FINANCIAL REPORTING DISCLOSURES:

Investor Perspectives on Transparency, Trust, and Volume

Condensed Report

CFA Institute
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I. OVERVIEW: DISCLOSURE REFORM AND THE NEED TO FOCUS ON INVESTORS

Initiatives are under way to reform financial reporting disclosures. The current dialogue is centered on developing a disclosure framework—that is, an overarching framework that will make disclosures more effective. CFA Institute supports enhancements to disclosures because high-quality financial statement disclosures are essential to an investor’s understanding and analysis of a company’s financial performance. In effect, such understanding is fundamental to sound investment decision making.

As we reviewed contributions to the disclosure reform initiatives currently in progress—and experienced the dialogue on disclosure reform—we noted that such efforts are heavily informed by reports based on interviews of, surveys of, and the work of preparers, accountants, and auditors rather than investors. The conclusion of such research is that investors are inundated with excessive financial statement disclosures and, therefore, investors overlook the most relevant financial information. The inference is that disclosure reform should aim principally to reduce the quantity of disclosures.

Because investors are the consumers of financial reporting and disclosures and their input had not been used in a substantial way in the dialogue on disclosure effectiveness and reform, CFA Institute decided to provide the investor’s perspectives on disclosure reform. We believe we are uniquely positioned to do so because of our membership (analysts and investors using financial statements) and our four decades of experience in liaising with investors on financial reporting matters.

Therefore, in 2012, we conducted a survey of our members (the 2012 Disclosure Survey) to obtain their perspectives on disclosure reform priorities. Based on the findings of this survey, on the results of prior CFA Institute surveys on disclosure, and on our long-standing relationship with the investment community, CFA Institute developed the report titled “Financial Reporting Disclosures: Investor Perspectives on Transparency, Trust, and Volume” (called in this condensed report the “Investor Perspectives Report”). The report aims to contribute investor perspectives on disclosure reform priorities as well as provide recommendations to enhance financial reporting effectiveness. (Appendix A of the “Investor Perspectives Report” contains the details of the 2012 Disclosure Survey, and Appendix B summarizes our findings from prior surveys.)

Section 1 of the “Investor Perspectives Report” provides background on the importance of disclosures to investors together with the historical perspective of CFA Institute on the principles of high-quality financial reporting and disclosures and the need for an investor focus in developing disclosure reforms.

II. DISCLOSURE REFORM: CONSIDER IN CONTEXT OF INVESTOR EXPERIENCES AND CURRENT ENVIRONMENT

Missing from the discourse on disclosure reform is, in our view, consideration of how recent and current economic events and secular trends have informed policymaker efforts to reform financial reporting disclosures. Investors believe that any dialogue regarding financial reporting and disclosure reform must be informed by current events and the current environment, or context, into which such reforms might be introduced. Without such a frame of reference, we cannot ascertain whether the reforms will be effective in addressing sources of disclosure ineffectiveness.

Furthermore, if financial reporting is meant to serve the needs of investors, current disclosure reform initiatives should give consideration to investors’ present frame of reference and the lens through which investors evaluate disclosure effectiveness. To that end, Section 2 of the “Investor Perspectives Report” provides background on the events and factors currently shaping investor perspectives.

Financial Crisis: Inadequate Disclosures Contribute to Lack of Transparency, Trust, and Investment

Investor perspectives on disclosures have been shaped by the recent financial crisis. Investors’ perceptions regarding financial reporting effectiveness have been profoundly affected by how they experienced the events leading up to, through, and following the 2008 financial crisis. How well disclosures served their needs during this tumultuous period unequivocally informs their views regarding the efficacy of financial reporting and disclosures.

Investors believe the 2008 financial crisis and the ensuing five years of economic uneasiness plainly revealed the insufficiency of disclosures, especially in the case of financial institutions. Investors point to the countless reporting and analyses of failures and bailouts of high-profile financial institutions during and since the
2008 financial crisis as evidence of the insufficiency of disclosures in providing the necessary transparency to investors regarding exposures, risks, uncertainties, and leverage of such financial institutions.

