or not to include in filings) continue to pose a major challenge for companies as they prepare their financial reporting packages. Respondents believe that increased disclosure requirements combined with the lack of clarity and judgment involved in determining what to disclose have significantly contributed to internal debate and, ultimately, to increased disclosure to avoid time-consuming second-guessing.

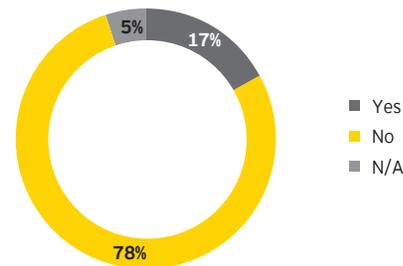
When asked how companies measure materiality for reporting purposes, the responses identified covered a wide spectrum of thresholds, with approximately two-thirds indicating they use a percentage of net income (5%). Interestingly, 41% of the respondents stated they used qualitative measures and 24% stated they used “other quantitative” measures spanning an assortment of measures. Respondents generally felt it would be helpful to clarify the consideration of materiality to ensure more consistency.

Calculate materiality (respondents could select all that applied)

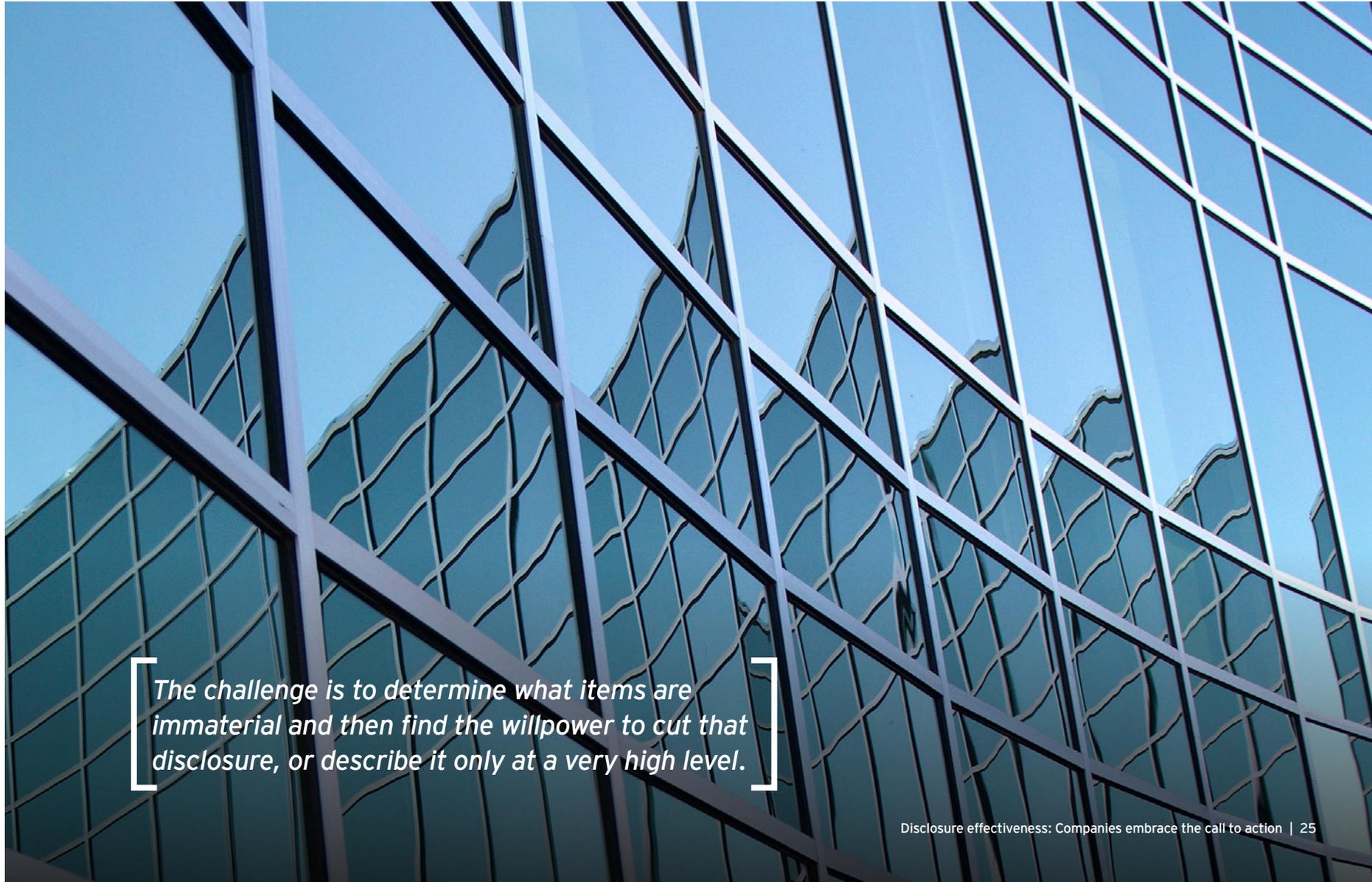


Participants were also asked whether they have changed or reconsidered their methodology of measuring materiality as a result of their improvement initiatives. While nearly one-fifth of respondents have reconsidered their evaluation of materiality, a significant majority have not.

Change in materiality methodology as a result of improvement initiatives



Kimberley Anderson agreed that materiality is the primary issue for companies. “The challenge is to determine what items are immaterial and then find the willpower to cut that disclosure, or describe it only at a very high level.” She adds: “Assuming that the disclosure being eliminated was immaterial or duplicative, I don’t believe companies expose themselves to increased risk. However, over time, it is likely that much of the historical information is far more detailed than is required and includes information no longer relevant.”



