Ernst & Young LLP
5 Times Square
New York, NY 10036

Tel: +1 212 773 3000
ey.com

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

21 July 2016

Re: Concept Release on Business and Financial Disclosure Required by Regulation S-K (Release No. 33-10064; 34-77599; File No. S7-06-16)

Dear Mr. Fields:

Ernst & Young LLP is pleased to provide comments to the Securities and Exchange Commission (SEC or the Commission) for consideration in its review of the business and financial disclosure requirements in Regulation S-K.

We are highly supportive of the SEC's initiative to improve the content of information provided by registrants and the manner in which it is provided. We believe it can serve to meaningfully assist investors and creditors in making better informed investment and credit decisions while simplifying the disclosure regime. We note that we previously made recommendations on changes the SEC could make to its requirements for registrant's financial statements in a comment letter dated 20 November 2015. And in our 11 September 2012 comment letter, we addressed certain disclosure requirements in Regulation S-K. In this letter, we incorporate and expand on our previous recommendations for enhancing the disclosure framework, the effectiveness of business and financial disclosure and the delivery of information to investors.

Some of the recommendations we make in this letter were informed by the perspectives of investors, company executives and other stakeholders with whom we held discussions about existing disclosure requirements.[1] We also share our observations about where we believe there may be inconsistencies in the purpose or intent of disclosure requirements (e.g., due to business developments, changes in US GAAP).

Overall recommendations

We suggest that the SEC should consider making the following changes in its business and financial disclosure requirements:

- Disclosure framework
  - Identify and embed objectives that clearly articulate the intent of each disclosure requirement, which should help registrants assess whether their disclosures achieve the underlying objective

[1] For more details, see our November 2014 publication, *Disclosure effectiveness: What investors, company executives and other stakeholders are saying.*

- Identify a nonexclusive and non-presumptive list of possible disclosures that might be relevant in achieving these objectives
- Eliminate prescriptive disclosure thresholds that fail to consider materiality thresholds (e.g., whether a specific disclosure would change the total mix of available information affecting the investment decisions of a reasonable investor)
- Adopt formal "sunset" provisions that would require the Commission to consider the effectiveness, costs and benefits of mandated disclosures, as well as changes in the economic, business and regulatory landscape
- Reconsider the need for explicit scaling of the disclosure requirements applicable to smaller registrants under an objectives-based disclosure framework; delay effective dates before smaller public companies must comply with new disclosure requirements; where scaling is offered to smaller public companies, evaluate whether similarly streamlining disclosures also may be appropriate for larger public companies
- Allow semiannual financial reporting by smaller reporting companies that are not listed on a national exchange

- Business and financial disclosures
    - Articulate the disclosure objectives to help companies better align the business, risk factor and management's discussion and analysis (MD&A) sections
    - Coordinate with the Financial Accounting Standards Board (FASB) to reduce redundancy with US GAAP disclosure requirements
    - Consider enhancements in various disclosure areas, including risks, critical accounting estimates and industry-specific disclosures
- Presentation and delivery of information to investors
    - Design a disclosure framework that will be adaptable and compatible with the next-generation disclosure delivery system
    - Explore changing the way information is filed and presented to investors through a company profile approach

Disclosure framework

Objectives-based approach

We support a principles-based disclosure framework that articulates clear disclosure objectives. We believe this approach would allow registrants to more effectively communicate to investors material information that is more relevant, organized and focused on a registrant's facts and circumstances.

The existing disclosure regime consists of line-item requirements that largely do not specify the objective of the disclosure. Because markets and business models have evolved, certain disclosures may no longer be relevant or may only be relevant to certain industries. Such prescriptive requirements without clear underlying objectives make it challenging for preparers to assess whether their disclosures are appropriate and sufficient. Disclosures that comply with the prescriptive requirements still may not provide the most relevant information to investors or in the most coherent form. For example, disclosing the number of employees may help some investors understand the size and scale of operations, but companies with different or changing employment practices may need to provide more context to make the disclosure meaningful to investors.

We encourage the SEC to articulate and embed objectives for each area of nonfinancial disclosures. These objectives should be fundamental and broad enough to apply across industries and remain relevant over time. These principles-based objectives should be supplemented with a nonexclusive and non-presumptive list of possible disclosures, the applicability of which registrants can consider in achieving the stated objective. In this manner, the framework can move from prescriptive line-item requirements to one in which registrants can craft more effective disclosures to communicate material information to investors. Accordingly, the SEC would be able to strike an appropriate balance between flexibility and structure in its disclosure framework.

For example, instead of the line-item requirement to disclose the number of employees, the SEC could articulate a disclosure objective to communicate the nature of the registrant's workforce, its composition and necessary specialized skills, and other human capital factors that have or may materially affect the registrant's business. A nonexclusive list could specify various human capital and workforce factors that should be considered to meet the objective, such as (1) the proportion of union employees versus non-union employees, (2) whether and how current labor relations may potentially result in work stoppages that could materially affect operations, (3) the proportion of outsourced employees versus statutory employees, (4) turnover in the workforce and the implications of labor shortages and wage pressures, (5) the implications of shifts in the geographic location of human resources and (6) how the need for specialized skills and the dependence on key employees may affect the company's operations.

Further, we believe the primary consideration in determining whether to make any disclosure inside or outside the financial statements is materiality (i.e., whether it would change the total mix of available information and affect the investment and voting decisions of a reasonable investor). We recommend that the Commission eliminate all quantitative disclosure thresholds, such as related party activity greater than $120,000 under S-K Item 404 and legal proceedings involving claims that exceed 10% of consolidated current assets.