Commentary on the failures of such entities as Lehman Brothers, MF Global, and Bear Stearns and the enormous losses, bailouts, or acquisitions of such entities as Morgan Stanley, American International Group, Countrywide, and Merrill Lynch provide innumerable examples for investors to cite. Consider, for example, the following press release dated 14 November 2012 from the Committee on Financial Services of the U.S. Congress regarding the investigation of MF Global and related report:

Since MF Global did not initially disclose the full extent of its European bond holdings, federal regulators and the investing public were not aware of all the risks facing the company.

Investors believe each of these high-profile institutions exemplifies a situation where management did not communicate to shareholders the risks and uncertainties associated with significant transactions or activities they were engaged in. The institutions’ managers either (1) had not fully identified or understood the associated risks and uncertainties or (2) did not intend to provide meaningful communication of the risks and uncertainties.

The lack of transparency persists in the postcrisis era. The “Investor Perspectives Report” notes two recent publications of the European Securities and Markets Authority that highlight the persistence of the lack of transparency in the financial reporting by European institutions, particularly with respect to the risks and uncertainties they face.

This lack of transparency in financial reporting—especially when it occurs in financial institutions—creates a vicious cycle, with implications for investors’ trust and their willingness to invest. Lack of trust in financial institutions, which are the handmaidens to the broader economy, produces lack of trust and lack of investment in the broad economy. Recent remarks by laypeople, sophisticated investors, and regulators demonstrate the lack of investor trust emanating from the lack of transparency in disclosures.

Section 2 of the “Investor Perspectives Report” contains excerpts of these remarks because such remarks exemplify what CFA Institute has heard repeatedly in the past five years from our members and investors regarding the lack of transparency in financial reporting and the lack of trust and lack of investment in the broad economy. Highlights of the commentary are presented here.

A Layman’s Perspective
A recent article in the Atlantic demonstrates the link between the financial crisis and the lack of transparency in bank financial statements, the continuing opacity in bank financial statements, and the ongoing lack of trust by investors in lay language.

When we asked Dane Holmes, the head of investor relations at Goldman Sachs, why so few people trust big banks, he told us, “People don’t understand the banks,” because “there is a lack of transparency.”

Some four years after the 2008 financial crisis, public trust in banks is as low as ever. Sophisticated investors describe big banks as “black boxes” that may still be concealing enormous risks—the sort that could again take down the economy.

Frank Partnoy and Jesse Eisinger, “What’s Inside America’s Banks?” Atlantic, January 2013, pp. 3

A Sophisticated Investor’s Perspective
Similarly, in a recent exchange with Jamie Dimon, CEO of J.P. Morgan Chase, at the 2013 World Economic Forum, Paul Singer, an investor and hedge fund manager from the investment fund Elliott Associates, expressed his views regarding the opacity of financial institution reporting and the need for greater disclosures. Dimon’s response was to quote the number of pages in the bank’s Form 10-K, implying that the volume of disclosures reflects sufficient transparency. This exchange exemplifies the difference between preparer and investor views. Preparers equate the number of pages in the financial statements with transparency, whereas investors do not believe disclosures are sufficient.

Singer: One doesn’t know from disclosures, or one can’t find out from disclosures, whether global financial institutions are actually risky or sound and I think that is something which needs to be fixed by global cooperation.

Dimon: . . . You’ve made this comment publicly before. I called you up and asked you what you’d like to know. You probably have not read our Form 10-K. It is 400 pages long where we break out assets by . . .
Investors See a Need to Redefine the Policy Response Toward Greater Transparency and Trust

Investors, informed by such recent economic events, find it surprising that disclosure reform efforts currently under way—after the greatest financial crisis since the Great Depression and during a period of continued economic uncertainty—have concentrated on reducing the quantity of disclosures rather than improving the disclosures that proved most troublesome. Addressing the problematic disclosures would enhance transparency and ultimately trust for investors. The paradox only grows when investors contrast efforts by current policymakers to the response of policymakers following the Great Depression. The financial crisis of the late 1920s and early 1930s led to substantial expansion of and reforms to disclosures via passage of the Securities Acts.