The challenge is to determine what items are immaterial and then find the willpower to cut that disclosure, or describe it only at a very high level.



Respondents and interviewees also expressed a number of other challenges that sometimes hinder their disclosure effectiveness efforts and ability to implement changes.

■ *The auditor disclosure challenge*

Some have suggested that the prescriptive nature of the auditor disclosure checklist impedes better communication, since it often limits the flexibility companies have in emphasizing material information or scaling disclosures (e.g., based on relative importance).⁸

The financial reporting team of an electronics company agreed that the disclosure review by the auditor was their main challenge. “We have to go through a auditor’s disclosure checklist – all items that are not disclosed must be explained,” a member of the team told us. “Our auditors go through the list to ensure that we are compliant. For each item, we need to explain, ‘here is why we didn’t disclose something.’ To help with this challenge, the reporting team normally identifies the reasons up front to avoid these questions in the back end. Since the team is very thoughtful and skilled, we do not get much pushback from our auditors or any other group for that matter.”

Still, others said that abandoning the disclosure mindset with a more principle-based mindset around communicating material information to investors could go a long way toward markedly improving disclosure effectiveness.

■ *Resistance from high up*

While many respondents cited senior-level management as a catalyst for the disclosure effectiveness process, in some instances that may not be the case. The director of SEC and financial reporting of a bank shared that their biggest challenge is sometimes internal, from those who sign the financial statements. He explained: “Generally, the information is prescribed through either [Regulation] S-K, S-X or accounting rules. [The financial statements] represent the reflection of [how the CFO and the CAO] want to say things – because in effect, they’re signers, and it becomes a little bit of a reflection of what they want. ... They have a vision, and when you try to change it, the resistance comes from the people ultimately who sign it.”

To overcome this challenge, the group provides examples of other disclosures and explains why those particular disclosures do or don’t add value. Another tactic they use is to solicit the input of their investor relations team, before they make any recommendations. The director shared that the investor relations group is critical and there should be close interaction with them, because “they provide a sense of the types of questions, feedback issues” currently of concern to investors.

■ *Fear of the SEC review*

The Audit Committee member of a large financial institution suggested that another challenge is the fear of SEC filing reviews. He explained, “If they shorten or eliminate disclosures, they may be likely to get a question about it. This is less of a fear about the effect on investors and more of a fear about SEC [comment letters].”

Some respondents have added that proactive communication with the SEC is helpful, including addressing previous disclosures that may have been added due to comments received but that the company no longer believes are relevant. These respondents believe the SEC has been increasingly receptive and welcoming of engaging in dialogue ahead of meaningful reporting changes.

■ *Just too busy with day-to-day responsibilities*

Some companies may also be busy with meeting ongoing financial reporting requirements, which can get strenuous especially if companies are dealing with such stresses as inorganic growth through acquisitions.

⁸ See also EY’s *Disclosure effectiveness: what investors, company executives and other stakeholders are saying*, November 2014, [http://www.ey.com/Publication/vwLUAssets/DisclosureEffectiveness_CC0404_DialogueDinners_13November2014/\\$FILE/DisclosureEffectiveness_CC0404_DialogueDinners_13November2014.pdf](http://www.ey.com/Publication/vwLUAssets/DisclosureEffectiveness_CC0404_DialogueDinners_13November2014/$FILE/DisclosureEffectiveness_CC0404_DialogueDinners_13November2014.pdf).

It takes a lot more time to thoughtfully revise and shorten a Form 10-K or other filing than it does to just mark up the prior document. As the SEC and FASB are adding more and more responsibilities to the plates of the financial reporting professionals, it is hard for them to find that time.

Mr. Cannon believes that companies would like to improve their financial statements and other disclosures but often lack the resources. “I think the thing that gets in the way is resources and mergers,” he explained. “A lot of companies are continuing to do mergers all the time and their accounting staff can barely keep up with the M&A accounting in addition to everything they need to do, so they’re unable to put in initiatives to improve their financial statements.”

| It takes more time to write less

Mr. Brink Dickerson agreed and added, “It takes a lot more time to thoughtfully revise and shorten a Form 10-K or other filing than it does to just mark up the prior document,” he explained. “And as the SEC and FASB are adding more and more responsibilities to the plates of the financial reporting professionals, it is hard for them to find that time. It reminds me of the old saying, ‘If I had more time, I would have written a shorter letter.’ A secondary issue is simply that not everyone enjoys writing or necessarily is a good writer, and work product often reflects that. Financial reporting is a staff function, not a productive line function, and there always will be pressure on staffing. Companies that are sincere about improving their financial reporting need to recognize that it may take more staff in order to say less. And a lot of smaller companies do not have that luxury.”

Mr. Martijn Bos, Policy Advisor Reporting and Audit at Eumedion representing the institutional investors’ interests, expresses a similar view: “I think it is easier to tell a story in many words than to tell a story in few words. The starting point for the new annual report is often the former annual report. ... It takes a lot of quality and courage to take things out.”

| “A very litigious society”

An audit committee member of a financial institution believes that a major challenge companies face is the “litigious” environment. He explained, “The issue over the years, whether it’s after SOX or after the additional ‘lawyering’ that took place, is it’s still a very litigious society that we live in, and that is what has been driving the volume and complexity of the reporting.”

Legal counsel we interviewed provided some insight into the major issues companies face if they wish to enhance their financial reports from a legal standpoint. The overall consensus from legal counsel was that over-disclosure is less risky than the alternative, that materiality should be the key area to consider, and that one should always consider the balance between producing a legal document and an informational document.