We acknowledge that effectively developing a comprehensive objectives-oriented disclosure framework will be a substantial regulatory undertaking and will take time for companies to become comfortable applying such a framework. Accordingly, we encourage the SEC to take a piecemeal approach to modernizing its disclosure requirements, starting with specific disclosure topics, such as the description of business. After proposing and adopting an objectives-oriented framework for the business section, the SEC could commence a pilot program, under which companies could elect to apply either the existing rules-based requirements or the new objectives-oriented disclosure framework. The rulemaking process and the experience of companies that elect to apply the resulting objectives-based framework would inform the development of additional objectives-oriented disclosure requirements, as well as the SEC's decision whether to require all registrants to follow the objectives-oriented disclosure framework.

Automatic sunset provisions

Articulating disclosure objectives should help make clear when a particular disclosure requirement is no longer needed. However, we believe that the SEC should consider adopting a formal "sunset" provision (e.g., five to 10 years) when it adopts significant new disclosure requirements in response to current events or market developments. A sunset provision would require formal SEC action to indefinitely extend or modify disclosure mandates before they would be allowed to expire. A sunset provision would also require the SEC to consider changes in the economic, business and regulatory landscape and revisit its cost-benefit analysis to assess whether the disclosure requirements should be modified, made permanent or allowed to expire.

For example, in 2003 the SEC amended its MD&A standards to require disclosure of material off-balance sheet arrangements (as defined) in a separately captioned subsection. These detailed and prescriptive MD&A requirements were primarily intended to help investors understand certain exposures that weren't considered sufficiently transparent in the notes to the financial statements. However, many of the related disclosure requirements have since evolved under GAAP (e.g., variable interest entities) and now address some of the objectives of this MD&A section. Further, we question whether the rule as adopted has been effective in eliciting useful information in many circumstances. Sunset provisions could have prompted the SEC to consider rescinding the MD&A rule on off-balance sheet arrangements, thereby avoiding overlap and duplication of that MD&A section with the improved financial statement disclosures being provided to investors.

Scaling

We support the goal of a disclosure regime that all registrants can consistently apply. Given the premise of materiality, we question why specific disclosure topics would be relevant for investors in larger listed companies but not for the investors in smaller listed companies. While we understand the concern about compliance costs for smaller companies, when a requirement appears sufficiently onerous to exempt smaller companies, the SEC should question whether it is appropriate for larger companies, notwithstanding the perception that larger companies have sufficient resources to absorb the related compliance costs. In addition, we believe scaling disclosure requirements based on the size or nature of the reporting entity could introduce unnecessary complexity and compliance risk to the disclosure system.

Instead, we believe that articulating and adopting disclosure objectives would mitigate the need for scaling disclosure requirements based on the size or nature of the reporting entity. Since smaller reporting companies often have less complex business structures and financial reporting issues, we believe that less extensive disclosures would be necessary to communicate material information that satisfies the specified disclosure objectives.

We believe that the disclosure relief provided to smaller reporting companies generally should be limited to timing considerations that take into account the more limited resources of smaller entities. For example, we support delayed filing due dates for periodic reports, and the SEC should consider delayed effective dates before smaller public companies must comply with new disclosure requirements.

In addition, the concept release solicits feedback about the frequency of interim reporting. We support scaling interim reporting requirements only in limited circumstances. For example, we believe that semiannual financial reporting would be sufficient for smaller reporting companies that are not listed on a national exchange. This approach would significantly reduce compliance costs by eliminating two mandatory reports. This recommendation would scale the interim requirements for non-listed smaller reporting companies and align them with comparable companies that are now able to use the Regulation A exemptions, providing a more level playing field for small public companies that were required to register under the Securities Exchange Act of 1934 before the relief provided under the Jumpstart Our Business Startups Act. The recent amendments to Regulation A require only semiannual reports for Tier 2 issuers that offer up to $50 million in unregistered securities to the public each year. Also, many foreign private issuers (FPIs) are required to report only semiannually in their home markets and in SEC registration statements.[2] Non-listed smaller reporting companies could elect to report quarterly. See our comment letter dated 20 November 2015 for further recommendations on interim reporting requirements.

Further, if the SEC retains or adopts scaled disclosure requirements for smaller public companies, the SEC should evaluate whether it would be appropriate to streamline those disclosures for larger reporting companies.

Business and financial disclosures

Summary

The SEC's interim final rule, *Form 10-K Summary*, permits a registrant to include a summary in its Form 10-K, provided that each item of the summary is cross-referenced to the detailed disclosure in the filing.[3] We support the Commission's efforts to encourage registrants to include a summary in the Form 10-K that provides a discussion of highlights and recent developments. We believe that this disclosure should continue to be optional and management should have the discretion to provide information that it considers most meaningful to investors. However, we recommend that the Commission monitor evolving company and industry practices (including private sector efforts to disclose standardized metrics in the summary) and encourage innovation and best practices.

Description of the business

We have observed that the description of business provided in response to Item 101 of Regulation S-K has become considerably longer over time. In addition, certain portions of the description of business section often are repeated in other sections of the filing because the disclosure requirements overlap with GAAP requirements or are otherwise included within MD&A or risk factors. For example, requirements about segments and geographic regions frequently are cross-referenced to the notes to the financial statement, while segment results are discussed in MD&A. Another example is the requirement to disclose backlog, which may not provide useful data to investors in several industries (e.g., media and entertainment, real estate) and may be more relevant in MD&A depending on the facts and circumstances (e.g., when it is appropriate to address known trends that could have a material effect on future revenues and margins).

[2] Item 8.A of Form 20-F requires FPIs to include interim financial statements covering at least six months of the fiscal year if the effective date of the registration statement is more than nine months after the last audited fiscal year end.

[3] Release No. 34-77969, Commission File No. S7-09-16.

We have the following recommendations to develop clear disclosure objectives for the business section:

- *Emphasize recent or pending business developments that materially affect or may materially affect operations*: After a company's initial public offering (IPO), the ongoing requirement to discuss business developments over five years often results in a lengthy business history discussion that is already public and does not provide meaningful new information .

