



Pacesetters in Financial Reporting

Key takeaways from the conference
hosted by Pace University, FEI and EY

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Overview

In late 2016, Lubin School of Business at Pace University, Financial Executives International (FEI) and Ernst & Young LLP jointly hosted the Pacesetters in Financial Reporting conference. The conference was designed to stimulate discussion about how to enhance financial reports and to acknowledge, and learn from, companies that are striving to better meet the information needs of today's investors.

This publication summarizes the views expressed by the speakers representing diverse perspectives of various financial reporting stakeholders, including:

- ▶ Representatives from the Securities and Exchange Commission (SEC), Financial Accounting Standards Board (FASB) and Sustainability Accounting Standards Board (SASB)
- ▶ Financial analysts and investors
- ▶ Company executives, including those responsible for preparing and reviewing financial statements and SEC filings
- ▶ Audit committee members
- ▶ Legal advisers and academics

The discussions focused on the following topics:

- ▶ Actions companies are taking voluntarily to improve their financial reports (e.g., 10-Ks, 10-Qs), along with the benefits and challenges of providing more effective disclosures

- ▶ Recent concept releases and proposals from the SEC and the FASB to simplify disclosures and improve their effectiveness
- ▶ Actions that can be taken to improve sustainability disclosures in SEC filings and the SASB's role in developing standards for such disclosures
- ▶ Consideration of materiality when streamlining disclosures relevant to investors
- ▶ Investors' perspectives on the areas of disclosures needing greater attention by companies and regulators

Panelists also discussed a research study by EY and the Financial Executives Research Foundation (FERF), *Disclosure Effectiveness in Action: Companies Make Great Strides*, which was issued in conjunction with the conference. In the study, EY and FERG analyzed changes in disclosures by companies in the Standard and Poor's (S&P) 500 index and included examples from Form 10-K filings and annual reports showing the use of graphs, charts, summaries, and other means companies are using to make their disclosures easier to understand.

In his keynote address, Jeff Bornstein, Chief Financial Officer of General Electric Company (GE), discussed what GE has done to revamp financial reports.

"... Officials from the SEC and FASB have been urging companies not to wait for official guidance from them but rather to take the initiative and find ways to make their financial reports more effective under the existing standards and regulations."

**– Leslie Seidman
Lubin School of Business
Pace University**

Disclosure effectiveness initiatives by regulators and standard-setters

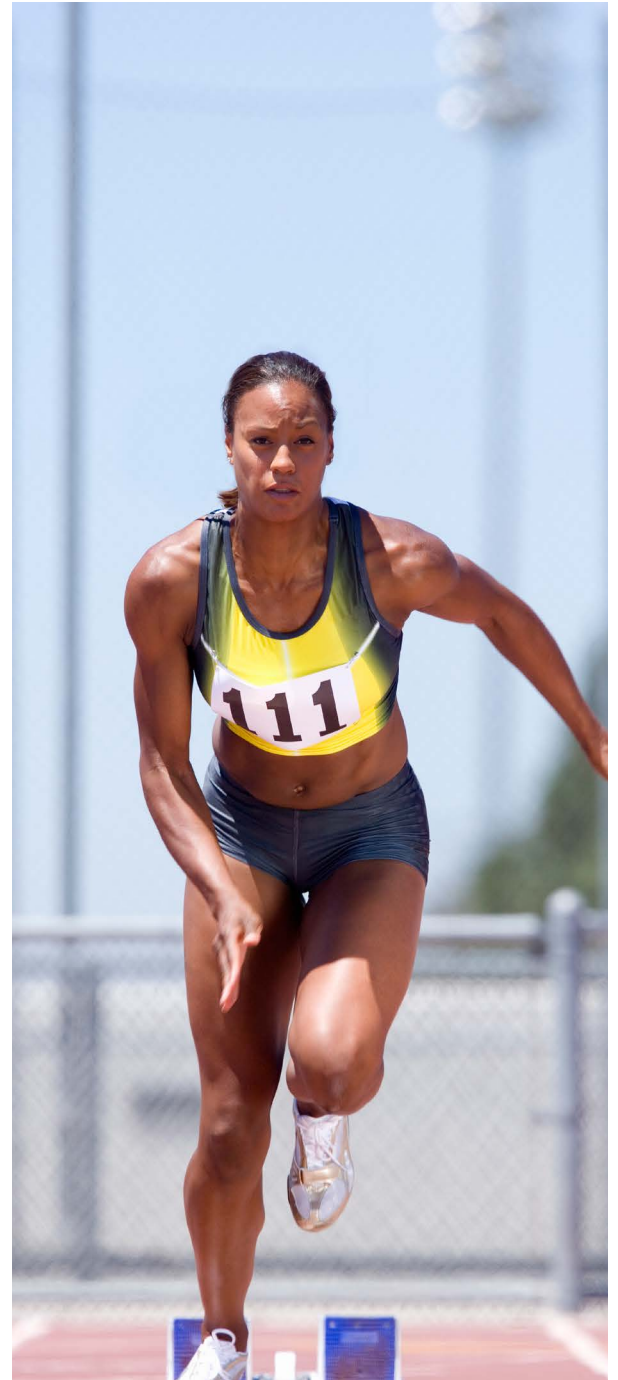
Leslie Seidman, Director of the Center for Excellence in Financial Reporting at the Lubin School of Business, moderated the panel discussion addressing actions being taken by the US financial reporting regulators. This panel consisted of Keith Higgins, Director of the Division of Corporation Finance at the SEC; James Kroeker, Vice Chairman of the FASB; and Elisse Walter, Former SEC Chair and current board member at the SASB.

