Concurrent Session: The Future of Financial Reporting

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Moderator:
George Yungmann, SVP-Financial Standards, NAREIT

Panelists:
Russell Golden, Chair, Financial Accounting Standards Board
Wesley Bricker, Deputy Chief Accountant, U.S. Securities and Exchange Commission

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Compendium of significant accounting and reporting issues

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Summary

Representatives of the Securities and Exchange Commission (SEC or Commission), the Financial Accounting Standards Board (FASB or Board) and the International Accounting Standards Board (IASB) (collectively, the Boards) and the Public Company Accounting Oversight Board (PCAOB) shared their views on various accounting, financial reporting and auditing issues at the annual AICPA National Conference on Current SEC and PCAOB Developments (Conference) last week in Washington, DC.

Highlights included:

Internal control over financial reporting — SEC and PCAOB officials emphasized the importance of strong internal controls throughout the Conference. They observed that recent PCAOB inspection findings on internal control over financial reporting (ICFR) may indicate deficiencies in the design of management's controls, particularly the documentation of key management review controls, and said auditors must take a risk-based approach when auditing ICFR. They said auditors must discuss with management and audit committees their expectations about the extent of documentation management needs to support the effectiveness of key controls, which should be commensurate with the associated risk.

New revenue recognition standards — Representatives of the SEC, the FASB and the IASB discussed efforts to implement the new revenue recognition standards the Boards jointly developed. The SEC staff members stressed the objectives of achieving consistent application of the standards for similar fact patterns and resolving significant implementation issues that could result in diversity in practice when companies adopt the standards. The SEC staff also said it expects disclosures about the effects of the new revenue standards to be more robust as their effective date approaches.

EY

Building a better working world

Disclosure effectiveness, including non-GAAP financial measures — Representatives of the SEC and the FASB provided updates on their disclosure effectiveness initiatives. The SEC representatives said they expect additional rulemaking in 2016 related to Regulations S-X and S-K, as well as improved search functionality for filings on the SEC's website. FASB representatives provided an update on the Board's disclosure framework project and its focus on material disclosures. SEC representatives said they were encouraged by recent efforts by companies to make voluntary improvements to their disclosures but highlighted several focus areas where they expect more meaningful disclosures. For example, they said the use and disclosure of non-GAAP financial measures requires close attention.

Segment reporting — SEC and PCAOB representatives said that segment reporting continues to be a critical focus area because investors continue to identify it as the most important disclosure area in SEC filings. They are focusing on whether companies are appropriately identifying and aggregating operating segments, as well as the design and operation of internal controls over these judgments.

Remarks of senior representatives

Remarks by Mary Jo White, SEC Chair

SEC Chair Mary Jo White highlighted the importance of reporting reliable financial information so that investors can make informed decisions. She talked about the shared responsibility of preparers, auditors, audit committees, standard setters and regulators for reliable financial reporting to investors and the vital role each plays in making sure that the US capital markets remain "the safest and strongest in the world."

> '… ICFR must remain the strong bulwark of reliable financial reporting that it has become.'
>
> — Mary Jo White, SEC Chair

Internal control over financial reporting

Chair White observed that preparers often make difficult judgments to meet the objectives of US GAAP or IFRS (e.g., revenue recognition, impairment, fair value) and said that reliable financial reporting depends on accounting staff and internal auditors challenging management's conclusions if they have questions about transactions, judgments and risk areas.

Chair White also said that management's ability to fulfill its financial reporting responsibilities depends on effective ICFR. She noted that there is still a debate about the extent of testing and related documentation that companies and auditors are required to perform related to the assessment of ICFR and said the SEC staff is monitoring discussions PCAOB officials are having with companies and auditors about these issues. She encouraged preparers, auditors and regulators to continue the dialogue to address any challenges in the operation and assessment of ICFR but said ICFR must remain "the strong bulwark of reliable financial reporting that it has become."

Non-GAAP measures

Chair White observed that non-GAAP financial measures are used extensively by companies and analysts but can be a source of confusion. Chair White said that the use of non-GAAP measures deserves close attention to make sure that the rules are being followed and to ask whether the rules are sufficient. She asked preparers to carefully consider the following questions when they use such measures:

- Why is the non-GAAP measure being used and how does it provide investors with useful information?
- Are any non-GAAP measures being given greater prominence than the GAAP measures?
- Is the explanation of the non-GAAP measure and its usefulness to investors, accurate and complete rather than boilerplate?
- Are there appropriate controls over the calculation of the non-GAAP measure?

How we see it

Chair White's comments suggest that the SEC is closely monitoring the expanding use of non-GAAP measures. Registrants should ensure that their non-GAAP measures are transparent, balanced and fully comply with the SEC's requirements.

Gatekeepers for high-quality audits

Chair White talked about the critical role of external audits performed by independent, knowledgeable and skeptical auditors in maintaining the strength of financial reporting. She said the PCAOB's inspection program and enhancements the PCAOB has made to its auditing standards have improved audit quality. However, Chair White expressed concern that PCAOB inspections still find significant deficiencies in various areas and that the SEC has had to bring enforcement actions against audit firms for missing or ignoring red flags.

Chair White expressed concerns about the increasing workload of some audit committees and questioned whether directors who serve on multiple boards and audit committees can effectively discharge their responsibilities. She said that only people who have the time, commitment and relevant experience should be selected to serve on audit committees. She said that audit committees of every public company should be able to properly oversee the auditors and adequately review how management is designing and implementing ICFR and how non-GAAP measures are being used. She noted that the SEC has issued a concept release on possible revisions to audit committee disclosures and said the audit committee report should evolve to meet the needs and expectations of investors.

Standard setters and regulators

Chair White said the FASB needs to preserve its independence and that accounting standards must provide objective, accurate and credible information that is useful for investor decisions. She commended the FASB and the IASB for working jointly in several areas to develop converged, high-quality globally accepted accounting standards (e.g., revenue recognition, business combinations, fair value measurements), even though certain priority projects did not result in completely converged guidance.

She also said that the SEC staff has developed a recommendation for the Commission's consideration on the possibility of allowing US issuers to voluntarily disclose supplemental IFRS information and that the staff will be discussing it with the Commissioners to help them determine a path forward. Chair White further added that she believes "it is important for the Commission, as a Commission, to make a further statement about its general views on the goal of a single set of high-quality global accounting standards."

Chair White observed that the SEC has seen "concrete progress" by companies in making their disclosures clearer and more understandable. However, she said that there is more work to be done. She said that while it may be beneficial to reduce the volume and complexity of disclosures to help investors focus on important matters, there are certain areas (e.g., foreign income taxes) where more transparency would be beneficial. She talked about the status of the SEC's disclosure effectiveness initiative and its request for comment on Regulation S-X requirements. She said that she expects the SEC to issue a release on Regulation S-K in 2016, as well as other changes related to financial statement disclosures and improvements to the presentation of filing information and search tools on the SEC's website (i.e., EDGAR).

Chair White also noted that one of the tools to ensure high-quality financial reporting is a strong enforcement program. She discussed several recent cases in which auditors and other gatekeepers did not meet requirements. She also noted that financial reporting will continue to be a high-priority area for the SEC's enforcement program.

Remarks by James Schnurr, Chief Accountant

ICFR and enforcement actions

Mr. Schnurr said management's ability to fulfill its financial reporting responsibilities depends on the effective design and operation of ICFR. He noted that the PCAOB continues to issue frequent inspection findings related to ICFR, which may reflect not only inadequate audit execution but also deficiencies in management's controls and assessments. He encouraged auditors, management and audit committees to have a robust discussion about the design and assessment of ICFR.

He also said that the SEC's Enforcement Division has focused on internal control matters and the role of gatekeepers, including audit firms and audit committee members. He highlighted recent enforcement actions brought against audit firms for dismissing red flags and failing to evaluate contrary evidence and exercise professional skepticism.

IFRS reporting by US registrants

As mentioned by Chair White, Mr. Schnurr said the SEC staff will soon discuss its recommendation with the Commissioners to allow US issuers to voluntarily disclose IFRS information as a supplement to their US GAAP financial statements. The SEC staff's recommendation would permit companies to voluntarily provide IFRS information without it being considered non-GAAP information subject to additional disclosures, including reconciliation to US GAAP.

The Commission will soon consider the SEC staff's recommendation to allow US issuers to voluntarily provide supplemental IFRS information.

In response to a question, Mr. Schnurr said that he believes there will be market demand for voluntary IFRS disclosures by certain US issuers, particularly if they have foreign peers that adopt new IFRS standards that are not converged with US GAAP.

In the near term, Mr. Schnurr emphasized the importance of continued convergence efforts in order to further the objective of a single set of a high-quality global accounting standards.

Disclosure effectiveness

Mr. Schnurr said that companies must have appropriate processes and internal controls to apply judgment about financial statement disclosures. He observed that these judgments might result in eliminating immaterial disclosures or adding disclosures beyond the specific requirements to avoid misleading investors. The process of making such judgments should include coordination between management and the audit committee as well as consideration of the perspective of a "reasonable investor." Mr. Schnurr also emphasized the need for registrants to reevaluate whether existing disclosures continue to be relevant.

As part of the SEC's disclosure effectiveness initiatives, Mr. Schnurr shared that the staff expects to coordinate with the FASB to reduce duplication in the SEC and FASB disclosure requirements in addition to making other recommendations to the Commission.

Mr. Schnurr supported the recent efforts by the FASB to develop a disclosure framework that emphasizes principles and materiality when communicating information to users rather than a checklist of required disclosures.

Auditor independence

Mr. Schnurr noted that the staff is focused on the growing consulting practices of accounting firms. He said that consulting practices may benefit accounting firms by fostering specialized skill sets and driving profits that can be invested in improving audit quality but said this trend may raise independence questions when there are not appropriate safeguards to mitigate "scope creep" in consulting engagements.

Audit committee oversight

Mr. Schnurr observed that many audit committees have assumed responsibilities beyond regulatory requirements, such as the oversight of cybersecurity risks, emerging technologies and other compliance risks. He suggested that audit committees may need to "get back to basics" in their oversight of financial reporting, including:

- The appointment, compensation and oversight of auditors
- Preparation and disclosure of the audit committee charter
- Audit committee reporting to shareholders

He stressed the need for audit committees to establish a culture of compliance, ask probing questions about management's significant judgments and estimates and require follow-up on corrective actions when necessary. He also said that the selection of the independent auditor should be based principally on audit quality not the audit fee. He encouraged audit committee members to consider the PCAOB's concept release on audit quality indicators, which can be used to help evaluate audit quality even without further PCAOB action.

PCAOB standard-setting activities

Mr. Schnurr commended the PCAOB for efforts to improve its standard-setting process, which included engaging an external consultant to review the process. While he noted that the PCAOB plans to adopt a final transparency rule and is moving ahead with its auditor reporting project, he emphasized the importance of finalizing auditor performance standards as the most effective way to improve audit quality.

Remarks by Russell Golden, Chairman of the FASB

FASB Chairman Russell Golden echoed SEC Chair White's remarks on the importance of maintaining independence from the influence of politics and special interests in setting financial accounting and reporting standards. For many FASB projects (e.g., impairment of financial instruments, leases, materiality), stakeholders and, in some cases, members of the Board, have expressed conflicting points of view. Mr. Golden said that it is the Board's job to sort through these views and to set standards that accurately reflect economic transactions and provide the most useful information to users of financial statements.

Mr. Golden commented on the ongoing implementation efforts for the revenue recognition standard and what has been learned during that process to prepare for the implementation of future standards. He also discussed the status of several other active projects and briefly discussed the future direction of the FASB's agenda.

Revenue recognition standard

The FASB and the IASB formed a transition resource group (TRG) to help manage implementation issues for the new revenue recognition standard in an effort to limit diversity in how preparers interpret the standard prior to its effective date. Mr. Golden indicated that this was a successful initiative and has helped the Boards promote global comparability in revenue. He said 98% of the 87 implementation questions raised by constituents have been discussed by the TRG or resolved with the FASB staff. Although most of the issues discussed by the TRG did not lead to additional standard-setting, the results of those discussions help to educate stakeholders about the new standard. The FASB also has issued three proposals based on feedback from the TRG. Mr. Golden said that the practical expedients and other proposals will reduce the cost and complexity of applying the standard without significantly changing the quality of the information reported to users of financial statements.

Impairment of financial instruments

Mr. Golden said that the Board intends to apply the lessons learned in implementing the revenue recognition standard to the implementation of the upcoming standard on the impairment of financial instruments. As a result, a TRG has been formed before the standard is issued to identify any significant issues requiring the FASB's attention.

One of the major issues that TRG is facing involves misconceptions about what the standard will require. Mr. Golden addressed and dispelled each of the following common misconceptions related to the credit impairment standard:

- The new standard will require businesses to develop and install costly, complex new systems.
- Bank examiners will take a more conservative view than the standard requires.
- The credit crisis involved only large banks.
- The standard takes an unrealistic view of the economics of loan financing.

Other projects

Disclosure framework

The FASB's two materiality proposals in its disclosure framework project have received a lot of attention. The first would amend the definition of materiality in the Conceptual Framework to conform to the definition that is used by the SEC and PCAOB. Mr. Golden indicated that this proposal would not change the legal definition of materiality, as the FASB does not have this authority. Mr. Golden also clarified that the amended Concepts Statement would only apply to the Board's observation of materiality as part of its standard-setting process and would not apply to preparers and auditors.

The second Exposure Draft is intended to clarify the process that preparers follow in assessing the materiality of information in notes to financial statements. Mr. Golden indicated that this proposal would clarify what the Board understands to be the predominant current practice related to the assessment of materiality by preparers.

Leases

The FASB plans to issue its new leases standard in early 2016. Mr. Golden said that the Board is not planning to create a TRG for the leases standard, but will carefully monitor discussions with stakeholders during the implementation process and will be prepared to increase its education efforts if needed.

The new leases standard will require lessees to recognize most leases on their balance sheets. One of the major concerns the FASB heard was that additional liabilities would affect compliance with debt covenants. Mr. Golden stated that lenders have told the FASB that the addition of lease liabilities to a company's balance sheet will not alter a lender's view of the organization's financial position because most lenders currently adjust financial statements to recognize lease liabilities when making lending decisions. However, to help mitigate concerns, the FASB decided that most lease liabilities should be characterized as operating obligations in the financial statements rather than obligations that are equivalent to debt.

Future agenda

Mr. Golden said the FASB recently conducted a survey to identify future projects that should be considered a priority for the Board. The top five areas for improvement in financial reporting identified in the survey were (1) financial performance reporting, (2) cash flow classification, (3) pensions and other post-retirement benefits, (4) liabilities and equity and

(5) intangible assets. He also said that segment reporting was the top area of improvement identified by investors. Stakeholders will be given an opportunity to comment on a discussion paper that includes these and other potential FASB projects. The FASB plans to issue the discussion paper in early 2016.

Remarks of PCAOB Chairman James Doty

PCAOB Chairman James Doty observed that the PCAOB's overall responsibility is to serve investors by setting audit and professional standards, performing inspections of audits and firms' quality control systems and, when necessary, taking disciplinary actions against auditors who fail to comply with the standards. He stated that the PCAOB focuses auditors on their role as gatekeepers to the capital markets when they determine and report on whether a company's financial statements comply with the relevant financial reporting framework.

He said the PCAOB's work has resulted in the following three trends:

- Auditor conduct has changed.
- Audit quality has improved.
- The audit has gained credibility from stakeholders due to credible regulation.

Inspections update

Mr. Doty noted that, for firms that are committed to remediating deficiencies and identifying root causes, inspection findings have started to decline. He believes the PCAOB has established an interactive, fair and transparent inspection process. The PCAOB plans further engagement with preparers and audit committee members to educate and inform them about the inspection process and the results of inspections and help the PCAOB better understand the effects of its inspection process.

Mr. Doty spoke about the PCAOB's inspections in 46 foreign jurisdictions and expressed optimism that the European Commission's Adequacy Decision will be renewed in 2016. The PCAOB continues to have challenges reaching an agreement to perform inspections in China. In June, a pilot inspection program was approved by the China State Council, but Mr. Doty said it has been difficult to finalize the details of the program.

Auditor incentives

Mr. Doty stated that the PCAOB's programs both deter bad conduct and incentivize exemplary conduct. He said the PCAOB works to recognize the effects of incentives, both systemic and personal, and implement countermeasures for those that adversely affect audit quality.

Mr. Doty stated that research by the PCAOB's Center for Economic Analysis indicates there is a statistically significant increase in effort by the engagement partner and quality reviewer in the year following a deficiency being identified through inspections, without a statistically significant change in fees. The research also indicates that there is a statistically significant decrease in effort and increase in restatement rate following inspections in which no significant deficiencies were identified.