A Securities Regulators Perspective

In a speech titled “Capital Formation from the Investor’s Perspective,” Commissioner Luis Aguilar of the U.S. SEC highlighted the lack of trust on the part of individual investors and the importance of full and fair disclosure in enhancing investment and capital formation.

One persistent after-effect of the financial crisis has been a loss of confidence in the securities markets among individual investors. A recent survey finds that only 17 percent of Americans trust the stock market.

It is understandable that investors feel uneasy. It’s hard for them to know whether the capital markets are trustworthy.

Obviously, we need to turn this trend around. It is clear that if you want people to invest in the capital markets, you have to foster trust in the capital markets—and for that to happen, the capital markets must be trustworthy.

My experiences as an SEC commissioner make it clear to me that rules to promote full and fair disclosure, reliable financial information, and accountability for market participants are absolutely necessary.

SEC Commissioner Luis Aguilar, Capital Formation from the Investor’s Perspective, AICPA Conference on Current SEC & PCAOB Developments, December 2012

Singer: What 2008 showed was that many financial institutions didn’t actually have a handle on—nor did their regulators—the nature of their risks, and risk models which were being used were not adequate to describe transmission mechanisms. . . . What I am saying is that the path to normalization and a crystal clear ability of global financial institutions to exist outside of an implicit governmental guarantee partially is dependent upon more deleveraging and more disclosures.

Complete exchange can be viewed at: Global Financial Context, World Economic Forum Annual Meeting (2013)
Other Matters Investors See Influencing the Current Financial Reporting Environment

In addition to regarding financial reporting and disclosure reforms in the context of recent investor experiences, standard setters and policymakers should consider other matters investors perceive as affecting the current financial reporting environment. Three key factors influencing the usefulness of financial reporting and disclosures for investors that are absent from the conversations about how best to reform disclosures are technology, the existing accounting model, and measurement and related disclosures. We explore each of these factors in detail in Section 2 of the "Investor Perspectives Report" and summarize them here. (These are not all of the factors investors perceive as important but are matters with the most direct link to making financial reporting information useful for investor decision making.)

Technology: Irreversible Trend Toward Greater Connectivity and Data in Financial Reporting

Investors believe the dialogue on disclosure reform—indeed, on financial reporting in general—should consider the growing desire for information in an increasingly complex and global world. In this world, technology and connectivity have increased the desire for and capacity to deliver increasing amounts of data. Missing from policymakers’ decision-making process is how to harness the substantial advances in technology and connectivity made in the past two decades to better capture, manage, analyze, present, and deliver the financial data necessary to analyze and invest in complex global businesses. How technology can be used to reform the financial reporting process from beginning to end—not simply in the filing of documents with regulators—is where investors believe the dialogue should focus. It should not simply call for a reduction in disclosures.

Existing Accounting Model: Providing Decision-Useful Information in the New Economy?

Some suggest that the existing accounting model has not kept pace with the evolution of the business environment and that the accounting model—at a minimum, disclosures—should be modified to remain relevant. The valuation of intangibles in technology companies and the inability of standard setters to develop an appropriate standard on financial instruments and insurance contracts for risk-taking businesses (banking and insurance enterprises) are examples of the inability of the accounting model to keep pace with changes that can provide meaningful information to investors. If improvements in the accounting model or disclosures are not made, the shadow financial reporting environment becomes more relevant—and less reliable—to investors than the formal financial reporting environment. Investors believe that to remain sustainably relevant, the accounting model should adapt to the economic forces that are shaping businesses activities.

Resolving Measurement and the Disclosures that Make Measurements Meaningful

The current conceptually inconsistent measurements in financial statements are limited in their usefulness for making investment decisions. Investors believe a measurement framework is needed that defines the characteristics of assets and liabilities that establishes how they should be measured. Furthermore, a consistent measurement framework could inform consistent disclosure requirements. Consistent disclosure requirements for each type of measurement would enable investors to more readily identify and use the necessary information. Standard setters also need to resolve the debate with respect to the inclusion of forward-looking information in the financial statements in favor of the inclusion of this information. Forward-looking information is the only decision-useful information for investors. The inclusion of more forward-looking measurements requires the inclusion of forward-looking disclosures to make such measurements meaningful to investors.
III. INVESTOR PRIORITIES: ENHANCING ELEMENTS OF TRANSPARENCY AND QUALITY

To elicit what members believe the focus of standard setters’ and policymakers’ efforts should be if transparency is to be increased, the 2012 Disclosure Survey asked members to prioritize a variety of potential financial reporting initiatives. What Figure 1 illustrates, and we discuss in detail in Section 3 of the “Investor Perspectives Report,” is that what investors believe should be the focus of standard setters’ efforts (left side of the chart) is diametrically opposed to where standard setters are currently focusing their efforts (right side of the chart).