The panel discussed general feedback indicating that financial reporting disclosures are not always as effective as they could be for investors to understand the results of a company's operations and what risks and opportunities it is facing. Globally, regulators and accounting standard-setters are undertaking initiatives to make disclosures more effective for investors and other users of financial reports. Both the SEC and the FASB have various disclosure improvement initiatives and proposals currently in progress in the US. We have summarized the key themes of discussion below.

SEC's disclosure effectiveness initiative

The SEC recently proposed eliminating a number of disclosure requirements that are redundant or outdated in light of changes in SEC requirements, US GAAP or IFRS or changes in technology and the business environment.¹ This proposal is part of the SEC's disclosure effectiveness project that arose from the JOBS Act, but the rulemaking also was required under the FAST Act.

Earlier during the year, the SEC sought comments on a Regulation S-K concept release that was much broader in scope, dealing with matters relating to business and financial disclosures as well as public policy issues including sustainability disclosures.² For this concept release, the SEC took the approach of asking comments not only on what disclosures are currently required by Regulation S-K but also areas where investors want to see new or expanded disclosure. The SEC received over 350 comment letters on this release, which it is currently reviewing for reporting to Congress and future rulemaking.



¹ See [SEC Proposal on Disclosure Update and Simplification](#).

² See [SEC Concept Release on Business and Financial Disclosure Required by Regulation S-K](#).



Sustainability disclosures

The panelists said companies are voluntarily providing some sustainability disclosures in their reports. However, the utility to investors varies based on the specificity of such disclosures and their lack of comparability to other companies. The SEC is monitoring how sustainability disclosures are evolving and recognizes that there are still a number of questions yet to be answered regarding investors' needs. The SEC is assessing, among other alternatives, whether it should develop its own framework for sustainability disclosures or adopt a framework already developed by another organization (e.g., SASB, Global Reporting Initiative).

Meanwhile, the SASB continues its efforts to develop industry-specific standards for corporate sustainability disclosure, with the goal of identifying disclosures that are material, comparable, and decision-useful for investors. Such standards could also help registrants comply with their regulatory obligation to disclose material known trends and uncertainties in management's discussion and analysis (MD&A) included in reports filed with the SEC. Some of the panelists suggested that a private standard-setting body would be best suited to oversee the development of sustainability disclosures that are expected to continue evolving rapidly. It likely would be challenging for the SEC to keep pace with the changes in sustainability issues and make timely updates to related disclosure requirements.

Non-GAAP financial measures

The panelists discussed concerns that SEC officials have raised this year over the use of non-GAAP measures in registrants' earnings releases and SEC filings in a manner that may be inconsistent with SEC regulations. The SEC staff issued additional clarifications in an update to its Compliance and Disclosure Interpretations (C&DIs) in May 2016 to specify which non-GAAP measures or manner of use or communication may violate SEC rules. The SEC staff has started to crack down on the inappropriate uses of non-GAAP measures through its comment letters. The

³ See EY publications, *To the Point, SEC staff updates guidance on non-GAAP financial measures*, Technical Line, *Spotlight on non-GAAP financial measures* and Technical Line, *A closer look at the SEC staff's scrutiny of non-GAAP financial measures*, which discuss the SEC staff's main areas of focus and challenges companies are encountering with their non-GAAP disclosures.

SEC staff will continue to closely monitor practice and compliance of non-GAAP measures in SEC filings.³

Other panelists said non-GAAP measures can provide meaningful information to investors and can highlight the anomalies that affect the GAAP financial measures during a period.

Voluntary actions companies have taken to improve their disclosures

Many companies have taken voluntary actions to innovate, enhance and modernize their disclosures. The panelists encouraged such actions.