- *Consider disclosure objectives that relate to the company's strategic focus, principal products and/or services (e.g., markets, distribution channels, product life cycle), critical resources and relationships with customers and suppliers to guide more meaningful disclosures*: We believe these elements are key to how reasonable investors often evaluate the future prospects of a registrant's business. Articulating these principal objectives, consistent with our previous comments, will elicit greater and more informative disclosures without the need for specific rules or quantitative thresholds.

- *Broaden disclosure objectives related to all of a company's critical resources (e.g., human capital, intellectual property, technology) rather than solely hard assets (e.g., description of property under S-K Item 102, which we recommend be eliminated as a distinct disclosure item and incorporated into the broader description of business):* We believe that this objective would more effectively elicit disclosures based on the facts and circumstances of the company or its industry. For example, properties are no longer a significant element of enterprise value for many companies and industries, while other assets (e.g., intellectual property, mineral rights) may merit greater emphasis.

- *Integrate disclosure requirements related to results of operations (e.g., segments, backlog, revenue for similar products or services) into MD&A*: Eliminating disclosures about recent fiscal periods would reduce potential redundancy between the business and MD&A sections and provide a more integrated discussion of operations within MD&A.

- *Consider whether information about material, external threats such as seasonality, laws and regulation, and competition should be integrated with other risk disclosures*: Refer to the risk disclosures section below for further discussion about our recommendations.

- *Eliminate overlap with GAAP disclosures*: In developing disclosure objectives, we recommend that the Commission consider eliminating SEC requirements that overlap with GAAP disclosures, such as the segment and enterprise-level disclosures in Accounting Standards Codification (ASC) 280, *Segment Reporting*.

Refer to the Appendix for a summary of possible disclosure objectives and requirements related to the description of the business section.

Risk disclosures

With the increasing focus on enterprise risk management, there are significant opportunities for companies to more effectively communicate the variety of risk exposures they face and the potential implications. While the SEC's existing disclosure rules are comparatively less prescriptive and provide significant latitude regarding the nature and content of risk disclosures, there still is substantial overlap between the disclosure of (1) risk factors and the disclosures of uncertainties and risks under S-K Item 303, *Management's Discussion and Analysis of Financial Condition and Results of Operations*,

and (2) market risks under S-K Item 305, *Quantitative and Qualitative Disclosures about Market Risk*. In addition, we have noted that risk factor disclosures often do not discuss risk mitigation efforts or changes in the nature or likelihood of previously identified risks.[4]

We also see value in providing companies with more latitude to disclose certain risk factors that may be common to other issuers. Specifically, based on our observations and SEC staff comment letters, we recommend that the SEC eliminate the requirement that companies not include in their risk factor disclosures "risks that could apply to any issuer or any offering." While we agree that investors are better served by risk disclosures that are specific to the issuer, companies often want to identify general business and environmental risks that may also affect other companies, and such disclosures may benefit investors. Accordingly, we believe investors would be better served if the SEC did not restrict the ability of a company to identify risks it considers material.

More generally speaking, in our view and consistent with perspectives shared by other constituents,[5] the objectives of risk factor disclosures should include:

- How the risk specifically affects the registrant
- Risk management efforts to mitigate those potential effects
- Material developments in the nature, likelihood or magnitude of previously identified risks

While we do not believe any specific manner of presentation should be prescribed, we do believe the SEC should encourage certain practices. For example, we believe the SEC should encourage but not require a summary of the company's exposure to risk, particularly if it helps to address the stated disclosure objectives. This summary could provide an overview of risk types or categories, the company's risk management programs and policies, and emerging risk matters. It also could identify and prioritize the risk exposures that the company views as most meaningful to the company.

We also believe that companies should be permitted to experiment with different approaches to improve the effectiveness of risk disclosures and limit redundancy in their filings. The SEC should consider providing more guidance to encourage more effective communication about risks, including the following:

- *Consolidate all risk disclosures into a central risk location*: For example, a company could address all risks in a single section of its report, including those typically addressed in the description of business (e.g., laws and regulation, competition, seasonality).
- *Cross-referencing from the risk factors section when risks are addressed elsewhere in the filing:* For example, a company could address some risks in the risk factors section of the filing and provide cross-references to other disclosures within the filing that discuss other risks.

---

[4] Refer to the report by IRRCI Institute, The Corporate Risk Factor Disclosure Landscape, 21 January 2016. Ernst & Young LLP was the primary research entity for, and the primary contributor, to this report.

[5] See page 4 of our November 2014 publication, *Disclosure effectiveness: What investors, company executives and other stakeholders are saying,* for suggestions by participants about risk factor disclosures.

- *Integrate risk disclosures within the business and MD&A sections:* For example, a company could address all risks and the related disclosure objectives in a logical fashion directly in the business and MD&A sections, or elsewhere if more appropriate. Under this approach, the SEC should consider whether the disclosures would be required (or encouraged) to be clearly designated as related to risk factors or whether the company still would be required (or encouraged) to provide a single list that cross-references the risk disclosures throughout the filing.

Market risk disclosures

We consider S-K Item 305 to be primarily relevant to financial services institutions and certain commodity enterprises for which market risk is a fundamental aspect of their business. These entities typically are engaged in market-making activities and/or actively and extensively use derivative instruments as part of sophisticated risk management programs. However, the scope of S-K Item 305 is not limited to such entities, and most reporting companies have some exposure to market risks related to interest rates, foreign currency exchange rates, equity prices and/or commodity prices. Many of these entities use derivatives to hedge such risks to some degree and provide disclosures to comply with S-K Item 305. However, in many cases those disclosures indicate that the company does not have a material exposure to market risks after the effects of hedging are considered.