Mr. Doty also said audit committees that see their job as negotiating the lowest audit fee may not always be promoting audit quality. In his view, highly competent and strong audit committees promote auditor objectivity and independence from management.

Standard-setting projects

Mr. Doty said the PCAOB's standard-setting considers appropriate audit procedures as well as mechanisms that provide appropriate auditor incentives, with the overriding objective of enhancing the relevance and reliability of the audit. Mr. Doty highlighted the status of several ongoing projects and said the Board soon will adopt a final rule related to the disclosure of the engagement partner.

Maintaining public confidence

Mr. Doty said this is an exciting time to be in or entering the audit profession but noted that the profession faces the challenge of maintaining public confidence in the audit. He observed that auditors' value to the capital markets resides in their ability to provide an independent, objective and skeptical mindset when evaluating a company's financial statements.

Internal control over financial reporting

As discussed earlier, ICFR continues to be a source of significant PCAOB inspection findings. The SEC Chair and Chief Accountant stressed the importance of ICFR in providing high-quality financial information to investors and said the level of PCAOB inspection findings likely indicated problems with companies' controls.

In his remarks, the PCAOB Chair acknowledged that PCAOB inspections of audits of internal control had raised concerns among preparers about the extent of the auditor's assessment of management review controls, including the assessment of their precision and the level of documentation needed to support their effective operation. A panel comprised of representatives of the SEC, the PCAOB, large accounting firms and preparers discussed these and related matters:

- *Management review controls* — Panelists noted that not all management review controls are created equal. Representatives from the SEC and PCAOB said the Commission's guidance for management[1] and the PCAOB's Auditing Standard (AS) No. 5 are aligned with respect to the assessment of financial reporting risks and the selection of controls that adequately address those risks. They reinforced the importance of management and auditors having an appropriate understanding of the design of the management review control in order to assess whether it operates at a sufficient level of precision to address the financial statement risk(s) or whether lower level controls also need to be tested. SEC staff noted that in a number of higher-risk areas, it is unlikely that management review controls alone would be sufficient to address the risk, given the number of judgments required and the inputs needed to make them.

- *Population of controls* — During their outreach, the SEC and PCAOB noted that, in some cases, auditors and management were testing different controls to address certain financial reporting risks. Panelists noted that, in some cases, auditors may be testing lower-level controls while management may be relying on higher-level review controls. The panelists noted that management and the auditor may reach different conclusions about the precision of controls and said it is important that auditors and management communicate to make sure they understand the reasons for any differences. These discussions can help both parties understand the controls and potentially lead to improvements in the design of the controls or the control-testing approach. Discussing these differences also could minimize the risk of auditors and management reaching different conclusions on the effectiveness of the controls.

- *Evaluation and evidence of effectiveness of controls* — Mr. Schnurr and Brian Croteau, SEC Deputy Chief Accountant, stressed that the Commission's guidance for management requires documentation of how the design of a control addresses the relevant financial reporting risk as well as evidence to support that the control is operating effectively. Importantly, Mr. Croteau said the Commission's guidance requires more evidence of the operating effectiveness of controls in higher-risk areas. Mr. Croteau also noted that this principle is integral to the performance of an assessment using a risk-based approach, supports effective and consistent operation of the company's controls over time and is consistent with the auditor's requirements under AS 5.
- *Auditor's use of templates and checklists* — Panelists observed that auditors frequently use templates and checklists to facilitate ICFR documentation. Staff members from the SEC and PCAOB said these templates and checklists can help auditors consistently consider and document important elements of their procedures, particularly in higher-risk areas. However, the panelists agreed that templates and checklists should not be used as substitutes for auditor judgment and understanding, and they encouraged management and auditors to discuss any questions regarding the nature and purpose of the auditor's procedures.

In other remarks regarding material weaknesses in ICFR, Mr. Croteau reminded management and auditors that evaluating the severity of a control deficiency requires consideration of the "could factor," meaning whether it is reasonably possible that a material misstatement "could" occur and not be prevented or detected on a timely basis. That is, management and the auditor should not just consider whether a material misstatement occurred. Mr. Croteau also discussed the importance of considering whether changes to internal controls in conjunction with the adoption of a new accounting standard require disclosure as material change in ICFR in the relevant quarter under Item 308(c) of Regulation S-K.

How we see it

- We support the efforts by the SEC and PCAOB to encourage dialogue between financial statement preparers and auditors in response to the number of PCAOB inspection findings involving audits of ICFR.
- Management and auditors should work together early in the audit process to understand and agree on the level of documentation that should be retained by both parties for the audit of ICFR.

Accounting and independence matters

Segment reporting

Courtney Sachtleben, a staff member in the Office of the Chief Accountant (OCA), said that over the past year, OCA has been working closely with the Division of Corporation Finance and others, including the PCAOB, to emphasize the objectives and principles outlined in the standard on segment reporting. Ms. Sachtleben and other members of the SEC staff shared their observations related to the identification of operating segments, aggregation into reportable segments and ICFR.

EY resources

- *Financial reporting developments, Segment reporting* (SCORE No. BB0698)

Identification of operating segments

Accounting Standards Codification (ASC) 280 requires entities to identify operating segments in a manner consistent with the way management organizes the segments (i.e., management's approach). Ms. Sachtleben observed that, as business operations evolve, registrants should reassess their identification of operating segments, particularly after a change in organizational structure, key personnel changes or significant acquisitions and dispositions.

Ms. Sachtleben said that the periodic financial reporting package provided to the Chief Operating Decision Maker (CODM) and the registrant's organizational structure will often provide insight into how management has organized the company for purposes of making operating decisions and assessing performance. However, she cautioned that neither is determinative in the identification of operating segments and that a variety of information sources can enhance and corroborate this analysis, including information about the basis on which budgets and forecasts are prepared and how executive compensation is determined.

Ms. Sachtleben said that if applying the guidance in ASC 280 results in the identification of a single operating segment, a registrant should disclose that it allocates resources and assesses financial performance on a consolidated basis and explain the basis for that management approach. However, she said that it would seem counter to the objectives of segment reporting if the business description indicates the company is diversified across businesses or products but is not managed in a disaggregated way.

Nili Shah, a Deputy Chief Accountant in the SEC's Division of Corporation Finance, also discussed segment reporting in a panel with other members of the Division. Regarding the identification of operating segments, she emphasized the following points:

- When identifying the CODM, companies should focus on which person or group in the organization is making the key operating decisions and not necessarily the person who has the ultimate decision-making authority (e.g., CEO). ASC 280 contemplates that a company's Chief Operating Officer may be the CODM.
- When determining whether discrete financial information is available, a company shouldn't conclude that such information is not available simply because certain costs are shared and not allocated specifically to each component. She said this view would not be persuasive. Gross profit information provided to the CODM and used to assess performance and make resource allocation decisions could be considered discrete financial information.

Aggregation of operating segments

While the identification of operating segments follows a management approach, the determination of reportable segments considers both aggregation criteria and quantitative thresholds. The aggregation of operating segments is one of the more judgmental areas of the segment reporting literature. Two or more operating segments may be aggregated into a single reportable segment only when all the following criteria are met: (1) aggregation is consistent with the objectives and principles of ASC 280, (2) the segments have similar economic characteristics and (3) the segments are similar in each of the five criteria specified in the standard.

Ms. Sachtleben reminded registrants that the guidance on determining whether two operating segments are "similar" requires the evaluation to be made relative to the range of the company's business activities and the economic environment in which it operates. She added that it would be helpful to consider similarity from the perspective of a reasonable investor and that it is important to consider information such as industry reports and other analyses by users of the financial statements that may provide evidence of how a reasonable investor would analyze the company.

Ms. Sachtleben also reminded registrants that once they identify segments that require separate reporting, they need to consider additional guidance on combining any remaining segments. She said that in performing this analysis, registrants should consider what additional level of detail would be useful to the users of the financial statements consistent with the first criterion above. She noted that registrants also may want to consider whether their reportable segments facilitate a consistent description of the company in its annual report and other published information such as its earnings releases, investor presentations and financial information on its website.

Ms. Shah also highlighted aggregation of operating segments as an area of focus in the review of filings by the staff in the Division of Corporation Finance, and she emphasized the following points:

- When responding to SEC staff comments on segment disclosures, companies should discuss why aggregation is consistent with the objectives and basic principles of ASC 280 (i.e., how aggregation helps users better understand the company's performance and assess its prospects for future net cash flows).
- When evaluating economic similarity, registrants should understand that there are no bright lines and significant judgment is required. In addition, the types of metrics considered and the acceptable level of differences in those metrics among the segments being evaluated for aggregation may differ across industries.
- An expectation that operating segments will have similar economic characteristics (e.g., long-term average gross margins) in the future does not take precedence over the lack of similarity in current and past performance.
- The SEC staff has increased its focus on the qualitative criteria in ASC 280. She reminded registrants of the requirement to meet all of the aggregation criteria in ASC 280 and said that at times the staff has objected to aggregation even when the quantitative economic characteristics were considered similar.

Effective internal control over financial reporting supports the judgments required in segment reporting.

Internal control over financial reporting

Ms. Sachtleben highlighted that the guidance on segment reporting requires the application of reasonable judgment and that effective ICFR supports those judgments, including the determination of operating segments, aggregation and entity-wide disclosures. Input from, and interaction with, the CODM may be an important element in the design of effective ICFR, specifically how the CODM allocates resources and assesses performance. She said that documenting the design and effective operation of management's controls over these judgments is an integral part of management's support for the effectiveness of its ICFR and will be essential to the auditor's ability to evaluate these controls.

Other segment reporting discussions and considerations

Wesley Bricker, Deputy Chief Accountant, observed that segment reporting was ranked in the top three consultation areas in OCA during 2015. Mr. Bricker observed that some registrants have contended in their consultations, including on segment reporting, that they should not be required to apply a US GAAP standard because the result would be "competitively harmful" or "misleading." He noted that these arguments are troubling because they disregard the thoughtful balance taken by the accounting standard setters in crafting reporting standards that provide transparent, useful information to investors. He concluded that a better approach starts with identifying what information is useful to investors, as well as why and how that information can be appropriately reported.

Ms. Shah also mentioned that when the SEC staff has objected to a company's segment reporting conclusions, it generally has permitted the registrant to reflect changes to its segment disclosure in future filings. However, she cautioned that if goodwill is impaired as a result of a change in the registrant's reporting units, the SEC staff likely would require restatement of prior periods.

Finally, Helen Munter, Director of the PCAOB's Division of Registration and Inspections, said that PCAOB inspections in 2016 will include a focus on segment reporting, including the identification of the CODM, the identification and aggregation of operating segments, and the continued assessment of an issuer's ICFR related to segment reporting.

How we see it

Segment reporting continues to be a top focus area by the SEC staff. Entities should continue to reassess their segment reporting conclusions and evaluate whether internal controls are designed to make sure that the CODM, operating segments and reportable segments are appropriately identified in accordance with ASC 280. Management review controls often will be an important element of a registrant's internal control over segment reporting.

EY resources

- *Financial reporting developments, Share-based payment* (SCORE No. BB1172)

Effect of post-vesting restrictions on the measurement of share-based awards

ASC 718-10-30-10[3] clarifies that "a restriction that continues in effect after an entity has issued instruments to employees, such as the inability to transfer vested equity share options to third parties or the inability to sell vested shares for a period of time, is considered in estimating the fair value of the instruments at the grant date."

Barry Kanczuker, a member of the OCA staff, addressed the effect of post-vesting restrictions on the measurement of share-based payment awards and noted that market participant assumptions used in the fair value measurement of a restricted share may result in some discount relative to the fair value of a similar but unrestricted share. However, Mr. Kanczuker noted the SEC staff looks to ASC 718-10-55-5 to evaluate the appropriateness of any discount. It states that "if shares are traded in an active market, post-vesting restrictions may have little, if any, effect on the amount at which the shares being valued would be exchanged." He encouraged registrants to consult with the SEC staff if they believe their post-vesting restrictions would result in a significant discount being applied to the grant-date fair value of an award.

EY resources

- *To the Point, Potential alternative to develop discount rates used to measure defined benefit plan costs* (SCORE No. BB3053)

Discount rates used to measure the interest cost of defined benefit pension plans

The interest cost component of net periodic pension cost is the increase in the projected benefit obligation due to the passage of time at a rate equal to the assumed discount rate. Many companies use a weighted average discount rate, developed using a yield curve, to calculate the interest cost.

Ashley Wright, a member of the OCA staff, discussed a recent consultation on an alternative approach (a spot rate approach) to determine the discount rate used in the interest cost calculation. Under a spot rate approach, a company that determines its discount rate from a yield curve uses the individual spot rates along the yield curve that correspond with the timing of each future cash outflow for benefit payments to calculate interest cost. Ms. Wright stated that the use of individual discount rates results in a different amount of interest cost compared with the interest cost calculated using a weighted-average discount rate.

Ms. Wright indicated that the SEC staff would not object to a registrant that employs the yield curve approach changing from using a weighted average discount rate approach to a spot rate approach for measuring interest cost and accounting for this change as either a change in estimate or a change in estimate inseparable from a change in accounting principle.

However, Ms. Wright shared the following observations about companies that use a different method for measuring the pension benefit obligation (e.g., hypothetical bond matching methodology) and are considering changing to a yield curve methodology and the spot rate approach:

- A company's decision to select, or change the selection of, a particular methodology for determining the discount rate should align with the requirement to select the best rate(s) for which the obligation could be effectively settled.
- A change in the methodology used to determine the discount rate should be made only if alternative market information (i.e., source data) results in better information being used in measuring the pension benefit obligation.
- The selection of a best estimate is generally not made on the basis of materiality.
- Any change in the method used to calculate the best estimate of those rates should be made when a change in the facts and circumstances may warrant the use of a different method.
- A registrant may need to consider its arguments when it previously changed from a yield curve approach to a bond matching approach (if applicable).
- A change in the approach to calculate interest cost would not seem persuasive to change the basis for selecting a different source of market information (i.e., the approach to determining the discount rate(s)) used for measuring the pension benefit obligation.

The SEC staff said the examples in the accounting standard about discontinued operations do not establish bright lines or safe harbors.

How we see it

A registrant that believes it has facts and circumstances that would support a change from the bond matching approach to the yield curve approach, considering the points above, should discuss its fact pattern with the SEC staff.

Presentation of discontinued operations

The revised guidance in ASC 205-20 raises the threshold for reporting a discontinued operation by requiring that a component (or group of components) disposed of or classified as held for sale represent a strategic shift that has (or will have) a major effect on an entity's operations and financial results. Mr. Kanczuker discussed how ASC 205-20 allows for judgment to determine whether a disposal group meets the definition of a discontinued operation under the revised guidance.

He addressed concerns about which financial results should be considered in evaluating whether a disposal group is a discontinued operation. In his view, these metrics should be the primary metrics that are prominently presented in the financial statements and communicated to investors (e.g., revenue, net income) as well as other metrics that may be relevant from an investor's perspective, particularly when the company has used such measure(s) on a consistent basis for communicating operating and financial results. There is no single financial metric that is determinative of whether a disposal group meets the discontinued operations criteria. Instead, the totality of the evidence should be considered from the perspective of current, historical and forecast financial results.

EY resources

- *Financial reporting developments, Discontinued operations* (SCORE No. BB2878)

In Mr. Kanczuker's view, entities should consider both quantitative and qualitative factors when determining whether a disposal group represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. ASC 205-20 provides examples that include quantitative thresholds (e.g., 15% of total revenue, 20% of total assets) of what may constitute a strategic shift that has or will have a major effect on an entity's operations and financial results. However, Mr. Kanczuker indicated that the quantitative thresholds included in these examples are illustrative and do not establish bright lines or safe harbors. The staff member also noted that the less significance a disposal group has to the financial results, the more qualitative evidence is needed to support discontinued operations presentation (e.g., entities should consider how the disposal group and related qualitative factors were disclosed in previous filings).

EY resources

- *Financial reporting developments, Fair value measurement* (SCORE No. BB1462)

Fair value measurements

Kris Shirley, a member of the OCA staff, discussed several considerations for companies determining fair value measurements.

Identifying the principal or most advantageous market

A fair value measurement assumes the transaction to sell an asset or transfer a liability takes place in either the principal market or, in the absence of the principal market, the most advantageous market for the asset or liability. If an entity cannot transact in a market on the measurement date, that market may not constitute the principal or most advantageous market.

Mr. Shirley said that the company may need to consider whether the characteristics of its asset or liability being measured at fair value differ from the asset or liability that transacts in an observable market, as differences may prevent the company from accessing this market. This determination could lead to a different conclusion about whether the observable market is the principal or most advantageous market. For example, restrictions that may be unique to the entity's asset or liability that are not embedded in the asset or liability in the observable market may prevent an entity from accessing the particular price within the market. He also said there may be situations in which the market where the initial transaction occurred will not be the principal or most advantageous market.