Investor Priorities Differ from Standard Setter Focus

Figure 1

Emphasis of Matters:
Greater emphasis on matters of importance in a particular accounting period, including an improved MD&A that better explains the current period results and expected future results.

Improved Financial Statement Presentation:
Improved financial statement presentation with improved disaggregation and cohesiveness, account balance roll-forwards, and statements of cash flows.

Tables:
Increased use of tables and charts to better display information.

Cross-Referencing/Redundancy:
Improved cross-referencing where information that is already included in the notes to the financial statements is not repeated without further analysis or explanation in the other parts of filing documents.

Disclosure Framework:
Development of a disclosure framework that allows management to decide what disclosures are relevant and necessary.

Reduced Volume:
Removal of disclosures to reduce the volume of financial statements.

How important would each of the following potential financial reporting changes be to you in the use of financial statements? N = 303

- Very Important (4+5)
- Undecided (3)
- Not Important at All (1+2)
INVESTORS’ TOP PRIORITIES:
Greater Emphasis of Matters of Importance
Eighty-five percent of survey respondents attached high importance to greater emphasis on matters of importance during a reporting period, including an improved management discussion and analysis (MD&A) that explains the current period results and expected future results.

Improved Financial Statement Presentation
Eighty-two percent of respondents indicated that improved financial statement presentation was very important and indicated that substantial enhancements could be achieved by providing the following four elements:

- disaggregation,
- cohesiveness,
- account balance roll-forwards, and
- direct cash flows.

Furthermore, as can be seen in Figure 2, investors believe that the financial statement presentation project should be not only reinstated but also completed before an effective disclosure framework can be developed. The reason is that presentation is the foundation of financial reporting and disclosures are an explanation of the amounts presented in the financial statements.

COMMON GROUND:
Tables, Charts, and Cross-Referencing
Increasing the use of tables and charts and reducing redundancy by adding cross-references were also seen as important to investors. This view is shared by many corporate managers.

FOCUS OF STANDARD SETTERS:
Disclosure Framework Aimed at Reducing Volume
A majority of respondents did not see the creation of a disclosure framework or reducing disclosures as being as important as other improvements. Investors think elements of enhancing transparency and the quality of disclosures are the significant financial reporting issues.

CONCLUSION:
Need to Refocus Reform Agenda
Investor priorities (emphasizing matters of importance and improved financial statement presentation) are very different from standard setter and policymaker priorities (disclosure framework and reducing volume). Common ground exists on the need to enhance the communication and presentational elements of financial reporting (tables, cross-referencing, and redundancy). Standard setters should, therefore, focus their efforts on enhancing quality and transparency in the areas that investors see to be of greatest importance.

Financial Statement Presentation Priority Over Disclosure Framework
Figure 2

Do you agree or disagree that before developing a disclosure framework, as a first step, standard setters should simply reconsider how information is currently displayed in the financial statements?  N = 277
IV. INVESTOR CONCERN: NOT VOLUME BUT COMPLETENESS OF INFORMATION

Given the recent focus on enhancing disclosures principally through a reduction in the quantity of disclosures, Section 5 of the “Investor Perspectives Report” considers whether the volume of disclosures is an area of investor concern.

Figure 3 illustrates that it is not. Eighty percent of survey respondents either do not have an issue with the length of current disclosures or think that, although current disclosures may be lengthy, they contain necessary information. This finding is consistent with the response that others have received from sophisticated investors; however, it is a finding not well publicized.