"The Staff doesn't want companies to include disclosures just to quickly resolve staff comments. Never say we have to keep this [disclosure] in because we got an SEC comment on this four years ago."

– Keith Higgins
Division of Corporation Finance
Securities Exchange and
Commission

Company-led initiatives to improve disclosures

Reed Wilson, a member of the FEI Committee on Corporate Reporting, moderated the panel discussion on voluntary actions taken by companies to improve their disclosures. This panel consisted of Tim Flynn, Walmart's Audit Committee Chair and former Chairman of KPMG; Dan Murdock, Comcast Controller and former SEC Deputy Chief Accountant; and Alison Zoellner, Honeywell General Counsel.

The participants discussed what voluntary changes companies are making to improve their disclosures and how other companies can avoid or overcome challenges in the process. The panelists also discussed the importance of the audit committee's role during the disclosure improvement process.

We have summarized below the key themes of the companies' panel and the keynote address by Jeff Bornstein.

Voluntary disclosure improvements

The panelists said many companies are voluntarily taking actions to improve their disclosures. An EY/FERF study, "[Disclosure effectiveness in action: companies make great strides](#)," was issued in conjunction with the conference. It provides several examples of voluntary disclosure improvements by several S&P 500 companies, particularly in MD&A and the description of business disclosures. The panelists also discussed additional changes they have seen or that their companies employed to improve the clarity and readability of financial reports and SEC filings, including:

- ▶ Use of infographics and tables to remove lengthy texts, particularly from MD&A, Earnings Releases and Proxy Statements
- ▶ Elimination of redundant and immaterial disclosures
- ▶ Boilerplate language and making disclosures specific to the company, including risk factor disclosures
- ▶ Use of summaries in the Form 10-K and 10-Q filings to highlight the most important information
- ▶ Use of cross-references to avoid repetition
- ▶ Use of plain English, particularly when disclosures relate to complex accounting areas (e.g., pension, derivatives and hedging, stock compensation)
- ▶ Providing supplemental information based on investors' feedback

Later in the program, GE's Mr. Bornstein gave the keynote address and described GE's journey to improve its disclosure effectiveness, the impetus and reasoning for embarking on its initiative and the benefits that the initiative has yielded.

GE was recognized as a pacesetter in financial reporting for its efforts to enhance its financial reports and disclosures.

GE started its journey in 2008 with incremental improvements to its proxy statement and making additional improvements over next several years. GE's 2013 proxy statement included notable enhancements, including graphics, hyperlinks, tables, and use of plain English disclosures.

Over the last several years, GE has taken similar initiatives to improve disclosures in its earnings releases and annual and quarterly SEC filings as well as its annual reports to shareholders. In 2016, GE issued its first integrated summary report, which summarizes the most important information for investors from its 10-K, proxy statement, and sustainability report. Mr. Bornstein mentioned that these disclosure initiatives have improved GE's engagement with its investors and other stakeholders over time. While very well received by investors, GE's disclosure improvement initiative was not without challenges, said Mr. Bornstein during his keynote speech.

" ... [Our biggest hurdle while making changes to disclosures] was a mindset that [an SEC filing] is a compliance effort versus an investor communication ..."

**– Jeff Bornstein
General Electric Company**

GE initially encountered some internal pushback due to the fear of receiving SEC comment letters as a result of the proposed changes. GE also had to consider time, cost and resource constraints, as well as regulatory disclosure requirements when contemplating changes to its disclosures.



Overcoming internal and external constraints

Many companies have embarked on various initiatives to improve their disclosures. In doing so, companies are likely to face several internal and external challenges. The panelists shared the following leading practices to overcome these challenges:

- ▶ It is important that the team leading the disclosure effectiveness initiative be cross-functional and include representatives from legal, investor relations, operations, finance, and other stakeholder groups within the company.
- ▶ The success of any disclosure improvement initiative depends on whether the initiative is fully supported by senior management.
- ▶ To make meaningful improvements to disclosures, a company may need to change the mindset among various internal stakeholders to appreciate that periodic reports (e.g., Form 10-K, 10-Q) are not just a compliance exercise but serve as an important communication tool, both to the markets and to employees.
- ▶ Financial reporting teams need to understand the business operations, and operations teams need to understand the limitations of financial reporting, particularly when non-GAAP measures are used.
- ▶ Don't start with the mentality that a company's disclosure effectiveness initiative will reduce disclosures. Instead, the effort might identify the need to add disclosures to meet investors' needs.
- ▶ Companies can take a phased approach for revamping their disclosures to work within internal resource constraints.
- ▶ Companies should start the initiative earlier in the year and socialize the proposed changes with various stakeholders, including external auditors and audit committee members, in a timely manner.