Mr. Shirley noted that even when a market does not constitute the principal or most advantageous market, a company may still use observable prices from that market as one input into its fair value measurement. However, appropriate adjustments should be made for any differences in the characteristics of the company's particular asset or liability and those for which there is an observable price. Mr. Shirley provided an example of a company that measures a loan at fair value and on the measurement date looks to the securitization market for observable prices. The company would need to make appropriate adjustments to reflect the fact that its loan has not been securitized as of the measurement date.

Use of cost basis as fair value

Mr. Shirley observed that some companies use the initial cost basis of certain illiquid assets or liabilities as their fair value measurement for a period of time following the initial transaction. He noted that in determining fair value of an asset or liability, the transaction price may be a good starting point, but fair value under ASC 820 is an exit price at the measurement date under current market conditions and those conditions likely will be different from when the initial investment was made. This may be due to a number of factors, including changes in macroeconomic conditions (e.g., changes in interest rates), a change in market participants or a change in the expectation of cash flows.

Mr. Shirley said that companies will need to obtain evidence to support a conclusion that cost basis approximates fair value at the measurement date or why the fair value may not have changed materially from the initial cost basis. This may be supported through quantitative evidence, such as observable market pricing for the asset or liability or for comparable assets or liabilities with observable market prices, or qualitative evidence in certain cases.

ICFR for fair value measurements

Mr. Shirley also provided reminders about the importance of having a system of internal control over financial reporting related to fair value measurements, including those for illiquid assets or liabilities. The nature of these controls may differ based on the complexity of the estimate and whether the estimate was derived internally or by using a third-party service provider, among other factors.

Allowance for loan losses

Christopher Rickli, a member of the OCA staff, provided several reminders on management's responsibility under the SEC staff guidance in Staff Accounting Bulletin (SAB) Topic 6.L[4] for determining the allowance for loan losses (ALL).

Mr. Rickli said SAB Topic 6.L establishes expectations for management related to the development, documentation and application of a systematic methodology for determining the ALL. This includes an expectation that management will provide written documentation on certain decisions, strategies and processes for its ALL methodology. These processes should include effective internal controls designed to ensure use of relevant, reliable and sufficient data on which to base the ALL estimate. Mr. Rickli noted that these controls should not only include management review controls, but also transaction level controls in order to satisfy SAB Topic 6.L's expectations of data relevance and reliability.

When adjustments are made to the allowance that are intended to capture factors not already included in the entity's loss estimation model (e.g., changes in risk selection and underwriting standards, lending policies and certain economic trends and conditions), Mr. Rickli said that there is an expectation that management maintain sufficient, objective evidence to support the amount of the adjustments and explain why the adjustments are necessary. Also, management is expected to have an adequate understanding of the data currently being used in the ALL estimation model in order to be able to evaluate the necessity and the reasonableness of proposed adjustments.

Determining whether fees are a variable interest

Mr. Semesky discussed several considerations when determining whether a decision maker's fee is a variable interest when applying Accounting Standards Update (ASU) 2015-02, *Amendments to the Consolidation Analysis.*[5]

Three conditions must all be met to conclude that fees received by an entity's decision maker or service provider do not represent variable interests in that entity:

- The fees are compensation for services provided and are commensurate with the level of effort required to provide those services (i.e., commensurate).
- The service arrangement includes only terms, conditions or amounts that are customarily present in arrangements for similar services negotiated at arm's length (i.e., customary).
- The decision maker or service provider (and its related parties or de facto agents) does not hold other interests in the variable interest entity (VIE) that individually, or in the aggregate, would absorb more than an insignificant amount of the VIE's expected losses or receive more than an insignificant amount of the VIE's expected residual returns.[6]

EY resources

- *Financial reporting developments, Consolidation and the Variable Interest Model: Determination of a controlling financial interest (following the adoption of ASU 2015-02, Amendments to the Consolidation Analysis)* (SCORE No. BB3099)

Customary and commensurate

Mr. Semesky said that the determination of whether fees are commensurate often can be accomplished with a qualitative evaluation of whether an arrangement was negotiated on an arm's-length basis when the decision maker had no obligations other than to provide the services to the entity being evaluated for consolidation. He cautioned that this analysis requires a careful consideration of the services to be provided in relation to the fees.

On the evaluation of whether terms, conditions and amounts included in an arrangement are customary, Mr. Semesky said that this may be accomplished in ways such as benchmarking the key characteristics of the arrangement against other market participants' arrangements negotiated on an arm's-length basis or, in some instances, against other arm's-length arrangements entered into by the decision maker. Mr. Semesky emphasized that there are no bright lines in evaluating whether an arrangement is customary, and reasonable judgment is required in such an evaluation.

How we see it

The SEC staff member's observations are consistent with our view that determining whether a fee is commensurate and customary requires the use of professional judgment and a qualitative evaluation of the purpose and design of each entity and the terms and conditions of the fee arrangement. The presence of unrelated investors may be helpful in performing this evaluation, but is not determinative; all facts and circumstances should be considered.

Interests held by related parties

ASU 2015-02[7] states that, when an entity evaluates whether the fees paid to a decision maker or service provider are a variable interest, "any interest in an entity that is held by a related party of the decision maker or service provider should be considered in the analysis. Specifically, a decision maker or service provider should include its direct economic interests in the entity and its indirect economic interests in the entity held through related parties, considered on a proportionate basis … Indirect interests held through related parties that are under common control with the decision maker should be considered the equivalent of direct interests in their entirety." Questions have arisen about how a decision maker (e.g., manager) should apply this guidance when the decision maker does not have an ownership interest in the related party under common control (i.e., when the decision maker does not have an indirect interest).

Mr. Semesky highlighted an example in which an entity has four investors that are unrelated to one another and has a manager that is under common control with one of the investors. The manager has no direct or indirect interests in any of the investors or the entity other than through its fee, and it has the power to direct the activities of the entity that most significantly impact its economic performance.

Mr. Semesky said that in this example, if the manager's fee would otherwise not meet the criteria to be considered a variable interest (i.e., it was customary and commensurate), the fact that an investor under common control with the manager has a variable interest would not by itself cause the manager's fee to be considered a variable interest. However, Mr. Semesky cautioned that when a controlling party in a common control group designs an entity to separate power from economics to avoid consolidation in the separate company financial statements of a decision maker, OCA has viewed such separation to be non-substantive.

Additionally, Mr. Semesky concluded that once the manager determined that its fee is not a variable interest, it would not be required to consolidate the entity as a result of applying the related party tiebreaker test.

How we see it

The SEC staff member's observations on evaluating interests held by parties under common control provide much needed clarity to entities as they adopt the new consolidation standard. Absent the clarification, in many cases, the manager would have considered the interest of the party under common control as its own interest, which may have caused the fee to be considered a variable interest. While such a conclusion may not have resulted in consolidation of the entity by the manager, it would have resulted in further analysis by the manager and may have subjected the manager to additional disclosures.

EY resources

- *Technical Line, New Venezuelan currency regime — same accounting and reporting considerations* (SCORE No. BB2970)

Foreign exchange restrictions and evaluating control

Mr. Semesky noted that OCA has observed registrants deconsolidating subsidiaries in Venezuela. He reminded registrants of the need to reassess that conclusion continuously. If the conclusion to deconsolidate was based on foreign exchange restrictions and the severity of government-imposed controls, an improvement in exchangeability or loosening of government-imposed controls may result in the restoration of control and consolidation. He said that he would expect consistency in a registrant's judgments of whether it has lost control or regained control of a subsidiary, and that registrants should have internal controls over the assessment.

Further, Mr. Semesky cautioned that careful consideration should be given to whether a Venezuelan subsidiary would be considered a VIE, because power may no longer reside with the equity-at-risk holders. As a result, Mr. Semesky stated that registrants should clearly disclose their judgments on, and the financial reporting effect of, deconsolidation. They should also consider the required disclosures for interests in VIEs that are not consolidated.

How we see it

The conclusion to deconsolidate a Venezuelan operation (or to change the accounting for an investment from the equity method to the cost method) should be based on entity-specific facts and circumstances and will require significant judgment.

Accounting consultation activities and restatements

Mr. Bricker commented that OCA's primary consultation activities included revenue recognition, business combinations and identification and reporting of segments (which interestingly are not in the top three areas of restatement, he noted). For consultations that come through the Division of Corporation Finance, he cautioned registrants against benchmarking other registrants' disclosures or responses to SEC comment letters to establish their accounting policies without management doing the necessary work to determine and support their own policies.

Mr. Bricker provided observations regarding the top three restatement areas, which relate to debt/equity accounting, statement of cash flows classification and income tax accounting. Because the guidance in these areas can be difficult to apply, Mr. Bricker reminded companies and audit committees about the need to continually assess whether they have resources with sufficient training and competence available to support high-quality financial reporting and make sure proper controls and processes exist.

Auditor independence matters

Michael Husich, Senior Associate Chief Accountant in OCA, and Mr. Croteau emphasized that compliance with the auditor independence rules is the shared responsibility of auditors, management and the audit committee. When non-audit services are provided, the SEC staff members encouraged management and the audit committee to have policies and procedures for ongoing monitoring of the services provided. Mr. Croteau further highlighted the risk of "scope creep" that could impair auditor independence, result in unplanned changes in auditors and the potential need for re-audits, which can be costly for companies and could adversely affect capital-raising activities.

Mr. Husich discussed prohibited services related to bookkeeping services and financial statement preparation for broker-dealer audit clients, which have led to recent SEC and PCAOB enforcement actions. He emphasized that prohibitions on these services are not intended to discourage two-way communications or further engagement between the auditor and its audit client, as long as management takes ultimate responsibility for the accounting conclusions and does not rely on the audit firm to design or implement the controls. For example, SEC staff noted that audit firms may provide guidance about the proper application of the revenue recognition standard, including important factors to be considered in making judgments important to the accounting process. However, SEC staff cautioned that audit firms should always be mindful to not put themselves in the position of auditing their own work or of acting as management by, for example, having direct involvement in the development of specific revenue recognition policies.

Financial reporting and disclosure matters

SEC staff from the Division of Corporation Finance discussed specific reporting matters it commonly focuses on in filing reviews and in which disclosures could be more effective.

Non-GAAP financial measures

Keith Higgins, Director of the SEC's Division of Corporation Finance, reiterated the SEC's focus on non-GAAP measures, which Chair White highlighted in her remarks. Cicely LaMothe, Associate Director in the Division of Corporation Finance, outlined the following general themes related to the staff's review of non-GAAP measures:

- **Prominence** — Non-GAAP measures should not be presented more prominently than the comparable GAAP measures.
- **Compliance with securities rules** — Depending on the presentation, non-GAAP measures must comply with the disclosure and presentation requirements of Regulation G or Item 10(e) of Regulation S-K. In particular, registrants must clearly disclose how the non-GAAP measures are useful to investors without using boilerplate language.
- **Labeling** — Registrants should clearly label non-GAAP measures and related adjustments so they are understandable and not misleading. For example, registrants sometimes identify non-GAAP measures or adjustments using terms that are used in US GAAP, or they use a non-GAAP measure that they define differently than other companies. Instead, registrants should accurately describe the non-GAAP measures in their disclosures to minimize confusion and foster comparability.
- **Consistency** — As registrants make changes to their non-GAAP measures (or GAAP measures used as a base for non-GAAP), appropriate disclosures should be made to describe how these changes affect comparability with the measure previously disclosed.

SEC staff members also made the following points about specific non-GAAP measures. They said adjustments to pension costs should provide enough information for a user to understand the nature of the adjustments made. For example, a label such as "pension adjustment" does not provide enough information. In addition, describing the adjustment as non-cash is inappropriate because pensions are generally cash settled. They also said registrants should provide robust disclosures when eliminating the actuarial gain or loss on pension assets to help users understand the ultimate pension cost reflected in the non-GAAP measure as well as how the expected rate of return reflected in the non-GAAP measure compares with the actual rate of return.

The SEC staff has recently allowed registrants to disclose a "system-wide sales" non-GAAP measure with appropriate disclosures, but the staff has objected to measures that eliminate the effect of commodity price volatility with a "normalized market price." Panelists discussing MD&A said constant currency is a useful non-GAAP measure because it describes one of the three factors affecting changes in revenue (i.e., price, quantity, the effect of currency changes) and referred the audience to the Compliance and Disclosure Interpretations (C&DI) issued by the staff in 2010 stating that a reconciliation was not necessary for such a measure.[8]

Income tax disclosures

Ms. Shah said that registrants should continue to focus on the quality and clarity of key income tax disclosures within MD&A, including those related to income tax rate reconciliations and indefinitely reinvested earnings. Consistent with prior years, the SEC staff has requested that companies disclose the amount of large cash balances held overseas when the indefinite reinvestment assertion is made. Ms. Shah discussed the following ways income tax disclosures could be improved:

- **Discussing the items and changes in the effective income tax rate reconciliation** — Using the income tax rate reconciliation as a starting point for the narrative income tax disclosures in MD&A and tying MD&A disclosures directly to the rate reconciliation helps reduce confusion about where the items discussed flow through the reconciliation. The narrative disclosures should include detailed discussion of what drove the change in the effective tax rate, and the overall susceptibility of the rate to changes. This helps users determine whether the past rate is indicative of the future rate.

- **Clarity and transparency** — The SEC staff may question registrants if there are material items in the rate reconciliations that are not clearly identified and discussed in MD&A. Also, reconciling items affected by multiple factors should be clarified and disaggregated so that users can understand factors driving the reconciling item. For example, reconciling items labelled "foreign rate differential" should be limited to only statutory tax rate differences and not include other differences within the foreign jurisdiction. As an example, the SEC staff suggested a multi-column reconciliation that separately presents the reconciling items and taxable income by material foreign jurisdictions in addition to domestically and on a consolidated basis.

Fair value disclosures

Craig Olinger, a Deputy Chief Accountant of the Division of Corporation Finance, said the adequacy of fair value disclosures required by ASC 820 continues to be an area of focus. Investors have said that disclosures that allow them to assess the quantitative techniques and inputs used, particularly for measurements categorized in levels 2 and 3 of the fair value hierarchy, are important for making informed investment decisions. Registrants can achieve this by challenging the level of aggregation and related description of each class of instrument[9] (e.g., mortgage backed, treasury, collateralized debt) and the related quantitative inputs used to value each class. Mr. Olinger reminded registrants to appropriately consider

the nature, characteristics and risk in aggregating assets and liabilities for disclosure. The description of the valuation techniques and inputs used should be linked to each class and provide a detailed description of how the instruments were valued and the related inputs used, not merely list all potential valuation techniques or inputs.

How we see it

Earlier this year, the SEC staff issued several comment letters to registrants in the insurance industry about their basis for aggregating in their disclosures certain fixed maturity securities into defined classes and their descriptions of valuation techniques. Mr. Olinger's comments indicate that the SEC staff may be focusing on this topic more broadly.

EY resources

- *Technical Line, IPO financial statement accounting and disclosure considerations* (SCORE No. CC0423)

Predecessors in IPO registration statements

Initial public offering (IPO) structures may involve the combination of multiple entities in a "put-together" transaction or the carve-out or spin-off of operations from another company. In certain cases, the IPO registrant also may be a newly formed entity, or Newco, that has no significant activities but will acquire a business when or before the IPO becomes effective. The SEC staff said that these transactions require a careful evaluation of the facts and circumstances to determine whether an acquired entity represents a predecessor.

Identifying the predecessor is a matter of judgment and is based on whether an acquired business will constitute the main thrust of the business or operations of the combined entities. More information must be provided for a predecessor (i.e., the same as for a registrant) than for an acquired business under Rule 3-05 of Regulation S-X. For example, unlike a significant acquisition under Rule 3-05, separate schedules, selected financial data, MD&A and other disclosures required under Regulation S-K must be provided for each predecessor.

The SEC staff made the following observations about determining the predecessor:

- Factors to consider when identifying the predecessor may include the order in which the entities were acquired (i.e., which entity was acquired first), the size and fair value of the entities and the ongoing management structure. None of these factors is determinative, and all facts and circumstances should be evaluated.
- It is rare not to identify a predecessor, even if a Newco is determined to be the accounting acquirer.
- It is possible to identify more than one predecessor entity.

The SEC staff also reminded registrants that the predecessor's financial statements may reflect operations that will not be part of the IPO registrant. The SEC staff generally applies a legal entity concept when defining the predecessor. Therefore, if the IPO registrant or the predecessor is a legal entity that disposes or spins off businesses at or prior to the IPO, it may not be able to retroactively omit those businesses from the historical financial statements.

EY resources

- *Technical Line, Accounting risks related to the decline in oil prices* (SCORE No. BB3077)

Depressed oil and gas prices

The SEC staff said that it is focusing on changes in the reserve estimates of oil and gas registrants as well as potential asset impairment issues that may affect any registrant materially exposed to change in oil and gas prices.