80% Say Volume Not A Significant Concern

Figure 3

Which best describes your opinion regarding the length and content of current financial reporting disclosures?  
N = 325

Removal of Certain Disclosures: Investor Views

CFA Institute members reject recent suggestions on ways to reduce disclosure volume by excluding certain types of information, such as the summary of significant accounting policies (see Figure 4) and information already available from public sources (see Figure 5).
Representative quotes from investors about the survey question in Figure 4 follow:

- **Disclosures of significant accounting policies MUST [original emphasis] be made to enable users to know the bases of preparation of the financial statements, i.e., the methods for recognition and measurement of income, expenses, assets, liabilities, and equity. Users can then assess the suitability and other implications of the accounting policies.** Having to refer to outside financial reports for disclosures on critical accounting policies and other important matters would add to the difficulty, inconvenience, and cost of analysis. These negative effects would especially affect the poorer, less "sophisticated" and engaged users.

- **Financial reporting standards have choices of accounting methods.** Hence accounting policies can differ across companies and for companies over time. Similarly, critical risk factors and other matters requiring disclosures are specific to companies.
Several representative quotes from investors about the results in Figure 5 follow:

- Financial statements should provide a comprehensive look at an entity’s financial condition. Directing investors to other sources to obtain a full picture of the entity’s financial condition would prevent this goal.

- Although some investors are indeed sophisticated and can glean information from multiple sources, others are less so and shouldn’t be made to make uneducated decisions or, worse, decide not to invest merely because access to information made the process too hard.

- The following questions will arise: What is the public source? How accurate is the public source? In what context does the information provided by the public source apply to the company in question?

- Information sources are dynamic. There needs to be a constant/stable source of information pertaining to the financial statements.

If the FASB were to exclude certain information from the financial statements, do you believe this would raise questions regarding the boundaries of financial statements and what represents a complete and relevant set of financial information? N = 292

Investors cite concerns (see Figure 6) about the need for comprehensiveness, the dynamic nature of information sources, the definition of a complete set of financial statements, and the cost to investors of collecting such information as their major reasons for disagreeing with the exclusion of such information from the footnotes to the financial statements.

71% Concerned over Completeness and Relevance of Financial Statements

Figure 6

No Such Thing as Too Much Useful Information

Sophisticated investors who are capable of analyzing high volumes of data are not concerned with volume. Furthermore, we contend that investors cannot be overloaded with too much information if it is useful information. Useful information provides investors with greater transparency into their holdings and ultimately reduces the cost of capital, as we illustrate from the research cited in Appendix C to the “Investor Perspectives Report.”

Information overload or useless information may come from various sources, such as redundant, boilerplate, and overly condensed information. We support eliminating redundant information—that is, information that is repeated more than once. Eliminating boilerplate and overly condensed information—as has been proposed by some in the case of, for example, the significant accounting policies note—is not necessarily the right answer. It does not automatically translate into greater efficiency,
especially for investors. Instead, standard setters should work to establish requirements that ensure that the information is not boilerplate in nature, is entity specific, and is sufficiently disaggregated to be meaningful.

Disclosures need to truly explain the economic substance of transactions or events. Accordingly, we not only disagree with recent arguments for a reduction in disclosure volume, but we also maintain that to provide investors with the transparency they require, disclosures should, if necessary, go beyond the requirements in the standards. No list of disclosure requirements can comprehensively cover all transactions and events, and disclosure requirements generally lag new types of structures, instruments, and transactions.

**Volume: Not an Indicator of Completeness**

Many preparers cite the voluminous and ever-growing nature of annual reports and, positing that these materials must be burdensome for users to read, fail to consider whether the information they provide is complete and transparent.

**V. MATERIALITY: WHERE IS ALL THE IMMATERIAL INFORMATION?**

There has been much discussion and commentary regarding materiality—its definition and the perception that financial statements are full of immaterial clutter that obscures key messages. As discussed in Section 7 of the "Investor Perspectives Report," those maintaining this view encourage a continuing debate about what materiality means from a disclosure perspective, enhancing the use of materiality in financial disclosures, and deleting disclosures that do not contain material information.

**Materiality: A New Concept?**

The application of materiality to disclosure requirements is not a new concept. Materiality has long been applied to financial disclosures by both preparers and auditors. In the materiality spectrum, certain items are clearly material and others are clearly immaterial. A large grey area exits, however, where significant judgment needs to be applied when determining necessary disclosures. And the decision-useful information in this grey area should not be omitted from the footnotes.