Panelists emphasized the importance of seeking feedback from both internal and external stakeholders to the extent possible. Some companies have also reached out to the SEC staff to discuss certain planned changes. The SEC staff has generally supported companies' efforts to improve their disclosures.

Materiality

Panelists shared the view that the appropriate determination of materiality from investors' perspective is essential in evaluating meaningful changes to disclosures. Companies should evaluate both the quantitative and qualitative aspects of materiality when assessing specific disclosures. Companies' investor relations personnel often interact with institutional investors and can play a vital role in sharing feedback to inform the company's assessments. The evaluation of disclosures that are not material quantitatively, but still might provide relevant and meaningful information to investors, typically requires careful attention from senior management, sometimes with the help of the audit committee.

What role audit committees can play

Audit committees should particularly assess whether the management team has a disciplined process to continuously challenge the company's disclosures, not just during special projects.

Panelists emphasized that an effective audit committee should recognize that a company's business is constantly evolving and that disclosures also should evolve to remain relevant and meaningful for investors. Audit committees generally provide an important oversight role over disclosure effectiveness initiatives.

Investors' perspective on disclosure changes

Neri Bukspan, Ernst & Young LLP Partner, moderated the investor panel discussion. The investor panelists consisted of Fred Cannon, Director of Research at KBW; Mark Lamonte, Managing Director at Moody's Investor Services; Mary Morris, Investment Officer at CalSTRS; and Michael Stefanski, Senior Vice President Investor Relations at Verizon.

While the panelists generally supported the voluntary disclosure enhancement actions being taken, they also shared a general sentiment that a lot still needs to be done.

We have summarized below the key themes of the discussion held by the investor panel.

Lack of comparability

Investors need transparent and comparable information on consistent basis. Lack of comparability of financial information between US companies and non-US companies becomes a significant challenge for investors when the applicable accounting frameworks require significantly different accounting treatments. Panelists encouraged regulators and standard-setters to minimize such differences in their rulemaking process to the extent possible.

Companies need to evaluate what supplemental disclosures are being provided by their peers and whether and how such information is used by investors in their analysis or financial models. It is important for companies to understand the key inputs to the financial models of analysts and whether the source of those inputs is their periodic reports.

Volume of information in financial reports

The investor panelists observed that annual reports have become lengthier and more complex over time, and it is challenging for investors and analysts to effectively digest and process all the information included in financial reports.

The panelists encouraged companies to de-emphasize immaterial information and highlight the important information that directly tells the complete story of the business.

Companies should also leverage technology to reduce the length of their reports. For instance, cross-references and hyperlinks help avoid repetition and reduce the length of SEC filings.

The panelists discussed an alternative disclosure approach that allows companies an option to maintain reference and more static information (e.g., business description) outside of periodic reports (10-K or 10-Q), which could then focus on the current developments and changes during a period.

Importance of earnings releases

The investor panelists discussed the growing importance of information included in companies' earnings releases for investment decisions. Consequently, earnings releases need to include additional information to enhance investment analyses.

Regulatory disclosure effectiveness initiatives

The panelists supported both the SEC and FASB disclosure effectiveness initiatives to provide material and relevant information to investors. The investor panel also discussed the growing need for sustainability disclosures using standard and comparable metrics. Mary Morris also urged the SEC to require companies to provide corporate sustainability reports, because this information is important for investment decision-making.

" We need to think about financial reporting [improvements] in the context of how information is being consumed in the modern world and then start thinking about how we can provide the information to investors in a timely, meaningful and consistent manner."

**– Mark Lamonte
Moody's Investor Services**

Conclusion

The conference participants identified several key initiatives being undertaken by regulators and standard-setters to improve the content and delivery of financial information provided to investors. These actions also aim to simplify disclosures in periodic financial reports and provide more relevant and meaningful information to investors.

Many companies are not waiting for new rules and standards, and they are voluntarily improving disclosures in meaningful ways – with some doing a major revamping of disclosures, including providing integrated summary reports, while others are making more modest incremental improvements year-over-year that translate to more significant improvements over time.

While, the effort to make disclosures more effective is not always easy, it is rewarding.

Companies can learn from each other's experiences to address internal and external challenges in reassessing their disclosures.

The investor community applauds the actions being taken by regulators and companies, while acknowledging a lot still needs to be done, particularly in the area of sustainability disclosures.

At EY, we encourage all stakeholders to continue this discussion and contribute to the broader dialogue by submitting comments and suggestions to the SEC and the FASB as they pursue a variety of projects to improve the effectiveness of corporate disclosures.⁴

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