US GAAP disclosure requirements have significantly changed since S-K Item 305 became effective nearly 20 years ago. Most notably, ASC 815, *Derivatives and Hedging*, ASC 820, *Fair Value Measurement*, and ASC 825, *Financial Instruments,* now require disclosures that address the objectives underlying S-K Item 305. For most reporting entities, we believe that these GAAP disclosures in the notes to the financial statements are sufficient to inform investors about instruments with values subject to market risk, as well as the objectives and extent of hedging programs. Accordingly, we question whether S-K Item 305 should be retained, and whether a discrete SEC disclosure requirement about market risk is still needed. S-K Item 305 is another example of a mandated disclosure that may have outlived its usefulness in light of more recent GAAP requirements and should be rescinded or substantially modified through sunset provisions.

For example, if the SEC retains S-K Item 305, we recommend that it fully integrate the disclosure objectives underlying S-K Item 305 into the risk factor section. This would address the existing redundancy of S-K Item 305 resulting from the extensive disclosures now required about hedging, derivatives and other instruments in the notes to the financial statements. This also would allow companies for which market risks are highly significant to highlight the nature and extent of those risks and discuss related risk management and mitigation. We recommend that the SEC permit flexibility for registrants to provide quantitative information that is consistent with how they evaluate and manage market risk (i.e., not limited to one of the three alternatives currently required by S-K Item 305: tabular information related to contract terms, sensitivity analyses or value at risk disclosures).

MD&A

There is a significant amount of guidance from the SEC and its staff to assist companies in preparing MD&A, such as Interpretive Releases, Dear CFO Letters, and the Division of Corporation Finance's Financial Reporting Manual. While not all of this guidance is authoritative, in some cases it provides guiding principles to enhance and elicit more effective disclosures. In other cases, the supplemental guidance identifies considerations that might (or might not) need to be disclosed to achieve the underlying disclosure objectives. We believe the disclosure regime would benefit from consolidation

and prioritization of the various guidance. We accordingly encourage the SEC to assess all existing MD&A guidance and integrate the guidance that merits retention into the S-K Item 303 disclosure objectives, considerations and instructions.

Further, and as mentioned above, disclosures currently required to be included in the business section of the filing (e.g., backlog, revenue for similar products or services) may be more appropriate and reduce redundancy if addressed in response to the disclosure objectives of MD&A. For example, Regulation S-K requires disclosures about the registrant's securities and related stock issuance and repurchase activity (e.g., S-K Items 201, 701, 703). However, this data is not presented in the context of an integrated discussion of the registrant's capital structure, such as its cost of capital, capital-raising activities, actual and potential dilution from equity compensation and other freestanding and embedded equity derivatives, policies and objectives underlying treasury stock repurchases, and contemplated future debt and equity financing needs. In our view, investors could benefit from a more robust analysis of a registrant's capital management philosophy compared with that typically provided under the existing MD&A requirements to discuss liquidity and capital resources. Accordingly, we recommend that the SEC reassess the related disclosure objectives of MD&A, identify considerations to address those objectives and challenge whether the disclosures provided in response to other S-K items are effective on a standalone basis or could be integrated into MD&A.

We also offer the following observations in response to certain questions within the concept release about MD&A:

- *Liquidity* — Quantitative disclosures about a registrant's historical use of short-term funding sources may not be predictive of its future need for various forms of short-term financing. Accordingly, a registrant's qualitative disclosures in MD&A about its prospective financing plans and needs based on appropriate disclosure objectives would better inform investors about potential funding and liquidity risks.

- *Contractual obligations table* — We believe that clearly articulated disclosure objectives about liquidity should eliminate the need for prescriptive requirements for a contractual obligations table. We also question whether the contractual obligations table as currently contemplated provides a complete picture of a registrant's obligations and liquidity concerns. For example, a registrant can have a large or small amount of contractual obligations, but the disclosure of such amount doesn't necessarily provide investors with information about the registrant's ability to generate liquidity, its contractual obligations at any other point in time, or a complete picture of its expected uses of cash. In addition, there is significant overlap between the contractual obligations table and US GAAP disclosure requirements, including disclosures about debt, leases and unconditional purchase obligations. Extensible Business Reporting Language (XBRL) can facilitate the creation of customized tables that may more effectively summarize a registrant's obligations (e.g., by presenting future obligations by contractual or expected payout year rather than a combination of multiple periods as currently required by S-K Item 303(a)(5)).

- *Results of operations, including the number of periods* — We do not believe requiring companies to repeat the prior-year's MD&A in their annual reports provides additional value. A company's prior-year MD&A can be easily obtained through the EDGAR delivery system or a registrant's website.[6]

---

[6] In our 20 November 2015 comment letter, we also recommend that two years of financial statements should be sufficient for annual reports on Form 10-K. Financial statements covering three years are more voluminous and costly

We believe requiring a comparison of the preceding annual periods following the filing of an initial registration statement is unnecessary. Instead, the disclosure objective should promote a discussion of the trend information over the periods for which operating results are presented without requiring a detailed prior-year to preceding-year comparison.

- *Key performance indicators* — The instructions for disclosures about the results of operations should encourage preparers to discuss key performance indicators, including key trends and events affecting these metrics. Preparers that correlate key performance indicators with the consequences to operating results can provide information that investors may find useful.

- *Known trends or uncertainties* — Various elements of S-K Item 303 require a registrant to describe any known trends or uncertainties that have had, or that the registrant reasonably expects will have, a material favorable or unfavorable impact. Instruction 3 to S-K Item 303(a) states, "[T]he discussion and analysis shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition." However, according to the SEC's interpretive guidance,[7] registrants must consider disclosing any material trend or uncertainty that is known. The registrant must first determine whether the trend or uncertainty is reasonably likely to occur. If it is not, no disclosure is required. Otherwise, the registrant must assume the uncertainty will occur and provide disclosure in MD&A, unless it would not reasonably likely have a material effect.