One legal counsel explained the situation as follows:

“There is one dominant issue: the natural tendency of financial reporting professionals and their legal counsel is to be risk averse. It generally is less risky to say more than it is to say less. The SEC reporting regime, unlike some of the regimes in other countries, provides companies with broad discretion with respect to what to report, generally relying on determinations of ‘materiality.’ While I like this approach, the subjectivity leads companies to over-disclose since over-disclosing is the less-risky alternative. In the absence of erroneous disclosure (or buried disclosure), I am unaware of a plaintiff ever seriously asserting that a company said too much.” But, the attorney explained, “there is a lot of disclosure that goes well beyond the gray area of materiality, and companies can eliminate that without much worry. However, it takes time and purpose.”

A team member from one of the companies interviewed explained his perspective: “Disclosure is cheap insurance. So it’s better to have stuff in there even though it may be immaterial but you’re not quite sure. [But] I’m more and more of the view that financial statements are becoming less and less useful, and that they are getting much longer.”

Still, another attorney tries to put it in perspective. Mr. Lynn suggested that identifying the two different worlds (regulatory and investor community) you are writing for can be the biggest challenge. “What we are writing here [is] both a disclosure document and a litigation document,” he said. “So to some extent you have to assume that people are living under a rock somewhere, and they don’t know what is going on in the world and you’re going to have to spell it out to them. I think that is the challenge every company, their disclosure counsel and their financial personnel struggle with.”

For those companies that are reluctant to take action to improve their financial reporting or are wavering over their next course of action, Mr. Lynn offered a practical view. “Companies may be of the mindset, ‘Why shall I change it now, I have not been sued, nor has the SEC commented on the disclosure?’” Mr. Lynn stated. But when financial statements and communications are clearer and in more ordinary English, he argued, “perhaps it’s more protective of the company and reduces the risk profile, because now people are much more able to evaluate [financial] statements because they can actually understand them.”

What are the key lessons learned?

Most organizations plan to continue the process they have been using, but they have still learned a number of lessons.

They particularly mentioned the need to start early and get broader buy-in, especially from the investor relations team. Companies also expressed the need to engage investors who have increasingly become more sophisticated, to better understand their needs and processes so they can deliver more transparent reports. They also noted the need to plan ahead. Survey respondents indicated that as the business and regulatory environment changes, companies grow and strategies change, disclosures should similarly evolve in order to ensure that financial communication remains synchronized and responsive to technological advances. Many respondents also noted that information from the past that might have been added as a result of an acquisition, an investor inquiry or a regulatory comment may no longer be relevant, so it's important to scrutinize disclosures each period.

Another lesson is that the quarterly report (10-Q) is especially vulnerable to excessive information. Some debate whether interim periods should be treated as a discrete period or integral to the annual period. Others regard quarterly Form 10-Qs as bridging or updating the annual report (Form 10-K). In any event, the length of quarterly filings has increased significantly in recent years.

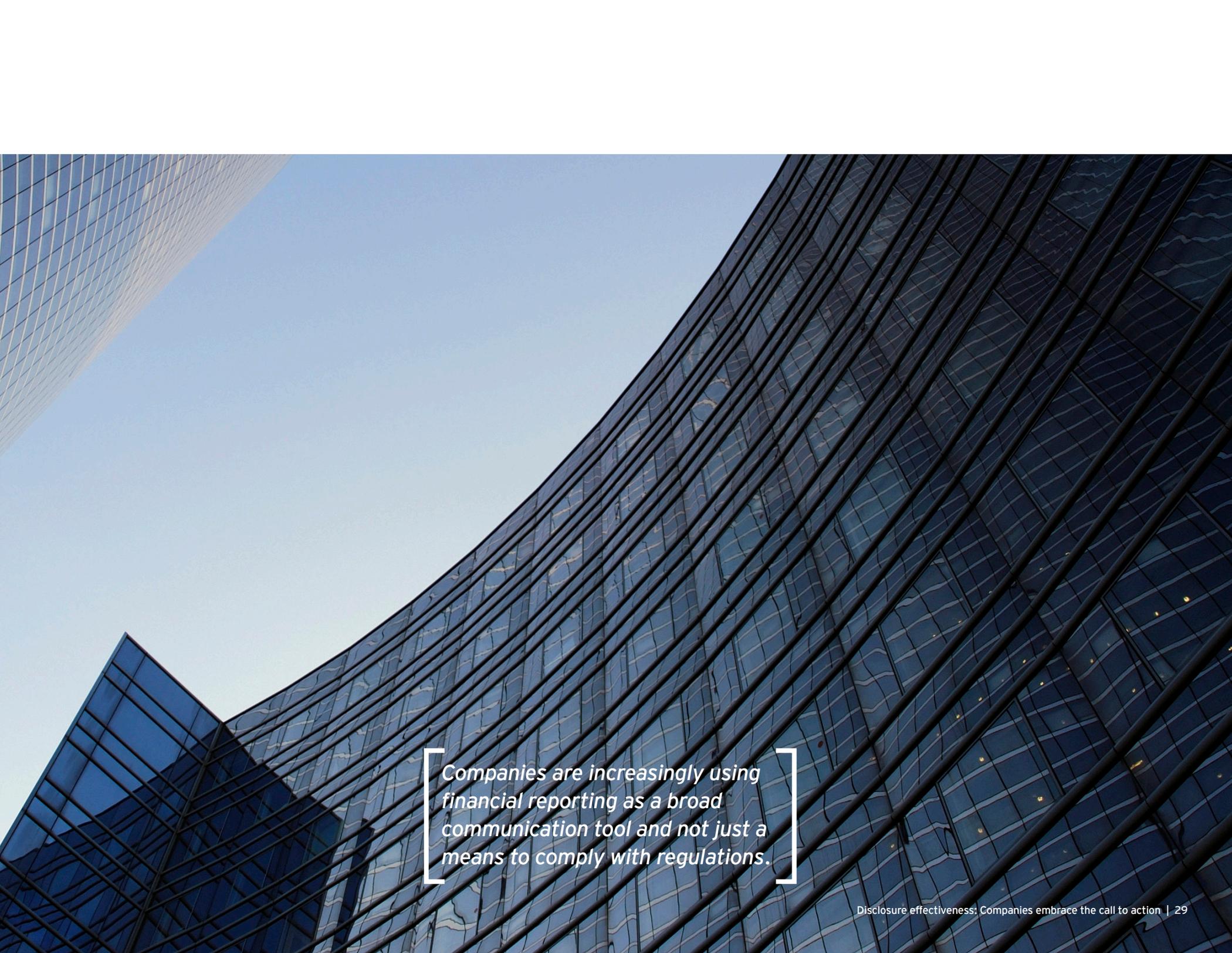
One company in the early stages of the disclosure effectiveness process said its main lesson learned was that they should have started two years earlier. Another lesson learned was to approach the financials on a comprehensive basis rather than selecting ad hoc disclosures.