**Perception vs. Reality: Research Needed to Demonstrate Increase in Immature Disclosures**

Many generalized claims have been made of immaterial disclosures being included in financial statements and the need to curtail such information. Specific research is needed, however, to identify examples of the inclusion of immaterial information before the conclusion can be drawn that extensive amounts of immaterial information is being included in financial statements and obscuring their usefulness. Research and examples specifically identifying the inclusion of immaterial information and the basis for its inclusion, in order to identify and address the root causes of this practice, are necessary. Many investors find that the more significant issue is the inclusion of boilerplate disclosures rather than immaterial information.

**Investor View: No Obvious Inclusion of Immature Information**

If the inclusion of extensive amounts of immaterial information in financial statements were obvious, we expect investors would find the impact of the enhanced use of materiality on disclosures clear and would call for the deletion of immaterial disclosures. The survey results shown in Figure 7 indicate, however, that 76% of respondents either find it difficult to discern what the impact of the enhanced use of materiality would be or do not think the impact would be significant. This finding suggests that a large majority of respondents do not currently observe extensive amounts of obviously immaterial information.
Which of the following statements most accurately describes your view regarding enhanced use of materiality in financial reporting disclosures as well as the deletion of disclosures that do not contain material information?

N = 301
Align Definitions of Materiality, Focus on Investor Perspectives, and Disclose Materiality Thresholds

A discussion of materiality—specifically as it relates to disclosures—needs to consider that materiality judgments are made by heterogeneous groups (i.e., preparers, auditors, and users) who are likely to have dissimilar views on materiality thresholds. Research demonstrates that, in general, users have lower materiality thresholds. An alignment of the definitions of materiality in the different pieces of accounting, audit, and regulatory literature, therefore, would be beneficial. We believe that investor perspectives should be central to this definition. Disclosure should also be made of the judgments about materiality made by preparers and auditors. A previous survey we conducted on this issue found that 82% of investors (see Figure 8) believe auditors should disclose their materiality thresholds in the audit report. Investors want to understand the materiality thresholds used by preparers. We, therefore, recommend disclosure of these thresholds in an accounting policy note. Such disclosure would provide transparency to users and assist them in assessing the information presented in the financial statements.

82% Say Disclose Auditor Assessment of Materiality

Figure 8

Representative investor quotes include the following:

- This will help the user understand what level of tolerable error to allow for analysis of the income statement and balance sheet. Importantly, it should also be disclosed whether one materiality level has been applied across the income statement and balance sheet or whether there are differences.

- I would consider the materiality definition one of the most important matters, esp. in light of cases like HealthSouth.

- This is a key issue. GAAP calls upon management to determine materiality. The auditors then provide judgment about management’s determination. Managers need to make materiality hurdles clear, and investors need to know what the auditor thinks.

Concluding Thoughts on Materiality

A perception has emerged among preparers and auditors that financial statements are filled with immaterial information, but investors surveyed don’t find an obvious overabundance of immaterial information. This disconnect in materiality assessments probably stems from a lack of communication about the materiality measures and thresholds used by corporate managers and auditors. Without greater communication of materiality measures and thresholds, the inability of users to provide feedback regarding materiality and its impact on their decision making will persist and the debate about immaterial information being included in financial statements is likely to continue.
VI. COMPLEXITY: A DISCLOSURE DRIVER, NOT A RESULT OF DISCLOSURES

Some suggest that increased disclosure volume has created complexity in financial reporting. We note in Section 6 of the "Investor Perspectives Report," however, that our experience with investors suggests that volume is not synonymous with complexity.

We see three key sources of complexity:

1) complex businesses and transactions;

2) disclosures that do not meet disclosure objectives that result in providing the information required to understand items recognized and measured in the financial statements; and

3) accounting standards that do not clearly communicate the underlying economics of transactions or that use disclosures to substitute for appropriate recognition, measurement, or presentation.