  We believe this two-prong approach is difficult for registrants to understand and apply. Further, we believe that the interpretation is inconsistent with how most companies evaluate and manage risk, generally considering likelihood and magnitude together rather than independently. We recommend that the SEC reconsider its interpretive guidance on known trends and uncertainties and revert to the original disclosure threshold of a reasonable expectation of a material future effect.

- *Critical accounting estimates* — The SEC expects MD&A disclosure about critical accounting estimates, but S-K Item 303 does not explicitly require it. Nevertheless, most companies include a section in MD&A to discuss their critical accounting policies or estimates. Such disclosures are frequently criticized as being repetitive of the notes to the financial statements or insufficiently insightful about key assumptions, management's estimation process or the susceptibility of the estimates to change in the future.

  We recommend that the SEC coordinate with the FASB to enhance GAAP disclosure requirements on significant accounting policies to provide more robust discussion about critical accounting estimates, underlying assumptions that are highly judgmental, and the susceptibility of such estimates to change. This would better serve investors by explaining accounting policies and related estimates in one place.

---

to prepare. For example, when applying retroactive accounting changes (e.g., discontinued operations, segment changes, adoption of retrospective accounting principles), the cost is higher when two comparative years of financial statements need to be recast and reaudited.

[7] FR-36, *Amendments to Management's Discussion and Analysis of Financial Condition and Results of Operations*, as included in the Codification of Financial Reporting Policies Section 501.

If instead the SEC still expects companies to discuss critical accounting estimates in MD&A, the rule should clearly articulate the disclosure objective to enhance compliance and the quality of the responsive disclosures. A well-crafted disclosure objective should help narrow the focus to accounting estimates with the highest levels of measurement uncertainty or that are most susceptible to material changes based on likely changes in assumptions in future periods.

- *Immaterial errors* — In response to the SEC's request for comment on whether it should require an issuer to disclose its evaluation that uncorrected errors are immaterial, we do not believe such a requirement would be of benefit to investors. Immaterial error corrections occur routinely, and companies and their independent auditors evaluate an array of quantitative and qualitative factors, including those described in Staff Accounting Bulletin (SAB) 99, to make judgments about their materiality, both individually and in the aggregate. We believe disclosures about items that are determined to be immaterial are unnecessary and, by definition, would not be material to investors. Explaining SAB 99 analyses regarding a conclusion that such items are immaterial also could result in extensive disclosures that would not yield any new material information.

- *Use of pro forma information* — Certain transactions, such as a material acquisition or disposition, may result in historical information that is not comparable within or between fiscal periods. For example, the application of pushdown accounting creates separate predecessor and successor periods for the different reporting entities. The SEC staff's existing guidance permits a registrant to supplement, but not replace, its MD&A discussion of historical results with a discussion of pro forma results if that information is prepared in a manner consistent with Article 11 of Regulation S-X. However, we question whether a discussion of historical results that are not substantially comparable is meaningful, or could be confusing, to investors. In this situation, we recommend that the SEC allow a registrant to exclude the discussion of the historical results and only provide a discussion of pro forma results, provided there is appropriate disclosure about (1) how the pro forma financial information was prepared and (2) why it is more meaningful to investors than the historical results. If the pro forma presentation is not prepared in accordance with Article 11, registrants should also disclose why they consider such an alternative pro forma presentation appropriate.

Auditor involvement

The Public Company Accounting Oversight Board (PCAOB) Auditing Standard (AS) 2710 (formerly AU 550), *Other Information in Documents Containing Audited Financial Statements*, addresses the auditor's responsibility with respect to other information (e.g., MD&A, selected financial data) in documents containing audited financial statements and the related auditor's report. The auditor currently is responsible for reading the other information and considering whether it is materially inconsistent with the audited financial statements. Although the PCAOB attestation standards[8] provide for the examination (or review) of MD&A by an independent accountant, in practice, attestation reports on MD&A have been rarely issued. In our view, market demand for such reports has not developed because the costs to obtain such assurance outweigh its perceived benefits.

However, we believe that auditor attestation on MD&A deserves further consideration. Auditor attestation on a registrant's entire MD&A disclosure would be a significant and costly undertaking. However, if disclosures about critical accounting estimates are retained in MD&A, auditor attestation

---

8 AT section 701, *Management's Discussion and Analysis*.

on only these disclosures could be a more modest and cost-effective alternative. Auditor involvement with MD&A disclosure of critical accounting estimates also could lead to improved disclosures. If investors express additional interest in auditor involvement with MD&A (or other financial information presented outside the financial statements), we believe that issuers, investors and auditors should have the opportunity to comment separately in the event that the SEC proposes a rule or issues a concept release focused on auditor involvement.

Selected financial data table

As discussed in our 20 November 2015 comment letter, we encourage the Commission to provide a practicability exception that allows registrants to omit the earliest years in the selected financial data table (prior to those presented in the US GAAP financial statements) if such information cannot be provided without unreasonable effort or expense. Item 3.A of Form 20-F already provides this accommodation for FPIs.

We believe the selected financial data table should permit registrants to present a retrospective accounting change only for the periods presented in the GAAP financial statements if the earlier periods cannot be recast without unreasonable effort or cost. To inform investors about why this information is not available in these cases, there should be clear disclosure about the unreasonable effort that would be required to recast the earliest periods and the resulting lack of comparability.

We also recommend that the SEC consider allowing all issuers to exclude the earliest periods from the selected financial data table in their IPO registration statements and to build on the selected financial data table in future annual reports. The SEC currently provides such relief to emerging growth companies, resulting in reduced compliance costs for these companies. We believe extending this relief to all issuers would not sacrifice material disclosure about trends in the business.