The director of SEC reporting and technical accounting of a diversified industrials company suggested that he should have gotten a broader buy-in to actually have more people involved in the process. "You need broad mid-management buy-in," he explained. "I find that if you have a broad mid-management buy-in, then usually senior management will buy into the process." Others amplified the need to set the right tone at the top and support a company's efforts to focus on disclosure effectiveness.

The director of SEC and financial reporting of a bank shared two key lessons. The first was to make sure to involve the investor relations group with the disclosure effectiveness initiative, and the second was to make sure that if a disclosure is determined to be removed, that disclosure is properly socialized – meaning, before it is removed, the management team should inform all relevant stakeholders well in advance. These stakeholders will range from investor relations to auditors to the Audit Committee.

A corporate controller at a major bank also thought it was important to have all key stakeholders aligned and informed throughout the process. He added, "It's also very important to plan well ahead of time (this is what worked)."





Companies are increasingly using financial reporting as a broad communication tool and not just a means to comply with regulations.

What can regulators and accounting standard setters do to help?

As discussed in the Foreword, regulators and accounting standard setters are in the midst of developing regulatory guidance to help support this initiative (see appendix).

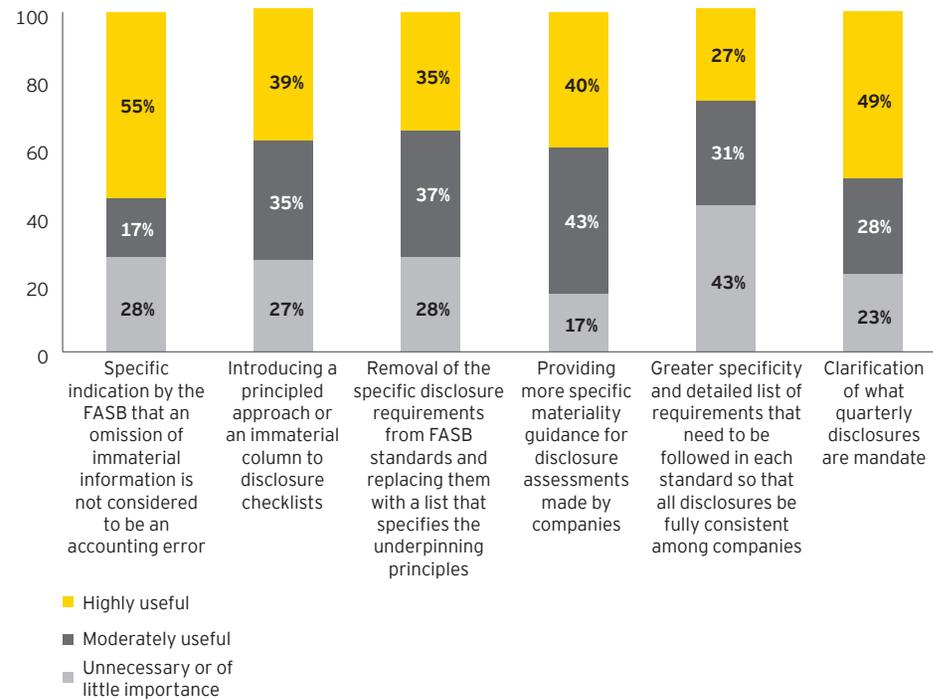
In addition, the FASB is developing new disclosure guidance for inventory, fair value measurement, income taxes and defined benefits⁹ as part of its broader disclosure framework initiative.

For International Financial Reporting Standards (IFRS) filers, the IASB is also making progress on improving the effectiveness of financial statement disclosure. In December 2014, the IASB issued amendments to *IAS 1* Presentation of Financial Statements as part of its major initiative to improve presentation and disclosure in financial reports. The amendments to *IAS 1* are designed to further encourage companies to apply professional judgment in determining what information to disclose in their financial statements.

Still, many survey respondents believe these authorities are not doing enough and should do more. As one CFO articulated, regulators and accounting standard setters must declare the seriousness of this initiative. The top three areas that respondents identified where regulators and/or accounting standard setters could help are: (1) specific identification that an omission of immaterial information is not considered an accounting error; (2) clarification around what quarterly disclosures are mandated; and (3) providing more specific materiality guidance.

Note that our survey was conducted prior to the release of the recent SEC and FASB proposals – it's yet to be seen whether preparers believe these initiatives go far enough.

Actions that would be most useful
(respondents could select all that applied)



⁹ "Q&A, FASB'S Disclosure Framework Project," October 2013, http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176163501430.