The SEC staff noted that it commonly sees boilerplate language about the effects of the continued decline in oil and gas prices that do not address how the registrant is affected. The SEC staff has asked registrants to consider additional disclosures about material uncertainties and the range of potential outcomes related to their impairment estimates and judgments. For

example, if management has projected a recovery in oil and gas prices that supports the valuation of the company's assets, the company should consider disclosure about whether a material impairment could result from a longer recovery period.

The SEC staff also said registrants should expand their disclosures if the depressed oil and gas prices materially affect the company's operational or growth prospects or if there is a reasonable likelihood that the reported results may not be indicative of future results.

Accounting, SEC and audit standard-setting update

EY resources

- *Financial reporting developments, Revenue from contracts with customers (ASC 606)* (SCORE No. BB3043)

SEC staff views about the revenue standard

In discussing implementation of the FASB's new revenue recognition standard, Mr. Bricker mentioned a recent survey that indicated "75% of responding companies had not completed their initial impact assessment and, of those, a third had not begun [the assessment]." This statistic is consistent with the results of a polling question posed to attendees during the conference. Mr. Bricker emphasized the need for audit committees to be involved and informed of management's detailed implementation plans and to make sure the company has sufficient resources to complete the work timely.

He said it is important for the TRG to continue its efforts as well as consider a global perspective to foster comparability among registrants. The SEC staff will interpret and expect consistent application among foreign private issuers (FPIs) and domestic registrants where the language in the FASB and IASB standards is the same. Mr. Bricker and others echoed statements previously made by Mr. Schnurr about the need to work through implementation issues in robust discussions with the AICPA's industry groups, the TRG, audit firms and SEC staff.

The SEC staff and other panelists further emphasized the need for registrants to give thoughtful consideration to the evolution of their SAB Topic 11.M[10] disclosures. Mr. Bricker emphasized that the SEC staff is looking forward to reviewing more detailed disclosures in upcoming filings about how companies expect to be affected by the new standard. He also said that companies that don't yet know how they will be affected should disclose that the effect is unknown, along with information about when they plan to complete their assessment of how they will be affected.

How we see it

As companies evaluate and determine the qualitative and quantitative effect of the new revenue recognition standard, their SAB Topic 11.M disclosures should evolve through the adoption date. These disclosures should provide users with detailed information relating to the adoption and should not include boilerplate language. We believe this may become a focus area for the SEC staff in its reviews of filings next year.

Ms. Wright shared some observations about the implementation of the new revenue standard. First, she said all companies will experience some degree of change, which may include changes to disclosures, processes, systems or controls, in adopting the new principles-based standard. She said management and audit committees should create a change management plan and should make sure that sufficient resources are allocated to the project. She also observed that some companies are achieving good results by taking a bottom-up approach to implementation, which begins with the identification of different revenue streams and contracts.

Ms. Wright also reiterated that one of the objectives of the new revenue standard is to improve comparability among companies with similar fact patterns. In this regard, she noted that the SEC staff is focused on achieving consistency in the application of the new revenue standard, even if diversity existed under prior revenue guidance. If different accounting conclusions are identified for similar facts and circumstances, companies should raise those differences during the implementation phase of the standard with the TRG, AICPA industry task forces or the SEC's OCA. Raising issues as soon as possible could potentially prevent companies from incurring costs to make changes to achieve consistent accounting conclusions (e.g., due to future interpretive standard setting by the Emerging Issues Task Force).

Mark Kronforst, Chief Accountant of SEC's Division of Corporation Finance, discussed questions the SEC has received about the requirement in Item 11(b) of Form S-3 to recast annual financial statements upon adoption of a new accounting principle, specifically how it applies to adoption of the new revenue recognition standard. Mr. Kronforst said that Item 11(b) is clear that retrospective revision of the annual financial statements in a new or amended registration statement is required for registrants applying a full retrospective method, if the change is material. For example, a calendar-year registrant filing a Form S-3 registration statement in 2018 after it adopts the revenue standard retrospectively in a Form 10-Q filing would be required to recast its prior-period annual financial statements (e.g., for 2015, 2016 and 2017). He acknowledged registrants' concerns of having to recast an additional year of financial statements, but said that any changes to the requirement would require rulemaking by the Commission. However, Mr. Olinger said the staff plans to issue guidance that would not require companies that adopt the revenue standard on a full retrospective basis to retest the significance of equity method investees for the periods that are revised.

How we see it

Given the continued uncertainty on this topic, companies should consider accelerating the timing for refreshing any shelf registration statements that expire in the year they will adopt the revenue recognition standard. Companies planning to register securities in the year of adoption for other reasons should consider how the need to recast the financial statements might affect their adoption and choice of transition method.

EY resources

- *To the Point, New legislation makes changes to JOBS Act and other SEC requirements* (SCORE No. CC0432)
- *To the Point, SEC proposes requiring 'clawback' policies and disclosures* (SCORE No. CC0413)

SEC rulemaking and other initiatives

Mr. Higgins discussed the new Fixing Americas Surface Transportation Act (FAST Act), which included amendments to the Jumpstart Our Business Startups Act (JOBS Act), many of which are effective upon enactment, and certain other mandates for the SEC (which we discuss in our To the Point, *New legislation makes changes to JOBS Act and other SEC requirements* (SCORE No. CC0432)). [11]

Under the FAST Act, in its IPO filing or confidential submission an EGC may omit the earlier of the two required years of annual financial statements if it reasonably believes it will provide an additional full year of annual financial statements by the effective date of its IPO. The SEC staff clarified that this relief extends to other entity financial statements (e.g., S-X Rule 3-05).

The SEC staff clarified that interim financial information for the current and prior year must be included in the EGC's IPO filing or submission because the interim periods are ***part of*** the financial information that will be required at effectiveness. For example, an EGC that is contemplating an IPO in 2016 could submit or file the registration statement for SEC staff review in early 2016 with only 2014 audited financial statements and the most recent interim period of 2015 (and comparable interim period of 2014) assuming it will include 2015 audited financial statements prior to distributing its preliminary prospectus.

Mr. Higgins said the SEC continues to focus on its remaining rulemaking under the Dodd-Frank Wall Street Reform and Consumer Protection Act, including rules relating to hedging, executive compensation and resource extraction payments, which the Commission recently re-proposed.

Audit committee reporting

In July 2015, the SEC issued a concept release seeking public comment on possible revisions to audit committee disclosures, with a focus on areas related to the audit committee's oversight of the independent auditor. Mr. Croteau observed that the Sarbanes-Oxley Act of 2002 (SOX) significantly expanded the audit committee's responsibilities, but that the SEC's disclosure requirements predate SOX. The concept release was developed in response to a desire by some investors to hear more from audit committees about how they perform their role as gatekeepers for the benefit of investors.

Mr. Croteau noted that many commenters support considering improvements to audit committee disclosure requirements. However, there were mixed views about the need for mandatory detailed disclosures, with some commenters suggesting that voluntary disclosures could be sufficient. Mr. Croteau noted that commenters were particularly interested in areas such as:

- The selection and appointment of the auditor
- The evaluation of the audit team
- Auditor compensation
- Composition of the audit committee

With respect to voluntary disclosure, both Chair White and Mr. Croteau observed that many audit committees have enhanced their disclosures beyond those required by today's rules in response to increased investor interest. Mr. Croteau encouraged audit committee members to consider the usefulness of their disclosures and whether additional insights could make the report more meaningful.

Disclosure effectiveness initiative

The Division staff continues to review the business and financial disclosures in Regulation S-K and S-X as part of the SEC's disclosure effectiveness initiative. The SEC staff also is considering how to leverage technology and the EDGAR delivery system to facilitate user access to meaningful information. Mr. Higgins said that the initiative continues to be a priority and he expects there will be significant progress in 2016.

Regulation S-X rulemaking

In October 2015, the SEC issued a request for comment on how it might enhance the effectiveness of disclosure requirements in Regulation S-X applicable to entities other than the registrant, including acquired businesses, equity method investees, subsidiary issuers and guarantors. Although the comment letter period has ended, the SEC staff said that it continues to accept and consider any comments submitted.

Mr. Kronforst said that the SEC received a wide range of recommendations from constituents, but comment letters highlighted several specific areas for improvements that the SEC staff is considering.

How we see it

The consistency of recommendations on some topics could enable the SEC staff to make recommendations to the Commission in a relatively short time frame about changes to the rules that could reduce complexity and costs for preparers and improve the usefulness of information for investors.

EY resources

- *To the Point, Our recommendations for changing Regulation S-X disclosures about entities other than the registrant* (SCORE No. CC0429)
- *Disclosure effectiveness – What companies can do now* (SCORE No. CC0403)
- *Disclosure effectiveness – What investors, company executives and other stakeholders are saying* (SCORE No. CC0404)

Regulation S-K requirements

The SEC staff is currently reviewing how to enhance the Regulation S-K requirements, including the following disclosure areas:[12]

- Eliminating overlapping and outdated requirements
- Determining the appropriate balance between bright lines and principles-based requirements
- Scaling disclosures for EGCs and smaller reporting companies
- Updating and incorporating the industry guides, particularly for bank holding companies

Technology improvements

Mr. Higgins cited a comment letter from the Center for Audit Quality and several trade organizations, including the US Chamber of Commerce, Financial Executives International and Business Roundtable, that suggested modernizing the SEC's website and the EDGAR system.[13] The SEC staff said that it plans to implement changes over the next couple of months in response to this letter.

Voluntary improvements by companies

In a panel, an SEC staff member and several company executives discussed voluntary efforts that registrants have made to improve their disclosures. The SEC staff member observed that more companies are considering their SEC filings to be communication documents, rather than merely compliance filings. Company executives summarized changes they have made to disclosures, including eliminating immaterial information, using charts and tables to highlight material information and reducing duplicative information by using cross-references.

The SEC staff said that it supports the use of cross-references to or from the financial statement notes and other sections of the Form 10-K as long as it is clear which disclosure has been audited. However, company executives said that they and their auditors rarely support cross-referencing from the financial statement notes (e.g., to MD&A) due to concerns about the clarity of audit responsibility.

PCAOB standard setting and other initiatives

Martin Baumann, PCAOB Chief Auditor and Director of Professional Standards, and Jay Hanson, PCAOB Board Member, provided an overview of the PCAOB's standard setting and other projects. They also discussed the evaluation of the PCAOB's standard-setting process that occurred during 2015 to create a more thorough, efficient approach to the standard-setting projects.

Recently approved standards

- *Related parties* — Mr. Baumann highlighted the Board's standard on related parties, AS 18, which is effective for audits of financial statements for fiscal years beginning on or after 15 December 2014. Mr. Hanson and Mr. Baumann noted concerns that have been raised by auditors and preparers as the standard has been implemented, particularly with respect to the requirement for auditors to obtain a representation from management that they have provided the auditor with a list of all related parties. Mr. Baumann observed that obtaining a list of all related parties is the starting point for an auditor's procedures. In response to a question, Mr. Hanson observed that this was not an area in which commenters raised concerns during standard setting.

- *Reorganization* — Mr. Baumann described the reorganization of the PCAOB's auditing standards that was completed this year and will be effective as of 31 December 2016. The PCAOB undertook this project to organize its auditing standards using a topical structure and a single numbering system for easier navigation.

Reporting standards

- *Transparency* — Mr. Baumann said the objective of this project was to provide important information to investors and promote accountability through disclosure of the name of the engagement partner and certain other participants in the audit. A supplemental request for comment was issued on 30 June 2015 to propose disclosing this information in a new PCAOB form, Form AP, rather than in the auditor's report. Mr. Baumann stated that this alternative would balance the benefits of such disclosure with the liability concerns raised by including the information in the auditor's report. The standard, which is subject to approval by the SEC, is expected to be approved by Board on 15 December 2015.

- *Auditor's reporting model* — Mr. Baumann said the PCAOB plans to re-propose a standard on the auditor's reporting model in the first half of 2016. It will reflect feedback the PCAOB received from comment letters and in public hearings on an earlier proposal. Mr. Baumann noted that expanded auditor reporting is already required in the United Kingdom and has been considered successful. Additionally, the International Auditing and Assurance Standards Board (IAASB) approved a new audit reporting standard, which includes the identification of key audit matters and how those matters were addressed during the audit, effective for 2016 listed company audits.

- *Audit quality indicators (AQIs)* — Mr. Hanson said that while constituents support the PCAOB's AQI concept release, they expressed diverse views on the next steps the PCAOB should take in the project. He said he believes the PCAOB should continue to monitor discussions between auditors and audit committees, encourage firms to issue quality reports and then assess whether to mandate the use of AQIs.

Performance standards

- *Supervision of other auditors* — Mr. Baumann said a proposal on supervision of other auditors in multinational audits would seek to strengthen the oversight of the other firms by the lead audit firm and provide improved guidance on directing, reviewing and using the work of other auditors.

- *Auditing estimates, including fair value measurements* — Mr. Baumann said the staff is planning to recommend that the PCAOB propose a single standard to replace the multiple existing standards that govern the auditor's work in this area. The proposal would address changes in the related accounting frameworks, the increased use of fair value measurements and pricing services and provide better linkage with the Board's risk assessment standards.

- *Specialists* — Mr. Baumann said the staff plans to recommend that the PCAOB propose general requirements for the oversight of specialists (whether used by the auditor or by management) and to develop more rigorous requirements on using the work of management's specialists.

Other projects requiring additional research or outreach

- *Going concern* — Mr. Baumann said that evaluating whether there is substantial doubt about a company's ability to continue as a going concern is important to investors. Following the FASB's adoption of a requirement for management to make an evaluation of substantial doubt, which it defined differently than existing PCAOB standards, the PCAOB reminded auditors that their evaluation of an entity's ability to continue as a going concern needed to comply with the PCAOB's existing auditing standards. The PCAOB is currently evaluating its next steps.
- *Other information accompanying the financial statements* — Mr. Baumann noted that in its 2013 proposal on the auditor's reporting model, the PCAOB proposed requirements for the auditor to read and evaluate the other information accompanying the financial statements and include a discussion of this evaluation in the auditor's report. Commenters expressed concerns about this proposed requirement, and the PCAOB is exploring its next steps.
- *Quality control standards* — Mr. Baumann said improved quality control standards could lead to improved audit quality and a reduction of inspection findings by the PCAOB and other global regulators. The IAASB has undertaken a similar project, and the PCAOB is planning to coordinate its efforts with the IAASB.
- *Other emerging issues* — The PCAOB's recently asked its Standing Advisory Group to identify the most important issues that could affect audits, auditors and the PCAOB. The issues identified included whistleblower activity, economic developments, use of data/data auditing, non-GAAP measures, the effect of FASB's materiality proposal, revenue recognition and cybersecurity.

International matters

The IFRS footprint and outlook for IFRS

Hans Hoogervorst, IASB Chairman, discussed the success of convergence efforts between the IASB and the FASB, including their revenue recognition and leases standards. He noted that the revenue standards are substantially the same and demonstrate that rules-based and principles-based cultures can be reconciled. He said the leases standards the Boards plan to issue early next year are converged on their main objective to put most operating leases on the balance sheet.

Mr. Hoogervorst said that 116 jurisdictions currently require the use of IFRS. He noted developments in Japan, India and China that advance the use of IFRS. He said these developments are clear progress for investors and preparers because companies will be able to use one accounting language in expanding parts of the world. However, Mr. Hoogervorst acknowledged that consistent application of IFRS requires "permanent attention and rigorous enforcement."

Mr. Hoogervorst also discussed the outlook for the IASB's standard setting over the next 12 months. The IASB and IFRS Foundation will conduct outreach on their standard-setting agenda and the effectiveness of their structure in 2016. He said the IASB needs to improve the communication value of financial reporting by addressing disclosure effectiveness and performance reporting. Other issues the IASB may address include how financial reporting relates to broader issues of corporate reporting (e.g., sustainability, value creation) and the effect of technology and Big Data on financial reporting. He encouraged entities to comment on the consultation papers that will be released in 2016.

Finally, Mr. Hoogervorst noted that the US has substantive interests at stake in IFRS due to its expanding use in the global economy. He gave an example of a recent high-profile IPO by an FPI that listed on a major US stock exchange using financial statements in accordance with IFRS as issued by the IASB. That's why, he said, regardless of its use by domestic companies, US constituents should stay engaged and help the IASB build IFRS in the future.

Considerations for IFRS in the US capital markets

Julie Erhardt, Deputy Chief Accountant in OCA, discussed the interaction between the US and IFRS and benefits of a single set of global accounting standards. She made the following points:

- **Shared origins** — The US was a strong supporter and active participant in the global accounting profession's decision to convert the International Accounting Standards Committee into the IASB, and there are many companies and organizations in the US with a connection to the IASB's work (e.g., US headquartered global corporations) suggesting that the US should continue to be actively involved with IFRS.
- **Shared knowledge** — The US is perceived as a leader on financial reporting policy matters. There is a potential benefit in US companies and standard setters sharing their experiences and views across borders.
- **Shared benefits** — A single recognizable/comparable set of standards benefits domestic companies and investors in the expanding global economy.