More fundamentally, we question whether the selected financial data table is necessary and should continue to be a required disclosure. The table may not be necessary given the availability of multiple years of data-tagged financial statements, which allow users to construct customized analyses of selected financial data. Instead, we suggest that the SEC encourage companies to include tables of selected financial data in the summary section of their annual reports if the information would highlight the key content and developments disclosed in the full report.

Auditor involvement

In addition to the auditor's responsibility under PCAOB AS 2710 to read the selected financial data and consider whether it is materially inconsistent with the audited financial statements, an auditor also may be engaged to report on selected financial data in accordance with PCAOB AS 3315, *Reporting on Condensed Financial Statements and Selected Financial Data*. The objective of this engagement is to report on whether the selected financial data is fairly stated in all material respects in relation to the complete financial statements from which it has been derived. However, in practice, these engagements are rare. Consistent with our recommendation about auditor involvement with MD&A, we suggest that issuers, investors and auditors have the opportunity to comment on a distinct proposed rule or concept release if investors express additional interest in auditor involvement with other financial information.

Supplementary financial information

We recommend that the SEC provide relief to a registrant that includes selected quarterly data under S-K Item 302(a) in an SEC filing after its IPO registration statement. A registrant is not required to present selected quarterly data in its IPO registration statement.[9] However, it would be required to provide selected quarterly data for each full quarter within the two most recent fiscal years and any subsequent interim periods in a registration statement filed after its IPO or in its next Form 10-K annual report. As a result, selected quarterly data may need to be presented for interim periods prior to those presented in the IPO registration statement or in quarterly reports on Form 10-Q.

We recommend that registrants be required to begin presenting selected quarterly data in their second annual report, since at that point quarterly financial statements on Form 10-Q would have been filed for each period, allowing investors to better understand patterns and trends throughout the fiscal year, as originally intended by the requirement.

Another option would be for the SEC to permit registrants to present selected quarterly data in post-IPO registration statements and annual reports based on the quarterly financial statements separately filed on a Form 10-Q. For example, the selected quarterly data could include year-to-date information for any interim periods disclosed in an IPO registration statement and quarterly information for those periods subsequently reported (e.g., six-month interim periods ended 30 June 2015 and 2014 presented in the IPO prospectus, quarterly information for the subsequently completed third and fourth quarters).

Auditor involvement

The SEC's concept release, among other things, solicits views about auditor involvement with supplementary financial information. Article 10 of Regulation S-X requires a review by the independent accountant of interim financial information included in quarterly reports on Form 10-Q. PCAOB AS 4105 (formerly AU 722), *Reviews of Interim Financial Information*, provides requirements and guidance when the auditor performs a review of the quarterly information, including the fourth quarter. The auditor must modify its opinion to include an explanatory paragraph if the quarterly data is not reviewed, not properly labeled as unaudited or does not appear to be presented in conformity with US GAAP.

We do not believe that a higher level of auditor assurance on interim periods (i.e., positive assurance as would be provided by an audit) is needed to increase investor protection because of the potentially high costs involved and the impracticality in meeting existing reporting deadlines. An alternative would be to present selected quarterly data in a supplemental schedule to the financial statements on which an auditor could conduct procedures in the context of the annual financial statements taken as a whole, similar to the schedules in Article 12 of Regulation S-X. While this alternative would have fewer drawbacks, we suggest giving issuers, investors, and auditors the opportunity to comment on a distinct proposed rule or concept release if investors express interest in increased auditor involvement with selected quarterly data.

---

[9] S-K Item 302(a) only requires a registrant to provide selected quarterly data if it has securities registered pursuant to Section 12(b) or Section 12(g) of the Exchange Act. As a result, selected quarterly data is not required until after the securities are registered in the registrant's initial registration statement.

Sustainability and public policy disclosures

Many investors view how companies address climate change and other environmental and social challenges as a proxy for the strength of the board and management and a metric for measuring governance risk. However, the concept release notes different perspectives from commenters about whether these disclosures are material to investment and voting decisions or whether they serve a different purpose. Consistent with our recommendations about other disclosure requirements, we believe disclosures on topics such as climate change and sustainability should be required if they are material, which may vary from company to company and over time. Given the growing interest in such disclosures, we encourage the SEC to monitor how these voluntary disclosures evolve.

Industry Guides

As discussed in the concept release, the SEC Industry Guides were developed to help reduce SEC staff comments on common issues that were delaying registration statements. The Industry Guides have not been updated in many years, and in the meantime GAAP disclosure requirements, as well as emerging business models and risks, have changed significantly, rendering certain portions of the Industry Guides obsolete, redundant or in need of revision. We understand that the SEC staff has begun a project to review the disclosure requirements in Industry Guide 3, *Statistical Disclosure by Bank Holding Companies*. In addition, the SEC has proposed changes to disclosure requirements for mining companies that would rescind Industry Guide 7, *Description of Property by Issuers Engaged or to be Engaged in Significant Mining Operations*, and incorporate mining-specific disclosures in Regulation S-K.[10] While we support these projects, we offer the following recommendations concerning industry-specific disclosure requirements:

- *Revisit the purpose and authority of Industry Guides* — The status and intent of the Industry Guides can be unclear, which can make it difficult for preparers to understand how to use them. Although the Industry Guides are listed in Regulation S-K, they do not represent rules, regulations or statements of the Commission. If the SEC determines that the Industry Guides are still necessary to identify industry-specific disclosure objectives and considerations, the SEC should consider incorporating the Industry Guides into Regulation S-K to help clarify their status.

- *Consolidate industry-specific disclosure requirements* — We believe it is preferable to consolidate, where appropriate, the industry-specific disclosure and reporting requirements that currently reside in Regulations S-K and S-X, SEC staff interpretations, and the Industry Guides. For example, disclosure requirements related to oil and gas matters are set forth in various places, including the Regulation S-K 1200 series, Regulation S-X Rule 4-10, SEC staff compliance and disclosure interpretations and SAB Topic 12.