Increased complexity in businesses, structures, and transactions has driven the need for greater and more robust disclosure requirements. Consequently, recently adopted disclosure requirements tend to be in the most complex topical areas, such as derivative instruments and hedging activities. To achieve greater transparency, new disclosure requirements were necessary to explain complex instruments, transactions, and measurements to the readers of financial statements.

Increased disclosure complexity as a result of increasingly global and complex businesses and business environments is something investors will have to adapt to. Inadequate communication and inadequate accounting standards, however, can compound complexity. Increasingly complex activities and transactions need to be clearly communicated and understood by investors; otherwise, investors will be impeded in their ability to understand the performance of a company, leading to suboptimal allocation of capital.

CFA Institute Survey: Investor Views on Disclosure Framework Objective

Members were asked how they saw the disclosure framework being integrated with current disclosures and what its objective should be. Key findings related to the disclosure framework are articulated in Section 4 of the "Investor Perspectives Report" and summarized here.

Figure 9 illustrates the following:

- 58% of respondents supported the development of a disclosure framework to guide decision making;

- 85% supported the retention of specific disclosure requirements contained within the individual accounting standards.
Which of the following best describes how, if at all, you would improve financial reporting disclosure information?

N = 323

Disclosure Framework with Specific Disclosure Requirements:
Develop a disclosure framework to guide decision making, but also provide specific disclosure requirements by accounting standard.

Specific Disclosure Requirements with Emphasis of Matters:
Maintain current process with specific disclosure requirements by accounting standard, and require management to emphasize matters of particular relevance in a given reporting period.

Disclosure Framework without Specific Disclosure Requirements:
Develop a disclosure framework to guide decision making with no specific disclosure requirements by accounting standard. Management is to make specific disclosure decisions.

Reduced Volume:
Reduce the volume of financial disclosures.

No Improvement Needed

Other
One of the most radical recommendations that has been made is to develop a disclosure framework that articulates the principal disclosure requirements and have it replace the specific disclosure requirements within the individual standards. Consistent with the results in Figure 9, Figure 10 illustrates that a majority (65%) of respondents believe that the disclosure framework should complement, not replace, specific disclosure requirements.

**Disclosure Framework: Complement, Not Replace, Specific Requirements**

**Figure 10**

<table>
<thead>
<tr>
<th>Complement</th>
<th>Replace</th>
<th>Neither</th>
</tr>
</thead>
<tbody>
<tr>
<td>33%</td>
<td>2%</td>
<td>65%</td>
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*When developed, do you believe the disclosure framework should complement or replace the specific disclosures contained within the individual standards? N = 220*

Investor quotes from the survey illustrate the responses:

- *Specific disclosure requirements in the standards should be maintained to help ensure disclosure consistency across companies for key standards.*

- *The framework should be more generic and explain the objectives and reasons. The individual standards should identify the specific details that each jurisdiction’s standard setters deem necessary to meet the overarching objectives contained in the disclosure framework.*
The Disclosure Framework Objective: Focusing on the Priorities of Those for Whom Financial Statements Are Prepared

The 2012 Disclosure Survey results reveal that, although investors give a higher priority to other efforts than to the establishment of a disclosure framework, there is nonetheless support for a disclosure framework primarily designed to guide disclosures and emphasize matters of importance. Figure 11 illustrates what members believe the primary objective of the disclosure framework project should be.

Primary Objective of Disclosure Framework: Increase Effectiveness

In your opinion, the primary objective of the disclosure framework project should be to...?  N = 320

- **Increase in effectiveness.** A majority (63%) of respondents indicated that the primary objective should be to increase the effectiveness of disclosures.
- **Better integration of disclosure information.** A significant minority (33%) believe that disclosures could be made more effective by better integrating disclosure information found in the various parts of the annual report.

In aggregate, 96% of respondents believe that more effective and integrated disclosures should be the focus of the disclosure framework.
VIII. RECOMMENDATIONS: ENHANCING FINANCIAL REPORTING AND DISCLOSURE EFFECTIVENESS

Investor views on financial reporting and disclosure recommendations should be considered in the context of factors investors perceive as affecting the current financial reporting environment. The 2012 Disclosure Survey and our outreach to investors show that the most effective manner by which to enhance transparency would be for standard setters to prioritize certain financial reporting improvements ahead of the establishment of a disclosure framework. Exhibit 1 provides a summary of the context and recommendations that are described in detail in Section 8 of the “Investor Perspectives Report.” The following text explains their importance to investors.