How we see it

While it appears that any SEC action in the short-term related to IFRS may be limited to acceptance of voluntary supplemental disclosures, there continues to be consistent support for continued convergence efforts and US engagement with the IASB and global standard setting.

Foreign private issuers

Mr. Olinger said that as of 31 December 2014, about 500 of the approximately 900 FPIs registered with the SEC prepared their financial statements in accordance with IFRS and about 400 prepared their financial statements in accordance with US GAAP. Very few FPIs prepare financial statements in accordance with local country GAAP reconciled to US GAAP.

Common issues and best practices related to foreign transactions

Mr. Olinger participated in an international reporting panel discussion with others on areas that are challenging in cross-border transactions. The panel highlighted the following reporting considerations for transactions that will be registered with the SEC:

- **Foreign status** — When contemplating a foreign transaction, a registrant needs to consider whether it and the target are US domestic filers, foreign businesses or FPIs. This distinction is important in understanding the basis (i.e., US GAAP, IFRS) of the financial information to be presented in the registration statement. Mr. Olinger clarified that a foreign incorporated joint venture that is 50% owned by a US-domiciled entity and 50% owned by a foreign entity does not qualify as a foreign business because neither entity controls the joint venture. When such a joint venture is consolidated by the non-US registrant for reasons other than voting rights under the consolidation rules, Mr. Olinger encouraged registrants to consult with the SEC staff to determine whether any of the foreign business accommodations could be used. Paul Dudek, Chief of the SEC's Office of International Corporate Finance, said that SEC rules do not specify the date on which the assessment must be made whether an acquiree meets the foreign business criteria; therefore, judgment is required, and registrants may consult with the SEC staff.

- **Auditor reporting framework** — The panel observed that, in an SEC filing, a target's financial statements must be audited under AICPA standards or PCAOB standards, but audits performed under International Standards of Auditing are not acceptable. Certain disclosures required by IFRS (e.g., market risks and critical accounting estimates) may be disclosed in MD&A and incorporated by reference in the notes to the financial statements. As a result, the audit report on IFRS financial statements must clearly extend to those disclosures.

Losing FPI status

Mr. Dudek discussed some considerations for a registrant that loses its FPI status when it makes the required assessment at the end of the second quarter of its fiscal year. For example, a calendar-year company that loses its FPI status as of 30 June 2015 may continue to file forms that are applicable to FPIs for the remainder of the year. The company will be subject to all of the requirements of a domestic company beginning 1 January 2016, including the requirement to file current reports and quarterly reports. The 2015 Form 10-K would need to include three years of audited financial statements prepared using US GAAP. The registrant must also reassess the significance of equity method investees under S-X Rule 3-09 of Regulation S-X using its US GAAP financial statements.

Considerations for certain Canadian companies

Certain Canadian companies listed in the US register with the SEC under the Multi-Jurisdictional Disclosure System (MJDS) and are afforded certain accommodations including the ability to provide two years of audited financial statements in their SEC filings. A public float of at least $75 million at year end is one of several eligibility criteria. Recent declines in energy prices and their effect on a company's stock price could result in a Canadian filer losing its MJDS status and having to comply with requirements as an FPI, including the requirement to provide three years of audited financial statements and comply with S-X Rule 3-09 for purposes of filing Form 20-F.

SEC enforcement and PCAOB inspection matters

Remarks of SEC enforcement staff

Andrew Ceresney, Director of the SEC's Division of Enforcement, and Michael Maloney, Chief Accountant in the Division of Enforcement, discussed the SEC's enforcement actions over the past year. The SEC filed more than 800 cases (a record) in fiscal 2015. In fiscal 2014, the SEC collected approximately $2 billion of disgorgements and penalties, which is either paid to wronged individuals or the US Department of Treasury (depending on the nature of the case).

Mr. Ceresney said the number of financial reporting and auditing cases continued to rise in fiscal 2015 to 114 from 79 in 2014 and 53 in 2013. The increase was driven in part by the Division of Enforcement's creation of a financial reporting and auditing task force and its use of data analytics. Mr. Maloney indicated the allegations in those enforcement actions stem from poor tone at the top, pressure to meet financial targets/earnings management, and growth outpacing infrastructure. The financial reporting actions focused on a variety of topics from revenue recognition (e.g., percentage of completion, accelerated/false revenues, bill and hold arrangements) to disclosure issues (e.g., missing or insufficient). The SEC also has filed enforcement actions against auditors for lack of professional skepticism, overreliance on management representations, failure to obtain audit evidence and having insufficient documentation.

Finally, Mr. Maloney discussed enforcement actions related to faulty valuations. He said these actions involved improper methodologies and unsupported or outdated assumptions, but the Division does not question valuations made in good faith. These actions often found that

auditors did not obtain a sufficient understanding of the models/assumptions used or placed overreliance on outside specialists. He emphasized that management, auditors and valuation specialists need to remain vigilant in complying with their respective responsibilities.

PCAOB inspections

Ms. Munter said that she believes the state of audit quality is improving. Ms. Munter stated that audit firms and audit partners are more engaged, and firms are focusing on root cause analyses and on timely and substantive remedial actions. Specifically, the PCAOB has seen improvements in the tone at the top, the training on complex audit areas, new practice aids and checklists to help auditors consistently and thoroughly apply the PCAOB auditing standards, coaching and support to audit teams and monitoring activities of firms.

Ms. Munter said the goal of the inspection process is not to only to identify deficiencies on specific audits but to leverage any observations from specific audits to help identify any systemic problems that may exist. The identification and remediation of any potential systemic issues can lead to more significant improvements in audit quality.

Ms. Munter also noted that many inspections result in no deficiencies being identified, and the PCAOB is looking to further its understanding of the root causes of high-quality audits inspected.

However, Ms. Munter noted there are still opportunities for improvement in certain areas of recurring inspection findings, including internal control, fair value and revenue recognition. These recurring inspection findings are consistent with findings identified by the annual survey of inspection results produced by the International Forum of Independent Audit Regulators. Other areas noted for improvement by the PCAOB staff include effective remedial action, root cause analysis, consistent global execution of an audit methodology and monitoring of independence.

Ms. Munter said the PCAOB's 2016 inspections will likely focus on:

- Recurring deficiencies, including ICFR, assessing and responding to risks of material misstatement and auditing accounting estimates
- Challenges created by the appreciation of the US dollar
- Segment disclosures, including identifying the CODM and determining the operating and reportable segments
- Mergers and acquisitions
- Income taxes, including management's assertion of indefinite reinvestment outside of the US and the related internal controls
- Going concern evaluation
- Cybersecurity
- Implementation of AS 18

Finally, Ms. Munter highlighted the PCAOB's focus on increasing the inspection information that is shared with the public. Inspection reports have been expanded to include industry information, and the staff introduced Inspection Briefs to highlight important matters about inspections. The PCAOB staff plan to further expand the data available about inspections on the PCAOB website, beginning in 2016.

Endnotes:

[1] Commission guidance regarding *Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934,* Release No. 33-8810 (June 20, 2007), is available at: https://www.sec.gov/rules/interp/2007/33-8810.pdf

[2] ASC 605-50, *Customer Payments and Incentives*.

[3] ASC 718, *Compensation-Stock Compensation*.

[4] SAB Topic 6.L, *Selected Loan Loss Allowance Methodology and Documentation Issues*.

[5] For public business entities, ASU 2015-02 is effective for annual and interim periods beginning after 15 December 2015. For all other entities, it will be effective for annual periods beginning after 15 December 2016, and interim periods beginning after 15 December 2017. Early adoption is permitted for annual and interim periods.

[6] ASC 810-10-55-37.

[7] ASC 810-10-55-37D.

[8] Refer to C&DI's on non-GAAP measures question 104.06 available at: http://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm

[9] ASC 820 states that the appropriate classes of assets and liabilities are determined on the basis of the nature, characteristics and risks of the asset or liability, and the level of the fair value hierarchy within which the fair value measurement is categorized.

[10] SAB Topic 11.M addresses disclosure of the effect that recently issued accounting standards will have on the financial statements of the registrant when adopted in a future period.

[11] The SEC staff recently issued C&DIs related to the FAST Act, which can be found at: http://www.sec.gov./divisions/corpfin/guidance/fast-act-interps.htm

[12] The FAST Act requires the SEC to take action to revise Regulation S-K requirements within 180 days and conduct further study in consultation with the Investor Advisory Committee and the Advisory Committee on Small and Emerging Companies.

[13] The comment letter can be found at: http://www.sec.gov./comments/disclosure-effectiveness/disclosureeffectiveness-40.pdf

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Appendix — Conference speeches

	Speech and link to source
SEC Chair, Mary Jo White	▸ Speech by SEC Chair: Keynote Address at the 2015 AICPA National Conference: "Maintaining High-Quality, Reliable Financial Reporting: A Shared and Weighty Responsibility"
SEC Chief Accountant, James Schnurr	▸ Speech by SEC Chief Accountant: Remarks before the 2015 AICPA National Conference on Current SEC and PCAOB Developments
SEC Deputy Chief Accountant, Wesley Bricker	▸ Speech by SEC Deputy Chief Accountant: Remarks before the 2015 AICPA National Conference on Current SEC and PCAOB Developments
SEC Deputy Chief Accountant, Julie Erhardt	▸ Speech by SEC Deputy Chief Accountant: Remarks before the 2015 AICPA National Conference on Current SEC and PCAOB Developments
SEC Deputy Chief Accountant, Brian T. Croteau	▸ Speech by SEC Deputy Chief Accountant: Remarks before the 2015 AICPA National Conference on Current SEC and PCAOB Developments
SEC Senior Associate Chief Accountant, Michael Husich	▸ Speech by SEC Senior Associate Chief Accountant: Remarks before the 2015 AICPA National Conference on Current SEC and PCAOB Developments
SEC Associate Chief Accountant, Barry Kanczuker	▸ Speech by SEC Associate Chief Accountant: Remarks before the 2015 AICPA National Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow, Kris Shirley	▸ Speech by SEC Professional Accounting Fellow: Remarks before the 2015 AICPA National Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow, Christopher Rickli	▸ Speech by SEC Professional Accounting Fellow: Remarks before the 2015 AICPA National Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow, Ashley Wright	▸ Speech by SEC Professional Accounting Fellow: Remarks before the 2015 AICPA National Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow, Christopher Semesky	▸ Speech by SEC Professional Accounting Fellow: Remarks before the 2015 AICPA National Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow, Courtney Sachtleben	▸ Speech by SEC Professional Accounting Fellow: Remarks before the 2015 AICPA National Conference on Current SEC and PCAOB Developments
PCAOB Chair, James R. Doty	▸ Speech by PCAOB Chair: Protecting the Investing Public's Interest in Informative, Accurate, and Independent Audit Reports
PCAOB Member, Jay D. Hanson	▸ Speech by PCAOB Member: PCAOB Standard-Setting Update — AICPA National Conference on Current SEC and PCAOB Developments
FASB Chairman, Russell G. Golden	▸ Speech by FASB Chairman: Remarks at the 2015 AICPA Conference on Current SEC and PCAOB Developments
IASB Chair, Hans Hoogervorst	▸ Speech by IASB Vice-Chairman: IFRS: 2015 and beyond
CAQ Executive Director, Cindy Fornelli	▸ Speech by CAQ Executive Director: Center for Audit Quality Update: Focus on the Future
AICPA Chair of the Board of Directors, Tim Christen	▸ Speech by AICPA Chair: Adapt, Evolve for Relevance: Driving Change to Preserve Our Future

Disclosure effectiveness

What companies can do now

October 2014

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Introduction

Overview

With regulators and standard setters now looking at how to make corporate disclosures more effective, companies can take steps now to make their own disclosures more meaningful.

The problems with disclosures are well known. As the volume of disclosures has grown,[1] regulators and financial statement users have repeatedly said that disclosure documents contain too much boilerplate and are so repetitive that it is difficult for investors to find the most important information. Meanwhile, some investors and other users have called for new disclosures or improvements in existing ones.

Companies that have successfully streamlined their disclosures by focusing on relevant and material information cite many benefits, including:[2]

- Increased investor confidence due to communication of more meaningful information
- Greater efficiency in preparing investor communications and auditing disclosures
- Improved coordination throughout the organization, including the board of directors, and with regulators and external advisers
- Strengthened market reputation and leadership

Companies that want to make their disclosures more effective will need to consider time, cost and resource constraints, as well as regulatory disclosure requirements. Developing appropriate processes to enhance disclosures often requires planning and support from executive management and the Audit Committee; outreach to investors; and coordination with lawyers, auditors and other advisers.

It may be more productive for a company to target specific disclosure areas that are particularly complex or lengthy rather than start with a blank sheet to rewrite the financial statements and SEC reports. We believe both preparers and users are best served when there is sustained focus on improving the quality of information provided to investors.

This publication discusses how companies might consider making their disclosures more effective. It highlights our recommendations, along with illustrations that may help companies take steps to improve their disclosures.

> "When disclosure gets to be 'too much' or strays from its core purpose, it could lead to what some have called 'information overload' — a phenomenon in which ever-increasing amounts of disclosure make it difficult for an investor to wade through the volume of information she receives to ferret out the information that is most relevant."
>
> – SEC Chair Mary Jo White[3]

1 In an EY study, we found that the average number of pages devoted to footnotes and management's discussion and analysis in the annual reports of 20 well-known companies quadrupled from 1992 to 2011. See our To the Point publication, *Now is the time to address disclosure overload*

2 Center for Audit Quality, *Financial Statement Disclosure Effectiveness: Forum Observations Summary*

3 *The Path Forward on Disclosure*, National Association of Corporate Directors — Leadership Conference, 15 October 2013

Disclosure effectiveness initiatives

The Securities and Exchange Commission (SEC) staff is reviewing the requirements of both Regulations S-K and S-X to identify ways to reduce the costs and burdens on companies while still providing material information to investors.

The initiative grew out of a December 2013 study of disclosure requirements in Regulation S-K, which was required by the Jumpstart Our Business Startups Act. In this study, the staff of the SEC's Division of Corporation Finance recommended that the SEC undertake a comprehensive review of the existing disclosure requirements. SEC Chair Mary Jo White has called the disclosure effectiveness initiative a priority and has directed the SEC staff to make specific recommendations this year.

Reducing the volume of disclosures is not the SEC staff's sole objective. If the staff identifies potential gaps in disclosure or opportunities to increase transparency, it may recommend new or enhanced disclosure requirements. It also will consider how technology and cross-referencing can promote these objectives.

The SEC is encouraging companies, investors and other market participants to submit their views on how to make disclosures more effective. Suggestions can be submitted through the spotlight page on the SEC's website.[4] The SEC is expected to issue one or more concept releases later this year to seek public input.

The Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) also are seeking ways to improve disclosures in the financial statement notes.[5]

The FASB has proposed adding a new chapter to its conceptual framework in an effort to improve the process for establishing new disclosure requirements and evaluating existing ones. In addition, the FASB will be revisiting certain disclosure requirements (e.g., for pensions, fair value measurements, interim reporting) in narrow, short-term projects. The FASB also is working on a project to provide guidance on the decision process companies should employ for evaluating what disclosures to make.

The IASB also is taking steps to improve disclosures, including:

- Identifying a set of principles that would inform the organization, format and linkage of information in financial statement disclosures
- Reviewing existing disclosure requirements to identify duplication and overlap
- Researching how materiality is applied in practice and considering whether further guidance is necessary

The following EY publications provide more information on these initiatives:

EY resources

- SEC in Focus, Issue 4 (SCORE No. CC0402), October 2014
- Financial reporting briefs (SCORE No. BB2827), September 2014
- SEC in Focus, Issue 3 (SCORE No. CC0396), July 2014
- Applying IFRS – Improving disclosure effectiveness (EYG No. AU2513), July 2014
- To the Point – A framework to help the FASB establish effective disclosures (SCORE No. BB2707), March 2014
- To the Point – SEC staff recommends a comprehensive review of SEC disclosure requirements (SCORE No. CC0386), January 2014
- To the Point – The SEC's opportunity to consider disclosure overload (SCORE No. CC0359), October 2012

In addition, several other regulators, standard setters and organizations around the world are undertaking similar disclosure effectiveness projects. These projects are summarized in the appendix to this publication.