- *Eliminate overlap with US GAAP* — Certain Industry Guides include significant overlap with US GAAP disclosures, which may challenge compliance efforts. For example, Accounting Standards Update (ASU) No. 2015-09, *Financial Services – Insurance (Topic 944): Disclosures about Short-Duration Contracts*, significantly expands the disclosure requirements for insurance companies with short-duration contracts, including property/casualty insurers. These requirements overlap

---

[10] Proposed rule, *Modernization of Property Disclosures for Mining Registrants*, Release Nos. 33-10098, 34-78086, Commission File No. S7-10-16.

with Industry Guide 6 disclosures, with some variations. For instance, both the Industry Guide and ASU require claim development tables, but the form and content of the disclosures differ. We recommend that the SEC evaluate and eliminate such redundant disclosure requirements.

- *Implement more frequent updating of industry-specific guidance* — Registrants should not have to monitor SEC staff comment letters to understand changes in SEC staff expectations, policies or practices, particularly regarding industry-specific disclosures. We encourage the Commission to implement a process to regularly update the Industry Guides for the benefit of preparers and investors. For example, the Commission could consider delegating the authority to update Industry Guides to senior SEC staff (e.g., the Director of the Division of Corporation Finance and the SEC Chief Accountant), which should allow more timely updates to avoid duplication with new GAAP disclosures and to respond to industry developments. In addition, the Commission could adopt a policy that requires the staff to perform and report the conclusions of a periodic (e.g., triennial) review that considers necessary changes to the Industry Guides.

Preferability letters

The concept release notes that, since 1975, the Commission has required an accountant's letter stating whether a change in accounting principle is, in the accountant's judgment, preferable. The requirement initially required registrants to involve their independent auditors when making voluntary changes in accounting principle during interim periods. The release notes that auditors are now required to review financial statements for interim periods and US GAAP includes prescriptive accounting guidance on preferability in ASC 250, *Accounting Changes and Error Corrections*.

While preferability letters may now appear redundant, we are concerned that eliminating the requirement to provide preferability letters could have unintended consequences. Many registrants and their auditors view the preferability letter requirement as a high hurdle, which is appropriate given the general presumption in GAAP that an accounting principle (including methods of applying a principle) once adopted should not be changed when accounting for events and transactions of a similar type. In certain cases, the requirement may result in a more timely and diligent analysis of a contemplated change in accounting principle. In other cases, a voluntary change in an accounting policy may not have a material effect on the current period financial statements, but it could have a material effect in future periods. In those circumstances, the requirement provides important investor protections that compliance with ASC 250 and AS 6, *Evaluating Consistency of Financial Statements*, alone might not provide. The requirement also provides greater transparency. Therefore, we strongly support the retention of the preferability letter requirement.

With respect to whether the auditor's report sufficiently highlights whether a change in accounting principle is preferable under the circumstances, we observe that the PCAOB's auditor reporting standard proposals[11] contemplate changes to the content of the auditor's report. However, the PCAOB does not specify what revisions it would make to the auditor's report to address whether a change in accounting principle is preferable. In our view, preferability letters provide investor protection and an effective control that deters frequent or questionable accounting changes, imposes appropriate discipline in the assessment of preferability and safeguards the integrity of financial reporting.

---

[11] PCAOB Release No. 2016-003, *Proposed Auditing Standards, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*.

Presentation and delivery of information

We believe that the current form-based system is anachronistic and long overdue for an overhaul to leverage improved technology.[12] If the Commission determines that the modernization of the disclosure system is a longer-term initiative, it is important that interim revisions to existing disclosure requirements contemplate and accommodate future changes in the filing and delivery systems.

The concept release seeks feedback on how cross-referencing, incorporation by reference, hyperlinks and company websites can improve the readability and navigability of SEC filings. At the encouragement of the SEC staff, we have observed several companies that have made significant improvements in their disclosure documents by reordering information and using graphics, hyperlinks and cross-references to communicate more effectively with investors.[13] To their credit, such innovations have been done voluntarily following current securities laws. We are actively encouraging other companies to undertake similar initiatives, and we are pleased to see many companies pursuing innovations and continuous improvement programs.

We offer the following additional observations about the various presentation tools:

- Mandating the use of cross-referencing, hyperlinks or graphics could impose additional costs that would likely have a disproportionate impact on smaller companies.
- Permitting hyperlinks to information outside of the SEC filing (e.g., on the company's website) would require clarity about the extent of liability and responsibility of auditors related to "other information" contained in a document that includes the auditor's report.
  - For example, external hyperlinks would raise questions about what information comprises a registration statement or document as defined by PCAOB AS 2710. In addition, if auditors are responsible for considering the hyperlinked information as of the filing date, questions could arise about whether they are still responsible if the hyperlinked information changes after the filing date, and/or how to determine that the hyperlinked information as of the filing date is appropriately retained in that form.
- If external hyperlinks are permitted or encouraged, the SEC should clarify that hyperlinked information does not become a part of the SEC filing unless it is expressly incorporated. That is, a registrant would be presumed to be providing a hyperlink to supplemental information investors might find useful rather than including hyperlinked information in an SEC filing.
- Cross-referencing in the notes to the financial statements to information elsewhere in the filing would raise similar questions about the scope of the financial statements covered by the audit or review.

---

[12] In addition, investors have said that improving the delivery system may have the most profound benefit as part of the disclosure effectiveness initiatives. See further details in our November 2014 publication, *Disclosure effectiveness: What investors, company executives and other stakeholders are saying*.

[13] The Financial Executives Research Foundation, in collaboration with EY, conducted a study to identify how companies have begun to implement disclosure effectiveness initiatives and to learn how those efforts are progressing. See results in the report, *Disclosure effectiveness: Companies embrace the call to action*.