Regulatory support is helpful, but more is needed

The director of SEC reporting and technical accounting of a diversified industrials company believes that the initiatives of the FASB and SEC will help reduce complexity and duplication, allowing his company to provide better communication of the things that matter most to investors. “The initiatives of the FASB and SEC give regulatory support to our company’s disclosure effectiveness goals,” he said.

A director of SEC and financial reporting of a bank agreed but offered another suggestion to the regulators: include guidance on “sun-setting.” This guidance could help companies remove unnecessary information and focus the reader on what’s important to know. He suggested regulators “put more of an emphasis on attempting to eliminate disclosures that really are not as relevant as they used to be – without this guidance, a financial statement can easily go from 60 pages to 250 pages.”

An audit committee member of a financial services company suggested the initiatives of the FASB and SEC will result in modest improvements for the investor community but believes that work still needs to be done by regulators: “I think certain requirements are written in a very prescriptive way, and companies are afraid to leave anything out, even if it’s immaterial, because it prolongs the audit process [to explain why something is missing] and raises the risk of receiving a review comment from the SEC. A targeted review of the most prescriptive sections, plus a reduction of overlapping requirements, is probably necessary to make significant progress.”

Another audit committee member added – he believes that the initiatives of the FASB and SEC will help investors but that many companies may be hesitant to start the voluntary process without official changes to the rules. He explained: “I think many companies will only go so far, perhaps eliminate redundancies, eliminate outdated information. But the basic organization of the SEC filings and some of the content requirements are not 21st century anymore. I believe that the regulatory bodies are extremely cautious – they have loads of administrative procedures and cost-benefit analysis and there is going to be opposition from people with vested interests, including the legal community.”

However, other audit committee members disagreed. One member suggested that the SEC and FASB have indirectly “authorized” companies to begin the streamlining process. “Through awareness, I believe that more companies will continue the effort of streamlining their financials regardless,” he said. “What a company should always be striving for is complete, effective and understandable communication between the company and its shareholders and stakeholders. I think you ought to continue to try to make that better year in, year out. Whether there are formal programs of the Commission and the FASB that are on point with this, I think it’s incumbent upon each of these parties to continue to try to improve the effectiveness of the communication. So, yes, I think [companies] will continue.”

A CFO agreed that the disclosure initiatives at the SEC and FASB are on the right track to help support companies’ efforts, but he added, “Preparers must be willing to accept the initiative may result in additional disclosures – to help analysts [and investors].”

A board member of a consumer products company candidly advised that regulators should provide more examples of what disclosures are necessary: “Please give us an example of what you want. We are all trying to do the right thing.” He believes it would also help tremendously if companies were allowed to provide a “draft” to regulators for feedback. “If the process was more collaborative between the regulators and issuers,” he explained, “and the goal of the regulators was clearer, it would make the disclosure process more effective for all parties.”

Some, however, don’t seem as optimistic that regulatory or accounting standard setter initiatives will work to put more effective disclosures in the hands of key stakeholders.

For instance, with respect to helping investors, Mr. Dickerson expressed skepticism that the regulators’ current disclosure effectiveness initiatives are working or will work in the future: “For the initiatives to be effective, both the SEC and the FASB are going to have to take a more realistic view on the volume of disclosure that they require and what is material and stop insisting on disclosure that is just ‘interesting.’ Until they change direction, their commitment to disclosure effectiveness (and shortening) is superficial.”

Through awareness, I believe that more companies will continue the effort of streamlining their financials regardless.

Mr. Dickerson continued: “Another issue that increasingly cuts against disclosure effectiveness is that accounting firms are receiving a loud and clear message from the PCAOB that their audits, and resulting disclosure, need to be better, and one response to that is the imposition of lower materiality thresholds and the insistence upon more disclosures.

“Unfortunately, some of the most tedious additional disclosure is being driven by Congress, particularly through the Dodd-Frank Act. Every dollar that a company has to devote to conflict minerals or pay ratio disclosure is one less dollar that is available for sound fundamental disclosure. We will have better disclosure documents if Congress stops requiring disclosures for political rather than market protection purposes. It is an easy factor to forget, but I am convinced that the quality of disclosure declined when the SEC shortened the filing periods. It simply is hard for most companies to produce a good document in less time.”

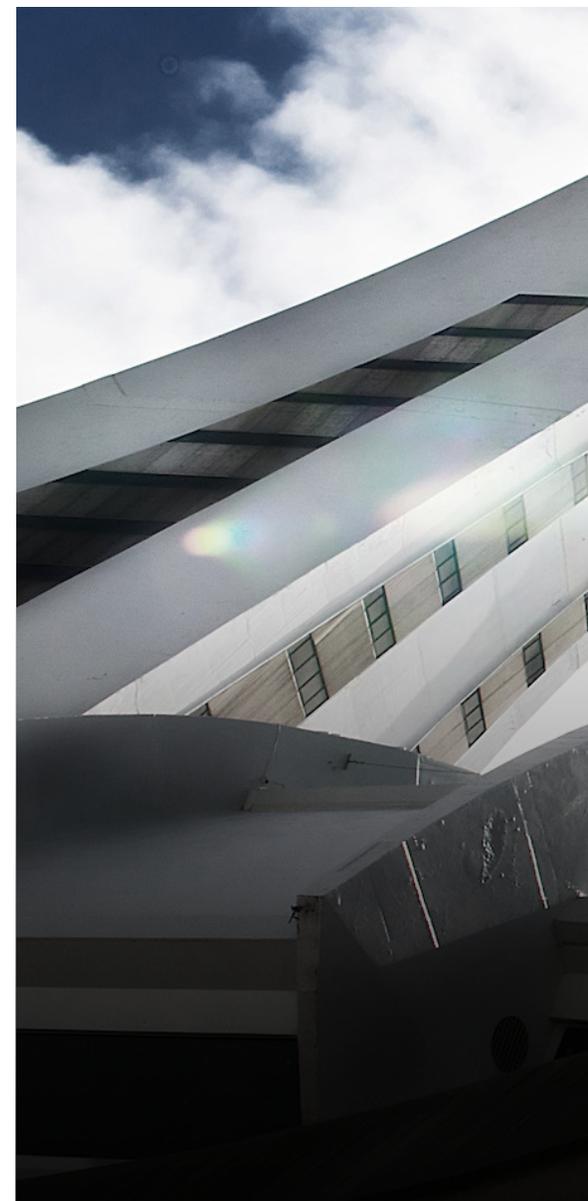
Mr. Lynn also believes that since the SEC and FASB have encouraged companies to think about disclosure effectiveness, companies need not wait for standard setting to take place. “I think the biggest challenge [for the SEC] is always to have tangible results see the light of day, and I think they’ve done a good job,” he said. “We’re all well served by the fact that both the SEC and the FASB have encouraged people to think about it on their own, and come up with approaches, rather than just kind of sitting around waiting for something to happen, because if history is any guide, very often something doesn’t ever happen.”