> "[O]ur goal is to both improve disclosure content – make it more useful to investors – and at the same time, where we can, reduce the amount of disclosure content … The framework is designed to lead to disclosures that clearly communicate the information that is most important to the users of the financial statements."
>
> – Russell G. Golden, FASB Chairman[6]

4 http://www.sec.gov/spotlight/disclosure-effectiveness.shtml

5 The primary advisory committees of the Boards, Financial Accounting Standards Advisory Council (FASAC) and IFRS Advisory Council, also have highlighted disclosure initiatives as top priorities.

6 *Remarks of Russell G. Golden, AICPA Conference on Current SEC and PCAOB Developments*, December 2013

The SEC call to action

While the SEC staff is reviewing the SEC's disclosure requirements, staff members also are asking companies to proactively enhance their disclosures by:

- Reducing repetition
- Tailoring the disclosure to focus on material information
- Eliminating outdated and immaterial information

In a recent speech at the US Chamber of Commerce, SEC Division of Corporation Finance Director Keith Higgins also invited companies that would like to discuss changes to their disclosures before including them in a filing to contact the SEC staff.

In this publication, we explore the staff's suggestions in greater detail and highlight areas where companies may apply them.

"Our effort will truly succeed only if all of the stakeholders in our current disclosure system — companies, investors, legal and accounting professionals and other market participants — contribute to the dialogue about the improvements that could be made to the quality and effectiveness of disclosure so that it is less burdensome both for companies to prepare and for investors to read."

— SEC Division of Corporation Finance Director Keith Higgins[7]

[7] *Disclosure Effectiveness: Remarks Before the American Bar Association Business Law Section Spring Meeting*, 11 April 2014

Materiality considerations

Materiality is one of the key principles of financial reporting. Efforts to make disclosures more effective typically focus on evaluating whether existing or proposed disclosures provide material information to financial statement users or merely add clutter.

The US Supreme Court ruled that a fact is material if there is "a substantial likelihood that the disclosure of the omitted fact ***would*** have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." (Emphasis added.) The Court rejected the view that a fact is material if an investor ***might*** find it important, concluding that "management's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information — a result that is hardly conducive to informed decision making."[8]

Several SEC staff members and commissioners have questioned whether the Supreme Court's fear has become a reality. In a recent speech,[9] SEC Commissioner Daniel Gallagher stated, "Companies' disclosure documents are being cluttered with non-material information that can drown out or obscure the information that is at the core of a reasonable investor's investment decision."

We agree with the view that investors are not well-served if disclosure documents are filled with immaterial disclosures. Materiality should determine whether information is included in or excluded from a disclosure document. Materiality also should influence how prominently the information is presented.

Evaluating materiality, however, requires significant judgment. SEC Staff Accounting Bulletin (SAB) Topic 1.M, *Assessing Materiality*, provides further guidance about materiality and states that materiality judgments involve the consideration of both quantitative and qualitative factors. The SAB provides a list of quantitative and qualitative factors for evaluating the materiality of a misstatement. While this list is neither easily applied to disclosure considerations nor all-inclusive, companies must eventually evaluate whether omitted or misstated disclosures, individually or in the aggregate, would affect a reasonable investor. When evaluating materiality, companies may consider whether their disclosures:

- Affect the fair presentation of the financial statements
- Indicate potential areas of management bias
- Relate to sensitive matters (e.g., executive compensation disclosures, fraud, noncompliance with laws)
- Affect significant accounting policies in areas for which there is a lack of authoritative guidance or consensus
- Relates to accounts or disclosures for which significant judgment is used in the application of accounting principles, including critical accounting policies

Making and documenting materiality judgments will never be an easy task, but companies that take a fresh look at their disclosures often identify areas that could be eliminated or substantially reduced without significantly altering the total mix of information.

> "After nearly a century in the making, our disclosure regime is not based entirely on line item requirements; rather, it is fundamentally grounded on the standard of 'materiality.' "
>
> — SEC Chair Mary Jo White[10]

The FASB defines materiality differently than the US Supreme Court did. In defining materiality, the FASB says, "information is material if omitting it or misstating it ***could*** influence decisions that users make on the basis of the financial information of a specific reporting entity."[11] (Emphasis added.) We believe that the FASB's use of the word ***could***, may contribute to excessive footnote disclosures.[12]

8 *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449-450 (1976)

9 *Remarks at the 2nd Annual Institute for Corporate Counsel*, 6 December 2013

10 *The Path Forward on Disclosure*, National Association of Corporate Directors — Leadership Conference, 15 October 2013

11 FASB Concepts Statement 8, *Qualitative Characteristics of Useful Financial Information*

12 In our comment letter to the FASB on its Discussion Paper, *Disclosure Framework*, we recommended that the FASB amend its definition to be consistent with the Supreme Court's opinion.

Materiality of an item

FASB Accounting Standards Codification (ASC) 105-10-05-6 states that "the provisions of the Codification need not be applied to immaterial items." However, neither the FASB nor the SEC provides specific guidance clarifying how to consider the materiality of individual disclosure requirements. As a result, companies often provide every specified GAAP disclosure that relates to each area (e.g., stock compensation expense) that they determine is material to their financial statements.

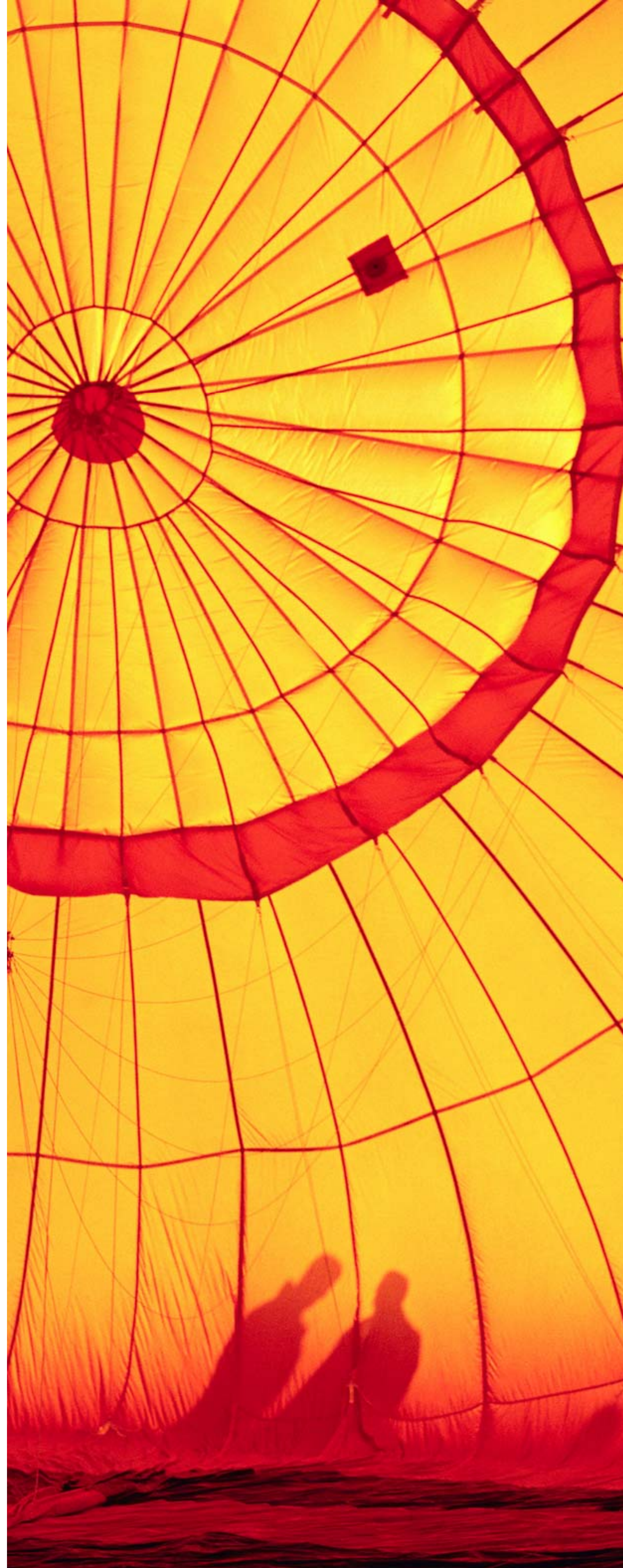
We believe that companies should consider how individual disclosures affect the total mix of information available. That is, companies don't need to include all specified disclosures if they conclude that an individual disclosure is immaterial. We believe this view is consistent with the Supreme Court's definition of materiality.

Materiality considerations as part of SEC review process

Companies tend to retain disclosures that were material in a previous period but may no longer be material. This phenomenon is especially true when the disclosure was added in response to an SEC staff comment. The SEC staff has said publicly that companies should remove disclosures made in response to earlier SEC staff comment letters if those matters are no longer material.

The SEC staff also has said that just because it raises questions, companies should not assume that they need to add more disclosures to their filings, particularly immaterial information. The SEC staff often issues comments seeking clarification rather than additional disclosure. In some cases, registrants should respond by revising their disclosure to make it more effective rather than adding new disclosures.

The SEC staff is assessing whether its comment letter practices have contributed to the disclosure of immaterial information and will consider whether any changes to its filling review and comment practices are necessary.



Leading practices on structure and content

The SEC has said that companies can improve the relevancy of disclosures and reduce clutter by presenting information in a logical, easy-to-read manner.

In 2003, the SEC issued FR-72, *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*, which provides interpretive guidance concerning the preparation, format and content of management's discussion and analysis (MD&A). FR-72 states that MD&A should provide an explanation of the company's financial statements that enables investors to see the company through the eyes of management.

In addition, FR-72 says the primary purpose of MD&A is for management to communicate with investors in a straightforward manner. It states that companies should:

- Focus on material information, eliminate immaterial information and avoid unnecessary duplicative disclosure
- Use a "layered" approach to present their disclosure so that the most important material information is most prominent
- Present MD&A in a clear and understandable way by using tables and headings to help readers follow the flow of pertinent information
- Provide not only required disclosure but also an analysis that explains management's view of the implications and significance of that information

We encourage companies to revisit these principles when enhancing the effectiveness of their MD&A disclosures. We also believe companies should consider whether similar principles can be applied to the presentation of financial statement notes or other disclosures outside their financial statements. For example, these principles may guide how a company presents and discusses both financial and nonfinancial information, including operational and strategic goals, key performance indicators, and corporate and social responsibility information considered material to its investors.

In the following sections, we discuss these concepts and best practices based on our review of filings by companies that have already applied them.

Use of layering

Layering refers to emphasizing the most important information and providing additional details elsewhere. Layering can be accomplished in several ways.

FR-72 encourages companies to use an executive-level overview to provide context for their MD&A. The summary should present the important factors in evaluating the company's financial condition and operating performance without merely repeating the detailed discussion and analysis that follows.

The SEC staff expects an informative executive-level overview to provide insight into material opportunities, challenges and risks on which the company's executives are most focused for both the short and long term, as well as the actions they are taking to address them.

In our view, companies can apply this concept to other disclosures. They can use summaries, activity rollforwards or hyperlinks that emphasize or allow navigation to the most important information, provide additional context and details, or minimize redundancies.

See below for recommendations and illustrations of how layering can be used to make MD&A and footnote disclosures more effective.

Longer term, we expect technology to play an important role in disclosure reform. For several years, the SEC has contemplated using technology to structure disclosure and make it easier for investors to find material information.[13]

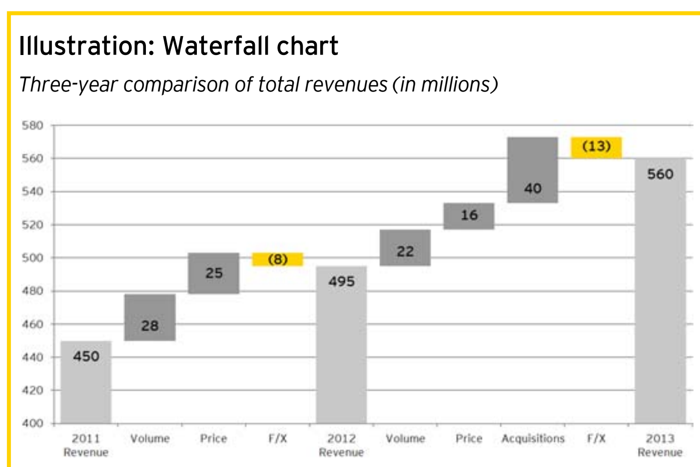
[13] For example, in 2008, the SEC formed the 21st Century Disclosure Initiative and released a report, *Toward Greater Transparency: Modernizing the Securities and Exchange Commission's Disclosure System*, with recommendations for comprehensive changes to the disclosure system.

Use of graphs, charts and tables

Information often can be presented more clearly and concisely in graphs, charts and tables than in text. In recent standards and rule releases, the FASB and SEC have encouraged and, in some cases, required tabular presentations of disclosure. For example, the rules related to executive compensation disclosures require tabular disclosures along with narrative discussion that supplements the tables.[14] Furthermore, FR-72 encourages the use of tables to compare and explain changes in results between different periods. The following is an example of a "waterfall" chart that some companies have used to depict changes in balances from one period to the next:

Illustration: Waterfall chart

Three-year comparison of total revenues (in millions)



As companies make greater use of charts and graphs in their disclosures, the presentation in annual reports is becoming more like that of investor-day presentations and internal managerial and board reporting.

As a leading practice, companies should avoid simply repeating in text information that is evident in the charts or tables. For example, some companies have stopped describing a change between periods that is reflected in a table and focused instead on discussing the reason(s) for the change. See our illustration under "MD&A — results of operations."

Use of cross-references

Regulators often point to duplicative disclosures as a factor contributing to information overload and investor confusion. When a company provides substantially similar disclosure in different areas of a filing, the document is longer than it needs to be and users aren't likely to understand why disclosure is repeated. Disclosures about significant accounting policies, loss and legal contingencies, and business descriptions are often repeated in different places in the disclosure documents (e.g., risk factors, MD&A, footnote disclosure).

Cross-referencing is an effective way to reduce repetition and direct the reader to a section that contains additional relevant information on a topic. There are valid concerns that cross-referencing from the financial statement notes to MD&A may result in confusion with respect to audit responsibility. Conversely, there are valid concerns that referencing from MD&A to the notes results in the loss of safe-harbor protections for forward-looking disclosures. Despite these concerns, we believe there are several areas where companies can use properly worded cross-references (e.g., from MD&A to the notes) to enhance their disclosure.

In addition, if information is complementary but not required content and could provide additional context, insight or detail, a company may point to such information outside the disclosure document (e.g., on the company's website) without making the information part of the SEC filing. A company also may consider, as appropriate, incorporating by reference disclosure from previous filings, thereby avoiding repetition.

[14] Executive Compensation and Related Person Disclosure, Release Nos. 33-8732A; 34-54302A; IC-27444A, 6 September 2006

> "Whatever is disclosed should be presented, when practicable, in a more accessible, straightforward manner — such as charts, graphs, tables, and summaries — so that the information is more digestible and understandable. A simpler presentation can make it easier for investors to focus on and process the information that matters most."
>
> — Former SEC Commissioner Troy A. Paredes[15]

Eliminating immaterial disclosures

We have seen companies effectively reduce the size of their filings by removing immaterial disclosures that have accumulated over time. For example, disclosures that were included for business conditions or events that are no longer material to understanding the company's operating results or financial condition may linger in filings for several periods.

As part of their financial reporting processes, companies should identify immaterial disclosures that can be omitted or substantially reduced. In conjunction with that, they should document their rationale. Contemporaneous documentation of the rationale for omitting immaterial disclosure items can be valuable if those omissions are later challenged by regulators or litigants.

In many cases, because the FASB does not list all specified disclosures in a single place,[16] companies use disclosure checklists that accumulate all individual SEC and FASB disclosure requirements to evaluate which disclosures are applicable and material. Companies should also use these checklists to document the relevant quantitative and qualitative factors they evaluated when deciding to exclude disclosures they deemed not material.

[15] Remarks at The SEC Speaks in 2013, 22 February 2013

[16] If the FASB accumulated all specified disclosures in one location, that list would represent approximately 400 pages of the Accounting Standards Codification.

Recommendations to improve disclosures

In this section, we explore how companies are making their disclosures more meaningful. The illustrations below reflect effective practices that we have seen in company filings. However, because every company's facts and circumstances are different, companies must tailor the structure and content of disclosure based on their needs.

Financial statement footnotes

Several companies have focused on making certain lengthy footnote disclosures more meaningful while still providing the required information.[17] Most commonly, we have seen companies change how disclosures about pensions and other postretirement benefits, stock-based compensation, loss contingencies, derivatives and hedging, and fair value measurements are presented such that required information is conveyed in a meaningful manner.

Order of financial statement notes

Most companies disclose their significant accounting policies in the first note to their financial statements. ASC 235, *Notes to Financial Statements*, encourages this format: "Disclosure is preferred in a separate summary of significant accounting policies preceding the notes to financial statements, or as the initial note, under the same or a similar title."