Company profile

As discussed in our 11 September 2012 comment letter, we support a company profile approach as we believe it would significantly improve the format and delivery of information to investors. A company profile would segregate reference information from periodic and transaction filings and organize company disclosures consistently and logically to help investors find the information easily. The company profile could incorporate a timeline of significant events, such as those currently reported on Form 8-K, as well as an "audit trail" to identify the addition, deletion or modification of content. This approach would reduce compliance costs and streamline the size of periodic reports and transaction filings while allowing investors to easily identify and navigate to the disclosures that interest them.

The company profile could allow users to navigate to disclosures organized by common themes, such as the company's business, securities, corporate governance, executive compensation, risks and exhibits. The profile also could logically organize and facilitate access to information about completed fiscal periods, financial statements and MD&A, including any retrospective revisions made following their initial filing. In this manner, the company profile would help investors find and use the company's primary financial statements and not a superseded version. As with SEC filings today, a company profile approach would not require registrants to provide continuous or real-time updates of their disclosures. Instead, the various components could continue to be subject to clear timeliness and periodic updating requirements. In addition, information could be shaded, highlighted or presented in another manner that would clearly indicate whether it is furnished or filed or whether it is subject to safe harbor provisions to alleviate potential concerns about the legal liability associated with information in the company profile.

* * * * *

We thank you for the opportunity to provide our comments on this important initiative and would be pleased to discuss our comments with the Commission or its staff at your convenience.

Yours sincerely,

Copy to: James Schnurr, Chief Accountant, Office of Chief Accountant
Keith Higgins, Director, Division of Corporation Finance
Mark Kronforst, Chief Accountant, Division of Corporation Finance
Russell Golden, Chair, Financial Accounting Standards Board

Appendix — Possible disclosure objectives and requirements for description of business section

We recommend that the SEC identify and embed objectives in each disclosure requirement, supplemented with a nonexclusive and non-presumptive list of disclosures that might be relevant in achieving the objective. This appendix includes examples of possible disclosure objectives and supplemental considerations that could be embedded in the requirements for the description of business section.

Item 101 — Description of business

(a) Developments and prospects of the business

Disclosure objective: Communicate the material developments and future prospects of the business, including recent or pending transactions and events that affect or may affect the company's operations

Provide disclosures necessary to meet the disclosure objective, which might include but not be limited to the following:

1. Events or developments in the most recent fiscal year, or that are more likely than not to occur in the foreseeable future, that are or would be material to an understanding of the business (for a registrant filing its initial registration statement, sufficient information about the general development of the business may be necessary to understand its nature and means of conducting business)

2. The company's strategic focus, including the significant opportunities and risks resulting from its market position and business model, and any material changes or contemplated changes

3. Identity and description of principal business activities, reportable segments and their geographic scope, as well as any recent or planned changes in business activity, internal organization and strategy

4. Any legal proceedings, bankruptcy or other developments that are important to an understanding of the business

(b) Revenue-generating activities

Disclosure objective: Explain the material revenue-generating activities, including the nature of the revenue streams, status of development efforts for new or enhanced products and services, and challenges and risks associated with these activities

Provide disclosures necessary to meet the disclosure objective, which might include but not be limited to the following:

1. The nature and type of material products, services or other revenue-generating activities, including any dependence on key products or product families (or key service offerings or suite of services) that may present material exposure to obsolescence or other risks

2. The methods of delivery, including any changes or risks in the distribution channels necessary to supply or serve customers

3. Recent developments that materially affect the results of operations, including material new products, research and development activities or trends in market demand or competition

4. The nature and risks of any material liabilities (e.g., product warranties, returns, allowances) related to products and services

(c) Critical reliance on assets and other parties

Disclosure objective: Describe any critical reliance on assets or relationships with suppliers, customers or other parties that materially affect the company's business

Provide disclosures necessary to meet the disclosure objective, which might include but not be limited to the following:

1. Sources and availability of raw materials or other inputs to production

2. Practices related to working capital management, including arrangements with suppliers and customers (e.g., payment terms) or the need to maintain significant amounts of assets or record deferred balances (e.g., inventory, accounts receivable, deferred revenue) during certain portions of the year

3. Dependence on a single customer or a few customers, including governmental customers

4. Importance of critical assets, such as intellectual property, plants or other physical properties, mineral rights or patents

(d) Human capital and workforce

Disclosure objective: Describe the nature of the registrant's workforce, its composition and necessary specialized skills, and other human capital factors that have affected or may materially affect the registrant's business

Provide disclosures necessary to meet the disclosure objective, which might include but not be limited to the following:

1. The proportion of union employees versus non-union employees

2. Whether and how current labor relations may potentially result in work stoppages that could materially affect operations

3. The proportion of outsourced employees versus statutory employees

4. Turnover in the workforce and the implications of labor shortages and wage pressures

5. The implications of shifts in the geographic location of human resources

6. How the need for specialized skills or dependence on key employees may affect the company's operations

(e) External exposures[14]

Disclosure objective: Identify and describe material, external exposures that may adversely affect the business

Provide disclosures necessary to meet the disclosure objective, which might include but not be limited to the following:

1. Seasonality — describe the extent to which the business and any of its reportable segments may be seasonal and the related impact

2. Laws and regulation — describe the legal and regulatory environment and the material effects or expenditures related to complying with such provisions

3. Competition — describe competitive conditions and information about the number and nature of competitors, identify the primary means of competition and competitive factors affecting the company's business

4. Geopolitical, natural and geographical — describe the extent to which the business and any of its reportable segments are affected by these exposures and their related impact

---

[14] Alternatively, disclosure objectives related to external threats could be integrated within the risk factor section to centralize disclosure requirements related to risks.