Mr. Lynn added, “How can it be that 30-some-odd years have gone by and Regulation S-K has never been really revisited or revised?” The reason, he explained, is the difficulty in achieving consensus. But he suggested that “when given the proper incentives, people in the issuer community and their lawyers can come up with ways to present the disclosure in an actually useful manner, without having to have the SEC telling them to do so,” and he offered the latest executive compensation disclosures in response to say-on-pay votes as an example.

Others admitted that the time has also come to better integrate distinct parts of financial reports together. Considering that technology has shaped how investors and users consume information, “who wrote the requirement?” (i.e., SEC or FASB) should be less of a concern than the informational value the contents provide.¹⁰

Many of the investors interviewed agreed. Regarding the voluntary efforts of organizations to date, Mr. Cannon advised that there might be some skepticism among members of the investor community at first, particularly if companies are removing information and investors are not apprised of the changes. However, he offered that if a company surveys the investment community and uses the results to support their initiatives, “I think that’s very important.”

¹⁰ A number of initiatives have taken place to address this issue, including the SEC Chief Accountant Financial Reporting Series.





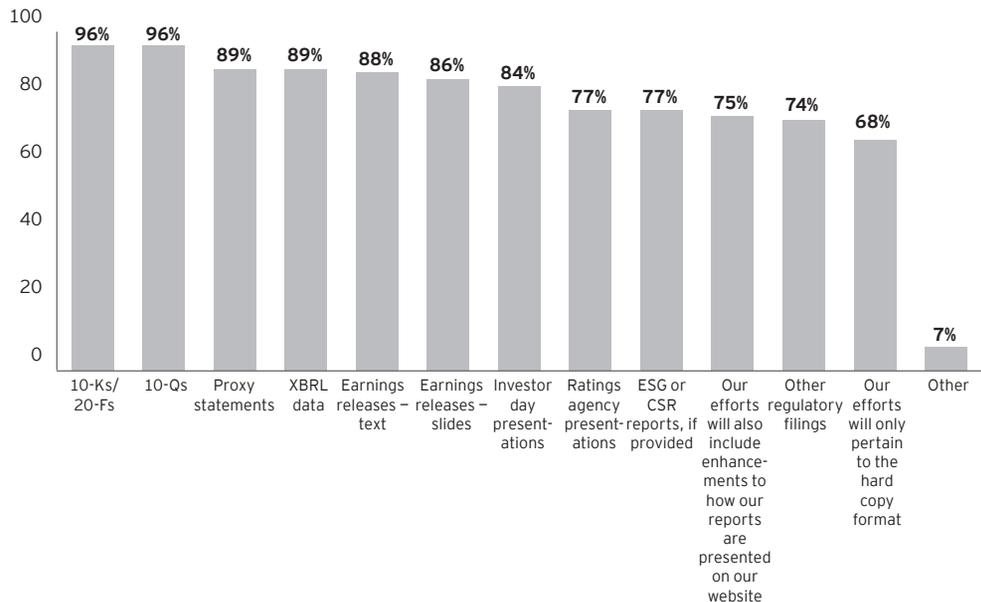
Another issue that increasingly cuts against disclosure effectiveness is that accounting firms are receiving a loud and clear message from the PCAOB that their audits, and resulting disclosure, need to be better, and one response to that is the imposition of lower materiality thresholds and the insistence upon more disclosures.

What disclosure elements are companies focusing on next?