However, ASC 235 states that entities have the flexibility to disclose information about accounting policies differently. The FASB's Discussion Paper, *Disclosure Framework,* also considers other ways to organize these disclosures that may be more appropriate. For example, notes could be grouped (e.g., by related transaction or by operating, financing or investing activities) and organized from most to least relevant. The Discussion Paper acknowledges that grouping information may make it harder to compare a company's disclosures with those of other companies but could make the disclosures more relevant to users.

Some companies have grouped the disclosure of certain accounting policies with the more expanded disclosures for that particular area presented elsewhere in the footnotes to avoid discussion of financial statement line items in multiple footnotes. In most of these cases, the company includes an initial note with a discussion of some significant accounting policies and uses a table to link to the relevant footnote where there is a more complete discussion of other policies, along with the related estimates and other required disclosures:

Illustration: Summary of significant accounting policies

The following table includes other significant accounting policies that are described in other notes to the financial statements, including the number and page of the note:

Significant Accounting Policy	Note #	Page #
Accounts Receivable	4	34
Fair Value Measurements	5	35
Investments	6	40
Derivatives and Hedging Activities	7	43
Goodwill	8	50
Pension and Other Postretirement Benefit Plans	9	52
Income Taxes	14	60
Stock-Based Compensation	15	65
Legal Contingencies	16	70
Reportable Segments	17	73

[17] In our comment letter on the FASB's Proposed Statement of Financial Accounting Concepts, Chapter 8: Notes to Financial Statements, we support the FASB's decision to address disclosure effectiveness. While reducing the volume of disclosure is not the FASB's primary objective in its project, we believe the FASB should use the project as an opportunity to develop a roadmap to address disclosure overload.

In addition, we also have seen companies make other changes to the financial statement presentation, such as:

- Organizing the notes based on importance
- Listing the applicable note about certain financial statement captions on the face of the balance sheet or income statement for ease of reference
- Using a chart immediately before the notes that provides a brief description of each financial statement caption and related accounting policy as well as a link to the related footnote[18]

Quarterly disclosures

Registrants may presume that users of quarterly financial information have read previously filed annual reports.[19] Therefore, they are not required to repeat annual disclosures from the latest annual report unless necessary for a fair presentation or to comply with ASC 270, *Interim Reporting,* and other accounting standards that specify interim disclosure requirements. Some companies have eliminated or streamlined quarterly disclosures of items that are required only in annual financial statements such as when no material changes have occurred in significant accounting policies since the last annual report. However, some quarterly filings include disclosures beyond those specified in US GAAP.

In recent years, new FASB standards have required essentially the same disclosures in both interim and annual financial statements. As part of its disclosure framework project, the FASB is considering amendments to ASC 270 to clarify that updated disclosures are not required if they don't significantly alter the total mix of information available to investors.[20]

Disclosure of significant accounting policies

The significant accounting policies note should identify and describe the material accounting principles followed by the company, the methods of applying those principles and the important judgments made in applying them. In particular, ASC 235 requires disclosure of material accounting principles and methods that involve any of the following:

- A selection from existing acceptable alternatives
- Principles and methods peculiar to the industry in which the entity operates, even if such principles and methods are predominantly followed in that industry
- Unusual or innovative applications of US GAAP

We often see companies go well beyond this requirement and describe policies for every line item. For example, a company may disclose its accounting policy for prepaid expenses even when it has made no material judgments or policy elections in the periods presented. Companies should consider removing disclosures of accounting policies that are not currently applicable or material to the financial statements or that require little to no discretion to apply.

Furthermore, companies frequently cite the requirements in the FASB Codification when they describe their policies. In our view, disclosure should not repeat what a standard says about policy requirements if the standard does not permit alternative methods. Instead, companies should describe policy elections they have made and the related judgments and estimates required to apply the authoritative literature to their transactions, if relevant.

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[18] This presentation can be useful for a web-enabled version of the annual report that can be placed on a company's website and can replace the outdated pdf version of the Word file.

[19] Regulation S-X, Rule 10-01 *Interim financial statements*

[20] Our To the Point, *A framework to help the FASB establish effective disclosures*, provides an overview of the FASB's exposure draft. In our comment letter, we supported the FASB's objective of improving disclosure effectiveness by developing a framework the Board would apply when instituting new disclosure requirements and evaluating existing ones. However, we are concerned that the proposed framework would actually perpetuate the significant expansion in disclosure that has occurred over the past few decades. We suggested changes to the framework and recommended that the Board provide guidance on materiality and clearly distinguish between annual and interim requirements.

SAB 11-M disclosures

SAB Topic 11-M, *Disclosure Of The Impact That Recently Issued Accounting Standards Will Have On The Financial Statements Of The Registrant When Adopted In A Future Period,* requires a company to disclose the effect of new standards that are not yet adopted "unless the impact on its financial position and results of operations is not expected to be material."

However, companies commonly include in their disclosures a description of each new standard, the alternative methods of adoption permitted by the standard and the method that the company expects to use, if determined, followed by this or a similar statement:

> "The Company does not expect the adoption of this standard to have a material effect on its financial position or results of operations."

Because companies are not required to summarize or disclose when effects of new standards are immaterial, companies should consider condensing these disclosures into one paragraph or eliminating these disclosures entirely.[21] A company should consider including a discussion of only new standards that are reasonably likely to have a material effect on its financial statements. A table also could be used to provide SAB 11-M disclosure in a concise manner as shown in the following before and after illustration:

[21] SAB Topic 11-M encourages, but does not require, the registrant to disclose that a standard has been issued and that its adoption will not have a material effect on its financial position or results of operations.

Recent accounting pronouncements

Existing disclosure:

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606).* This ASU will replace existing revenue recognition standards and significantly expand the disclosure requirements for revenue arrangements. The provisions of ASU 2014-09 are effective for annual periods beginning after December 15, 2016, including interim periods within that reporting period, and early application is not permitted. The new standard may be adopted retrospectively for all periods presented, or adopted using a modified retrospective approach. Under the retrospective approach, the fiscal 2016 and 2015 financial statements would be adjusted to reflect the effects of applying the new standard on those periods. Under the modified retrospective approach, the new standard would only be applied for the period beginning January 1, 2017 to new contracts and those contracts that are not yet complete at January 1, 2017, with a cumulative catch-up adjustment recorded to beginning retained earnings for existing contracts that still require performance. Management is currently evaluating the methods of adoption allowed by the new standard and the effect the standard is expected to have on our financial statements and related disclosures.

In April 2014, the FASB issued ASU 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. ASU 2014-08 changes the criteria for determining which disposals can be presented as discontinued operations and modifies the related disclosure requirements. Under the new guidance, a disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results and is disposed of or classified as held for sale. The standard also introduces several new disclosures. The guidance applies prospectively to new disposals and new classifications of disposal groups as held for sale after the effective date. ASU 2014-08 is effective for annual and interim periods beginning after December 15, 2014, with early adoption permitted. We do not expect that the adoption of this standard will have a material effect on our financial statements.

In July 2013, the FASB issued ASU 2013-11, *Income Taxes* (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Exists. This update requires unrecognized tax benefits to be offset against a deferred tax asset for a net operating loss carryforward, similar tax loss or tax credit carryforward in certain situations. This update was issued due to the diversity in practice in presentation of unrecognized tax benefits in those instances. Some entities present unrecognized tax benefits as a liability unless the unrecognized tax benefit is directly associated with a tax position taken in a tax year that results in, or resulted in, the recognition of a net operating loss or tax credit carryforward for that year and the net operating loss or tax credit carryforward for that year has not been utilized. Other entities present unrecognized tax benefits as a reduction of a deferred tax asset for a net operating loss or tax credit carryforward in certain circumstances. The objective of this update is to eliminate this diversity in practice. The amendments in this update must be applied prospectively for reporting periods beginning after December 15, 2013. We adopted the standard on January 1, 2014. As a result of the adoption we decreased noncurrent deferred income tax assets by $95 million with a corresponding decrease in other noncurrent liabilities.

Alternative enhanced disclosure:

The following table provides a brief description of recent accounting pronouncements that could have a material effect on our financial statements:

Standard	Description	Date of adoption	Effect on the financial statements or other significant matters
Standards that are not yet adopted			
ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*	The standard will replace existing revenue recognition standards and significantly expand the disclosure requirements for revenue arrangements. It may be adopted either retrospectively or on a modified retrospective basis to new contracts and existing contracts with remaining performance obligations as of the effective date.	January 1, 2017	We are currently evaluating the alternative methods of adoption and the effect on our financial statements and related disclosures.[22]
Standards that were adopted			
ASU 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Exists*	The standard requires unrecognized tax benefits to be offset against a deferred tax asset for a net operating loss carryforward, similar tax loss or tax credit carryforward in certain situations.	January 1, 2014	The adoption of this standard resulted in a reduction in noncurrent deferred income tax assets of $95 million and a corresponding decrease in other noncurrent liabilities.

[22] The SEC staff expects that an entity's SAB 11-M disclosures will evolve in each reporting period as more information about the effects of the new standard becomes available.

MD&A disclosures

As discussed, FR-72 encourages companies to focus their MD&A on material information from management's perspective. However, MD&A continues to be the top area of focus in SEC staff comment letters.

EY resources

- SEC Comments and Trends: An analysis of current reporting issues (SCORE No. CC0398), September 2014

Executive overviews

While many companies include an MD&A overview in their filings, the SEC staff has emphasized that the overview should continue to evolve over time and avoid generic or boilerplate language. The overview should summarize the most important aspects of the company, including its performance and financial condition, and complement the more detailed discussions in the rest of the document. It should not repeat discussion about the company's business provided earlier in the filing or language from management's detailed analysis in the sections that follow.

We believe the executive overview is one area that could be improved if companies started with a clean sheet of paper each period and outlined the significant and new information affecting their operations and financial performance.

Results of operations

The SEC staff often requests that registrants explain the results of their operations with greater specificity, including identifying underlying drivers of each material factor that has affected their earnings or that is reasonably likely to have a material effect on future earnings. MD&A also should disclose key performance indicators, financial or nonfinancial, used to manage the business.

Companies should provide insightful analyses of items that are material to understanding their results and trends. They should focus on an effective presentation and ensure their analysis highlights the most important information while omitting discussions of items that are not material. Many companies have moved away from MD&A presentations that list every financial line item and include separate discussions of each period-over-period analysis (i.e., separate sections to discuss 2014 vs. 2013 and 2013 vs. 2012 changes in financial statement line items).

Instead, we have seen effective MD&A disclosures that incorporate some or all of the following:

- Combine the discussion and analysis of material financial statement line items over three years
- Provide tables or charts to compare the periods, including the components of changes (e.g., table showing the components of sales growth), as well as trends in key performance indicators
- Include narrative discussion that does not repeat information that is evident in the tables or charts
- Use bullet points to quantify and explain reasons for changes, including the offsetting factors
- Disclose activity rollforwards followed by a description of material known trends, events or uncertainties
- Analyze trends in financial and nonfinancial information in a separate MD&A section about key performance indicators

The example on the next page shows how to apply several of these best practices to MD&A disclosures to reduce repetition and structure the discussion to enhance the analysis of key drivers and trends.

MD&A — Results of operations

Existing disclosure:

	2013	2012	2011
Revenue	$ 415,000	$ 350,000	$ 335,000

[*other line items excluded for illustration purposes*]

Year ended December 31, 2013, compared to year ended December 31, 2012

Revenues

Total revenues increased by approximately $65 million, or 19%, to $415 million during the year ended December 31, 2013 as compared to $350 million for the year ended December 31, 2012. The revenue growth results from the acquisition of ABC, Inc. in the US which contributed $35 million during the year, and increased sales of customers primarily as a result of significant focus on selling new products. Excluding the ABC, Inc. acquisition, North America revenue increased $29 million to $285 million in 2013 from $256 million in 2012 due to the increased sales of our new routing and switch products. Revenue in Europe increased from $94 million in 2012 to $95 million in 2013 due to a slight increase in data center equipment sales offset by the unfavorable effects of foreign currency.

Year ended December 31, 2012, compared to year ended December 31, 2011

Revenues

Total revenues increased by approximately $15 million, or 4%, to $350 million during the year ended December 31, 2012, as compared to $335 million for the year ended December 31, 2011. The revenue growth is primarily attributed to increased sales volume from our routing and switch products. North America revenue increased $21 million to $256 million in 2012 from $235 million in 2011 due to stronger demand for our networking, router and switch products. Revenue in Europe declined from $100 million in 2011 to $94 million in 2012 due to lower sales of data center equipment as a result of intense competition and the unfavorable effects of foreign currency.

Alternative enhanced disclosure:

Revenues

	2013	2012	2011
North America	$ 320,000	$ 256,000	$ 235,000
Europe	95,000	94,000	100,000
Total revenue	415,000	350,000	335,000
$ Change	65,000	15,000	
% Change	19%	4%	

The following are components of revenue growth compared to the prior year:

	2013 vs. 2012	2012 vs. 2011
Volume	7%	4%
Price	3%	1%
Acquisitions	10%	–
Foreign currency effects	(1)%	(1)%
	19%	4%

Total revenue changes are due to:

- North America revenues in 2013 rose by $35 million, or 14%, due to the ABC, Inc. acquisition and by $29 million, or 11%, due to organic growth related primarily to sales of our new routing and switch products. Increases in 2012 were due to stronger demand for our networking, router and switch products.
- Europe revenues were relatively flat in 2013 as the slight increase in data center product sales was offset by unfavorable foreign currency effects. Decreases in 2012 resulted from lower volumes of 3%, primarily in data center products, resulting from increased competition. The remaining change was due to unfavorable foreign currency effects.

Critical accounting estimates

Critical accounting estimates are those that are most important to the financial statement presentation and that require the most difficult, subjective and complex judgments. FR-72 reminds SEC registrants that MD&A rules require disclosure of a critical accounting estimate in either of the following cases:

- The nature of the estimates or assumptions is material because of the levels of subjectivity and judgment needed to account for matters that are highly uncertain and susceptible to change
- The effect of the estimates and assumptions is material to the financial statements

Disclosures about critical accounting estimates should provide a robust analysis that supplements the description of accounting policies in the notes to the financial statements and (1) addresses why the accounting estimate or assumption may be susceptible to change and (2) analyzes the following:

- How the company arrived at the estimate/assumption
- How accurate the estimate/assumption has been in the past
- How much the estimate/assumption has changed in the past
- Whether the estimate/assumption is reasonably likely to change in the future

The SEC staff has commented that some registrants repeat verbatim in MD&A portions of the significant accounting policies footnote. While accounting policies in the notes to the financial statements generally describe the method used to apply significant accounting principles, the discussion in MD&A should be limited to only those areas that use assumptions and judgments that most materially affect the financial statements. That section of MD&A should provide insight into the uncertainties involved in applying the principle at a given time and the variability that is reasonably likely to result from its application.

SEC registrants should consider a cross-reference to footnote disclosure about significant accounting policies if necessary, but should limit the MD&A disclosure to an analysis of the specific underlying assumptions and judgments.

The following illustration uses cross-references and tailors the discussion of critical accounting estimates. While the enhanced disclosure in the illustration is roughly the same length, it uses cross-references, bullets and tables to make the disclosures more effective.

Critical accounting estimates

The following excerpt from the critical accounting estimates section about pensions illustrates improvements that tailor the discussion to provide appropriate insight into management's judgments and uncertainties and use cross-references, bullet points and tables for more effective presentation:

Existing disclosure:

The Company sponsors multiple defined benefit pension plans that cover certain US employees. The Company accounts for its pension plans in accordance with Accounting Standards Codification (ASC) 715, *Compensation — Retirement Benefits*. The funded status of the plans is measured as the difference between the fair value of the plan assets and the projected benefit obligation. Liabilities and expense for pension plans are actuarially determined using significant assumptions, including the rate used to discount the projected benefit obligation, the long-term rate of return on plan assets and several assumptions related to the employee workforce (salary increases, mortality rates and other factors). There are inherent uncertainties related to these assumptions and management's judgment in applying them. Consistent with the accounting guidance, the Company has policies that generally defer the effect of changes in actuarial assumptions and differences between the expected and actual return of plan assets over future periods. Unrealized gains or losses are recorded in other comprehensive income (OCI), a component of shareholders' equity.

A significant estimate in determining pension cost in accordance with accounting guidance is the expected return on plan assets. The Company estimated the expected long-term rate of return on plan assets was 7.25% and 7.50% as of December 31, 2013 and 2012, respectively. The expected return assumptions were developed by considering various factors, such as the plans' investment guidelines, mix of asset classes, historical returns of equities and bonds, and expected future returns. Management believes these assumptions are reasonable. If the plan assets earn an average return less than 7.25% over time, future pension cost likely would increase.