Financial Statement Presentation

Investors believe improved financial statement presentation is a key element to improving financial reporting because poor financial statement presentation limits transparency. Furthermore, disclosures lose effectiveness when the financial statements, the foundation that disclosures are meant to complement, are not effective or when disclosures are used to compensate for poor presentation. Therefore, we make recommendations (1–4) in Exhibit 1 to enhance financial statement presentation.

Communication and Presentational Enhancements

Our survey reveals that investors and preparers can find common ground in making enhancements in communication style and presentational changes to make information more digestible and effective in communicating the company’s results. To this end, we provide recommendations (5–10) of this nature.

Most Troublesome Disclosures

The most challenging aspects of effective disclosures reside in communicating the judgments and estimates made in preparing the financial statements, providing a clear and complete picture of economic assets and obligations not included in the financial statements, and conveying the risks associated with the business. The 2008 financial crisis highlighted disclosures that our previous surveys, as set forth in Appendix B of the full report, had identified as most troublesome for investors. Furthermore, because disclosure requirements will always lag the development of business and economic issues, it is essential that preparers and auditors go beyond required disclosures to provide investors with a complete understanding of the underlying economic effects of transactions and account balances. To this end, we reiterate the importance of improving disclosures in the problematic areas before—or perhaps as part of—the development of a disclosure framework, and we make recommendations 11–17.

Key Considerations for Standard Setters and Regulators

As Exhibit 1 illustrates, we have addressed matters for consideration for standards setters in any decision-making process to improve disclosures. Recommendations 18–21 deal with issues that are important for standard setters to consider: materiality, technology, effective cost–benefit analyses, and the evaluation of underlying behavioral elements that have led to disclosure problems.

Disclosure Framework

We support the development of a disclosure framework, but investors believe other financial reporting reforms should have a higher priority with standard setters and regulators. The recommendations discussed so far are elements to be incorporated in any disclosure framework. We also recommend specific elements (22–27) for consideration in the development of a disclosure framework.
## Factors Impacting Investors Views on Current Financial Reporting and Disclosure Environment

<table>
<thead>
<tr>
<th>Category</th>
<th>Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Crisis/Great Recession</td>
<td>Lack of Transparency » Lack of Investor Trust » Lack of Investment</td>
</tr>
<tr>
<td>Technology</td>
<td>The Irreversible Trend towards Greater Connectivity and Data in Financial Reporting</td>
</tr>
<tr>
<td>Existing Accounting Model</td>
<td>Providing Decision-Useful Information in the New Economy?</td>
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<td>Measurement</td>
<td>Resolving Measurement and the Disclosures Which Make Measurements Meaningful</td>
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## Recommendations

<table>
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<tr>
<th>Category</th>
<th>Considerations</th>
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| Financial Statement Presentation        | 1. Disaggregation  
2. Direct Method Cash Flow Statement  
3. Cohesiveness  
4. Roll-Forwards of Key Balance Sheet Account |
| Communication and Presentational       | 5. Integration  
6. Entity-Specific Information  
7. Emphasizing Matters of Importance  
8. Organizing and Layering Information  
9. Simple Language  
10. Tables and Charts |
| and Presentational Enhancements        | 11. Estimates, Judgments, and Choices  
12. Risks  
13. Off-Balance-Sheet Items  
14. Commitments and Contingencies  
15. Intangible Assets  
16. Going Concern Issues  
17. Go Beyond Requirements, If Necessary |
| Most Troublesome Disclosures           | 18. Materiality  
19. Technology  
20. Costs and Benefits  
21. Behavioral Elements |
| Considerations to Incorporate in Decisions to Improve | 22. Focus on Equity Investors  
23. Include Disclosure Objectives  
24. Maintain Specific Disclosure Standards  
25. Disclosures Should Be a Focus, Not Afterthought, in Development of Standards  
26. Comprehensive Information Source  
27. Applicability (Entities and Reporting Periods) |