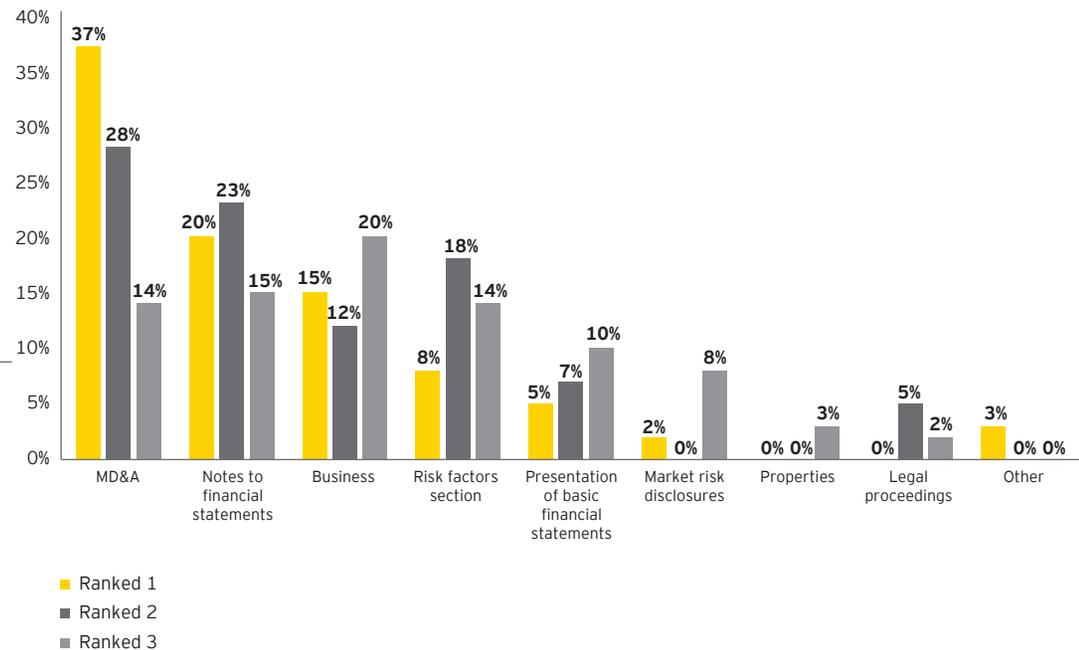
Within the next two years, companies plan to make improvements across a broad spectrum of forms and documents, including annual and quarterly reports (Form 10-K/20-F and Form 10-Q), earnings releases, proxy statements, ratings agency presentations, investor presentations, XBRL data, website presentations and more.

Over the next two years, respondents are planning to continue to focus on annual MD&A, notes to annual financial statements, and business sections and endeavor to incorporate any improvements and lessons learned into their quarterly filings.

Documents to be improved as part of your initiatives in the next two years

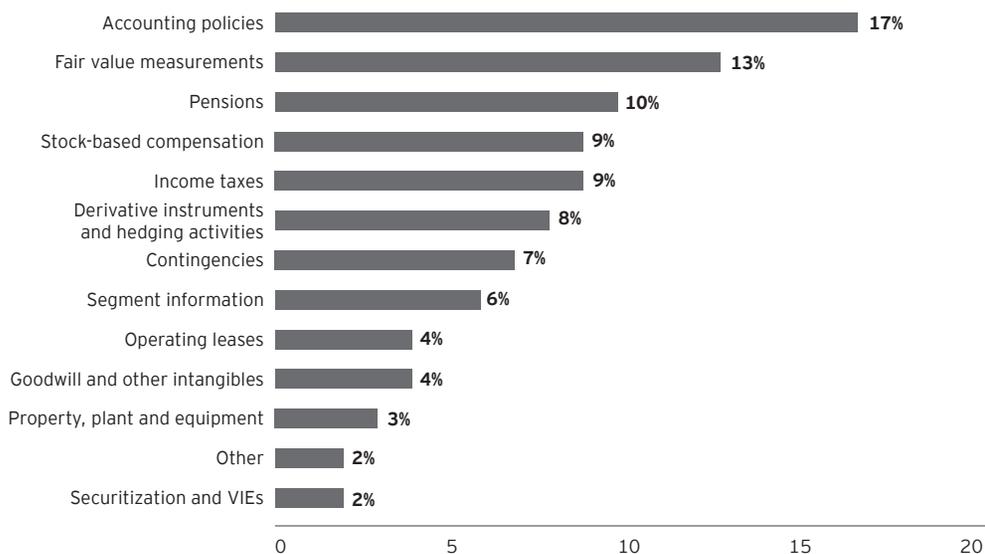


Part of annual financial report that respondent will improve in the next two years (respondents could select all that applied)



For those intending to focus on improving their footnote information, respondents expect the top five areas of focus to be the notes on accounting policies (17%), fair value measurements (13%), pensions (10%), stock-based compensation (9%) and income taxes (9%).

**Notes to the financial statements respondents will be improved in the next two years
(respondents could select all that applied)**



In addition, companies are also focusing on ways to make their financial statements much more contemporary, usable and interactive.

One former managing director and CFO of a financial services company suggested that companies are developing a much more formal and progressive investor relations department that is focused on communicating information rather than simply reporting it. He said that with the advent of electronic media, companies' communications have changed: "It used to be that a press conference was held once a quarter, but now, there are more meetings with analysts in a public forum to present information." Companies are using technology and public media in new and inventive ways, not only to focus on financial reporting, but also to explain corporate governance, how the company builds the proxy, positions the company has taken, etc. He explained: "These items have become much more elevated in the minds of investors and analysts. This is causing investor relations groups to spend more time simplifying financial communications. In most cases, the investor communications group is now reporting up to the CFO."

Appendix: disclosure effectiveness initiatives

Over the past several years, regulators, accounting standard setters and many key organizations have embarked on initiatives to improve the effectiveness of disclosures. The following provides a timeline of certain of those key initiatives:



July 2009	FASB	Disclosure framework project added to the agenda with the goal of establishing an overarching framework intended to make financial statement disclosure more effective.
July 2012	FASB	Disclosure Framework – discussion paper issued for comment ¹
December 2012	EFRAG	Discussion paper released setting out some key principles that European Financial Reporting Advisory Group (EFRAG), the Autorité des Normes Comptables and the Financial Reporting Council consider essential to the design of an effective disclosure framework.
January 2013	IASB	Start of a broad-based initiative to explore how disclosures in IFRS financial reporting can be improved. Discussions were based on results of a survey launched by the IASB in December 2012. ²
May 2013	IASB	Published a Feedback Statement summarizing the discussions at a forum hosted by the IASB on financial information disclosure. At the same time, the IASB signaled its desire to serve as a catalyst for collective action by preparers, regulators, and the accounting profession to address ongoing concerns about the quality and quantity of financial reporting disclosure. ³
July 2013	CFA Institute	Published Financial Reporting Disclosures, Investor Perspectives on Transparency, Trust, and Volume. Report provides investor’s recommendations on how to improve the effectiveness of financial reporting. ⁴
October 2013	FASB	FASB’s Disclosure Framework Project Q&A issued. This document is intended to answer common questions about the FASB’s Disclosure Framework Project. ⁵
December 2013	SEC	Detailed report to Congress provides the staff’s preliminary conclusions and recommendations about disclosure reform. The report is mandated by Section 108 of the Jumpstart Our Business Startups (JOBS) Act. ⁶ Section 108(a) of the JOBS Act directed the SEC to conduct a review of Regulation S-K to (1) comprehensively analyze the current registration requirements of such regulation; and (2) determine how such requirements can be updated to modernize and simplify the registration process and reduce the costs and other burdens associated with these requirements for issuers who are emerging growth companies.

March 2014	FASB	<i>Proposed Concepts Statement – Conceptual Framework for Financial Reporting: Chapter 8: Notes to Financial Statements</i> issued. This exposure document is intended to provide the Board with a framework for identifying information that could be appropriate for inclusion in notes to financial statements and relevant to the users of those statements. It is also intended to identify a broad range of possibilities for the Board to consider when deciding on the disclosures related to a particular topic with the intention of the Board using the information to identify a more narrow set of disclosures about that topic to be required. ⁷
August 2014	CCMC	The U.S. Chamber's Center for Capital Markets Competitiveness (CCMC) report outlining concrete ideas for modernizing the SEC disclosure regime is published. The report identifies short- and long-term improvements to enhance the utility and value of disclosure documents. ⁸
December 2014	IASB	Amendment to International Accounting Standards (IAS) 1 <i>Presentation of Financial Statements</i> to make clear that materiality applies to the whole of financial statements and that the inclusion of immaterial information can inhibit the usefulness of financial disclosures. Furthermore, the amendment clarifies that companies should use professional judgment in determining where, and in what order, information is presented in the financial disclosures.
December 2014	IASB	Proposed amendment to IAS 7 ⁹ in response to requests from investors for improved disclosures about an entity's financing activities; cash and cash equivalents balances; IAS 8 Accounting Policies' and Changes in Accounting Estimates and Errors to clarify the definitions of a change in accounting policy and a change in accounting estimate. Other disclosure initiatives by the IASB include Materiality, Principles of Disclosure and Standards level review of disclosures. ¹⁰
September 2015*	FASB	The FASB's proposed Accounting Standards Updated (ASU), Conceptual Framework for Financial Reporting Chapter 3: <i>Qualitative Characteristics of Useful Financial Information</i> , is aimed at modifying the definition of materiality by acknowledging that such a term is a legal concept which may afford a theoretically higher threshold than the current definition as documented in the conceptual framework.
September 2015*	FASB	The FASB's proposed ASU, Notes to Financial Statements (Topic 235): <i>Assessing Whether Disclosures Are Material</i> , is aimed at clarifying the concept of materiality by encouraging the omission of immaterial information and focusing readers on material and relevant information. In it the FASB suggests that companies should consider whether some, all or none of the requirements in a disclosure section are material. Specifically, the proposed ASU (a) clarifies that omission of immaterial information is not an accounting error and that materiality should be applied to the quantitative and qualitative disclosures individually and in the aggregate in the context of the financial statements taken as a whole and (b) refers to materiality as a legal concept.
September 2015**	SEC	<i>Effectiveness of Financial Disclosures about Entities Other than the Registrant (Release No. 33-9929)</i> is released. The SEC is seeking public comment regarding the financial disclosure requirements in Regulation S-X for certain entities other than a registrant. These disclosure requirements relate to registrants providing financial information about acquired businesses, subsidiaries not consolidated and 50% or less owned persons, guarantors and issuers of guaranteed securities, and affiliates whose securities collateralize registered securities.
October 2015	FEE	The Future of Corporate Reporting report is published by the Federation of European Accountants (FEE). The report outlines the developments in corporate reporting and refers to the key changes coming from market participants and from European and international standard setters and policymakers. The report also calls for views on corporate reporting. ¹¹
October 2015	ESMA	European Securities and Markets Authority (ESMA) publishes a public statement stressing the need for clear and concise disclosures that are company-specific and to avoid boiler-plate templates, highlighting that the size of annual reports often makes it hard for users to identify key information. ¹²
October 2015	IASB	The IASB published its draft guidance to assist companies in determining what information should be included, or excluded, from financial statement prepared in accordance with IFRS.

*Comment period ends December 8, 2015.

** Public comment period will remain open for 60 days following publication of comment request in the Federal Register.

¹ http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176160160107

² <http://www.ifrs.org/Current-Projects/IASB-Projects/Disclosure-Initiative/Discussion-Forum-Financial-Reporting-Disclosure/Project-news/Pages/news-28-jan-2013.aspx>

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⁴ <http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2013.n12.1>

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⁸ <https://www.uschamber.com/report/corporate-disclosure-effectiveness>

⁹ <http://www.ifrs.org/Current-Projects/IASB-Projects/Debt-disclosures/Exposure-Draft-December-2014/Pages/Exposure-Draft-and-comment-letters.aspx>

¹⁰ <http://www.ifrs.org/Current-Projects/IASB-Projects/Disclosure-Initiative/Pages/Disclosure-Initiative.aspx>

¹¹ <http://www.fee.be/library/list/50-corporate-reporting/1529-1510future-corp-rep.html>

¹² <https://www.esma.europa.eu/news/ESMA-urges-companies-improve-quality-disclosures-financial-statements>

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