In addition, the Company estimates the discount rate by performing an analysis of the rates of return on high-quality, fixed-income investments. The Company estimated discount rates of 4.50% and 3.75% at December 31, 2013 and 2012, respectively. Management believes these assumptions are reasonable. However, an increase in the discount rate would decrease the plan obligations and the net periodic benefit cost, while a decrease in the discount rate would increase the plan obligations and the net periodic benefit cost.

Alternative enhanced disclosure:

We sponsor multiple defined benefit pension plans that cover certain US employees. For a description of our related accounting policies, refer to Note 2 in the consolidated financial statements. Changes in significant assumptions could materially affect the amounts, particularly the long-term rate of return on plan assets and the rate used to discount the projected benefit obligation:

- Return on plan assets — We determine the expected long-term rate of return on plan assets based on the building block method, which consists of aggregating the expected rates of return for each component of the plan's asset mix. Our assumed expected rate of return considers past returns on plan assets as well as various other factors, such as the plans' investment guidelines, the expected mix of asset classes and current market conditions. The expected long-term rate of return on plan assets was 7.25% and 7.50% as of December 31, 2013 and 2012, respectively. The decline in the expected long-term rate of return is primarily attributed to a shift in the plan asset mix to fixed income securities from equities, which comprised 42% and 37% of plan assets as of December 31, 2013 and 2012, respectively.
- Discount rate — In estimating this rate, we analyze the rates of return on high-quality, fixed-income investments that receive one of the two highest ratings from a recognized rating agency and the schedule of expected cash needs of the plans. We estimated discount rates of 4.50% and 3.75% at December 31, 2013 and 2012, respectively.

The following illustrates the sensitivity of the net periodic benefit cost and projected benefit obligation to a 1% change in the discount rate or return on plan assets (in millions):

Assumption	Change	2014 net periodic benefit cost	2013 projected benefit obligation
Discount rate	1% increase	$ (8)	$ (85)
	1% decrease	9	90
Return on plan assets	1% increase	(15)	N/A
	1% decrease	15	N/A

For 2015, we expect net periodic pension cost to decline by approximately $2 million due to the 75 basis point increase in the discount rate partially offset by the 25 basis point decline in the expected long-term rate of return due to the shift in plan asset mix.

Other disclosure areas

Business disclosures

Item 101 of Regulation S-K, *Description of Business*, specifies disclosure about the registrant's business, including its operating segments and geographic areas.

Many companies have identified the business section in Item 1 of Form 10-K as one of the first areas where disclosures can be improved. Although the business disclosures may be fairly static from period to period, the discussion becomes lengthy when disclosures are added over time. In addition, certain portions of the business discussion often are repeated in other sections of the filing, including MD&A and risk factors. The company's website also may provide significant information about the company's business.

Although the company's Form 10-K should comply with the requirements of Item 101 of Regulation S-K, we believe companies can reduce repetition throughout their filings by using cross-references to other areas of the document or to other publicly available information.

Risk factors

Item 503(c) of Regulation S-K requires a registrant to disclose its significant risks and how it is affected by each of them. Risk factors should be specific to the company's facts and circumstances and not merely general risks that could apply to any company.

Because of the safe harbor in the Private Securities Litigation Reform Act of 1995, many companies are hesitant to limit the number or length of risk factor disclosures. However, investors frequently have said that risk factors are generic and confusing. The most important risk factors often are not presented first, and readers have a hard time determining whether a risk is likely to become a reality. The SEC staff also has questioned risk factor disclosures that could apply to any public company, saying they are not sufficiently specific or detailed to address the facts and circumstances of a particular company.

At a minimum, we believe risk factor disclosures can benefit from better organization and tailoring the discussion of the risk to the business.

For example, Item 503(c) requires the discussion of risk factors to be "concise and organized logically." Some companies have used headers to group risks by the type of factors, such as the following:

- Risks related to operational factors
- Risks related to technology factors
- Risks related to economic or market factors
- Risks related to legal and regulatory factors

Companies then use sub-captions to describe the risk factor specific to them.

Companies also may want to emphasize recent trends or changes during the period in the likelihood that certain risk factors may occur as well as their approach to manage and mitigate these risks.

Legal proceedings

Companies may include loss contingency disclosures in several sections of the filing, including the legal proceedings section, risk factors, MD&A and loss contingencies footnote to the financial statements.

There is significant overlap between the disclosure requirements for loss contingencies under US GAAP and Regulation S-K. Accordingly, many filings duplicate disclosure of litigation matters.

However, the SEC staff has emphasized that the disclosure requirements are different. For example, Item 103 of Regulation S-K requires registrants to briefly describe any material pending legal proceedings to which the registrant or any of its subsidiaries is a party. US GAAP[23] requires disclosures based on the likelihood of loss, including an estimate of reasonably possible losses or a statement that such an estimate cannot be made.

To improve disclosures in this area, companies should consider using a bullet-point list of material legal proceedings with the descriptions required by Regulation S-K and appropriate cross-references to MD&A and the financial statements footnotes where each matter might be discussed.

EY resources

- SEC Comments and Trends: An analysis of current reporting issues (SCORE No. CC0398), September 2014

[23] ASC 450, *Contingencies*

Process to improve disclosures

It is important for companies to have a process in place to regularly review the effectiveness of their disclosures and a plan to make ongoing improvements to their financial reporting.

Key stakeholders

First, companies need to identify key stakeholders and confirm their commitment to improving the company's financial reporting process and SEC filings. The following individuals (and/or senior members of their functions) typically are the key participants and influencers:

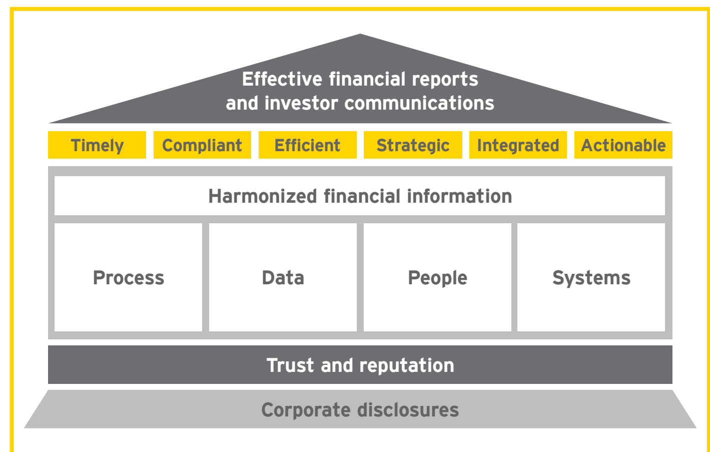
- Chief executive officer and chief financial officer (CFO)
- Controller, chief accounting officer, director of external reporting or equivalent roles
- Chair of the audit committee
- Head of the disclosure committee, if applicable
- General counsel
- Head of investor relations
- Chief risk officer and head of strategy
- Managers and CFOs of key operating business units or divisions

Depending on the nature of the business, input may be needed from other members of the management team (i.e., head of research of a pharmaceutical company, chief credit officer of a banking institution). Communication with the external auditor also is essential. In addition, companies can contact the SEC staff to discuss potential changes to their disclosures.

Process and plan

Companies should develop an overall plan with a clear timeline and project management support. Ideally, the focus should be the reporting process as a whole, not just the financial statement disclosures or MD&A in isolation. An effective plan integrates the company's processes, people, data and systems to:

- Address investor communications more holistically
- Identify and implement any necessary process, content and system changes
- Establish greater synergies between strategic, operational, financial, regulatory, and sustainability reporting and messaging
- Produce compliant SEC filings in a timely and efficient manner



Companies should consider benchmarking their disclosures against those of their peers. Benchmarking can identify best practices within the industry. Such an approach also can identify potential gaps that can be addressed with additional information or performance metrics to meet the needs and expectations of investors and/or analysts who follow the company or industry.

In addition, many companies are making meaningful improvements to their investor communications by developing web-enabled versions of financial reports that look better and are easier to navigate than traditional reports. These reports help readers focus more quickly on areas of interest, move from section to section, or find additional information using hyperlinks.

A journey, not an initiative

Companies may decide to make significant disclosure improvements all at once or incrementally by targeting one particular disclosure area at a time.

Some companies may start by focusing on making specific disclosures more effective as an initiative, but it is important to embed the objective of disclosure effectiveness into the company's financial reporting DNA to ensure that the changes are successful and sustainable.

Conclusion

As the SEC staff and the FASB work on their disclosure effectiveness initiatives, companies can take immediate action to make their disclosures more meaningful. These actions can go a long way toward enhancing disclosure and providing investors with information that is easier to understand.

We believe that companies that take the steps we describe in this publication will see a variety of benefits, including more efficient reviews by executives and directors and greater investor confidence.

While meaningful and lasting change to the disclosure regime will take time, we hope this publication has provided you with a road map of improvements you can follow in drafting your upcoming filings and financial statements.

Appendix

Current initiatives on disclosure effectiveness by standard setters, regulators and organizations include:

Standard setter/regulator/organization	Project/report/study
SEC	▸ Disclosure Effectiveness
FASB	▸ Disclosure Framework ▸ Conceptual Framework ▸ Simplification initiative
IASB	▸ Disclosure Initiative
Center for Audit Quality (CAQ)	▸ Financial Statement Disclosure Effectiveness: Forum Observations Summary
US Chamber of Commerce	▸ Corporate Disclosure Effectiveness: Ensuring a Balanced System that Informs and Protects Investors and Facilitates Capital Formation
UK Financial Reporting Council (FRC)	▸ Louder than Words ▸ Cutting clutter ▸ Financial Reporting Lab insight report: Towards Clear & Concise Reporting
UK Department for Business, Innovation & Skills (BIS)	▸ The future of narrative reporting
International Integrated Reporting Committee (IIRC)	▸ The International Integrated Reporting Framework
Joint oversight group of the Institute of Chartered Accountants of Scotland (ICAS) and the New Zealand Institute of Chartered Accountants (NZICA)	▸ Losing the excess baggage
European Securities and Markets Authority (ESMA)	▸ Consultation Paper – Considerations of materiality in financial reporting ▸ Feedback Statement – Considerations of materiality in financial reporting
European Financial Reporting Advisory Group (EFRAG)	▸ Discussion Paper – Towards a Disclosure Framework for the Notes
Australian Accounting Standards Board (AASB)	▸ Rethinking the Path from an Objective of Economic Decision Making to a Disclosure and Presentation Framework
Chartered Financial Analyst (CFA) Institute	▸ Financial Reporting Disclosures – Investor Perspectives on Transparency, Trust, and Volume ▸ Forward-Looking Information – A Necessary Consideration in the SEC's Review on Disclosure Effectiveness: Investor Perspectives
Enhanced Disclosure Task Force (EDTF)	▸ Enhancing the risk disclosures of banks
International Accounting and Assurance Standards Board (IAASB)	▸ The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications
Institute Of Chartered Accountants In England And Wales (ICAEW)	▸ Financial Reporting Disclosures: Market and Regulatory Failures

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To the Point

SEC — concept release

SEC seeks feedback on possible changes to audit committee disclosures

'Effective audit committee oversight is essential to investor protection and the functioning of our capital markets.'

— SEC Chair Mary Jo White

What you need to know

- The SEC issued a concept release seeking public comment on whether there would be benefit from mandating more disclosures from audit committees about how they execute their existing audit oversight responsibilities.
- The concept release seeks comment on whether more audit committee disclosures would help close the expectation gap by providing investors with better insights into the responsibilities of the audit committee. It also asks whether new disclosures would inform their investment decisions and voting decisions about whether to ratify the selection of the auditor or re-elect members of the audit committee to the Board.
- Comments are due 60 days after the concept release is published in the Federal Register.

Overview

The Securities and Exchange Commission (SEC) issued a concept release on possible revisions to its audit committee disclosure rules that explores whether audit committees should provide more qualitative disclosures about how they execute existing responsibilities to oversee the audit. The audit committee report in the annual proxy statement currently must affirm only that the audit committee carried out certain specific responsibilities related to communications with the external auditor.[1]

The SEC observed that while the Sarbanes-Oxley Act of 2002 (the Act) codified the role of the audit committee in overseeing a company's financial reporting process and the audit, the SEC's disclosure requirements for audit committee reporting to shareholders have not changed significantly since 1999. The Act required the audit committee to be independent from management and made the audit committee directly responsible for the retention, compensation

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and oversight of the independent external auditor. The SEC noted that, in recent years, many audit committees have voluntarily provided more robust disclosures about their oversight of the external auditor. It also observed that investors have increased their focus on activities and transparency of audit committees.

The concept release is part of a broader effort by the SEC and the Public Company Accounting Oversight Board (PCAOB) to increase transparency of the audit process. The PCAOB has proposed that auditors name the engagement partner and other public accounting firms that participated in the audit in regulatory filings.[2] The PCAOB also issued a concept release on audit quality indicators it believes might be useful to various stakeholders, including audit committees, audit firms, investors, regulators and others.[3] The comment period for all of these initiatives is now open so stakeholders have the opportunity to consider them holistically.

In its concept release, the SEC said it is seeking to understand whether mandating additional disclosure about the audit committee's oversight of the auditor would provide useful information that would help investors to make better investment decisions and voting decisions about whether to ratify the selection of the auditor or re-elect members of the audit committee to the Board. While the concept release discusses the views of certain investors and groups that have called for more audit committee reporting, it acknowledges that others have expressed concerns about the potential usefulness of additional audit committee disclosures.

Key considerations

The concept release requests public comment on 74 questions about possible disclosure changes primarily in the following areas:

- Oversight of the auditor
- Process for appointing or retaining the auditor
- Evaluation of the audit firm and engagement team qualifications

Oversight of the auditor

The concept release questions whether the SEC should require additional qualitative disclosures about the nature, timing and frequency of the communications between the audit committee and the auditor.[4] For example, the SEC seeks input on whether the audit committee should report on its communications with the auditor about topics such as the overall audit strategy, significant risks, the nature and extent of specialized skills used in the audit and the use of a company's internal audit personnel.

The concept release also asks whether disclosure would be useful about how the audit committee assesses, promotes and reinforces the auditor's objectivity and professional skepticism. In addition, it seeks feedback on whether the audit committee should disclose how it considered the results of PCAOB inspection reports and the audit firm's internal quality control reviews.

Process for appointing or retaining the auditor

The concept release discusses possible disclosures about the process and criteria the audit committee used to assess the auditor and its rationale for selecting or retaining the auditor. It cites the PCAOB's concept release on possible indicators of audit quality and asks whether an audit committee that uses these or other indicators should disclose which indicators it used to evaluate the auditor.

The concept release also discusses possible disclosures about the number of firms that were asked to propose providing audit services and what information the audit committee considered in making its selection. And it requests feedback about disclosures of any policy on shareholder ratification of the auditor and how the results of these votes were considered in the audit committee's decision to retain the audit firm.

Evaluation of the audit firm and engagement team qualifications

The concept release asks whether the SEC should require disclosures about the length of the company's relationship with the auditor (which the PCAOB previously proposed requiring in the audit report) and how the audit committee considered the auditor's tenure in deciding to retain the auditor. It also asks whether the audit committees should name and report on the qualifications of certain individuals who perform the audit (e.g., the engagement partner, the engagement quality reviewer, additional individuals subject to PCAOB rotation requirements) and identify other public accounting firms that participated in the audit. As discussed above, the PCAOB has proposed requiring disclosure of the engagement partner and other participating public accounting firms, either in the auditor's report or a new form to be filed with the PCAOB.

Applicability and location of possible disclosures

The concept release also seeks input on whether new and existing audit committee disclosures should be required to appear in one location and whether the requirements should apply to smaller reporting companies and emerging growth companies. Disclosures required by existing SEC rules are included in proxy statements but they are not required in the prospectus delivered to investors for public offerings. The concept release asks whether investors would benefit from these disclosures being included in that prospectus.

The SEC is seeking input on whether and how additional reporting may be useful to investors.

How we see it

- Enhancing audit committee transparency can increase investors' confidence in financial reporting and their confidence in the role of the audit committee in overseeing the audit process and promoting audit quality in the interest of investors.
- Many audit committees have begun telling investors more about what they do in overseeing the audit and the independent auditor. Meaningful disclosure about what audit committees do and how they oversee auditors would provide a window into the work they perform, which could further the alignment among auditors, audit committees and investors, an outcome we strongly support. However, additional requirements that result in largely "boilerplate" disclosures would offer little value to investors.
- Commenters should consider the range of possible disclosures presented in the concept release to identify disclosures that would provide the most decision-useful information to investors.

Endnotes:

[1] The SEC's disclosure requirements are in Item 407 of Regulation S-K and Exchange Act Rule 10A-3.

[2] See PCAOB Release No. 2015-004, *Supplemental Request for Comment: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form*.

[3] See PCAOB Release No. 2015-005, *Concept Release on Audit Quality Indicators*.

[4] Audit committee and auditor communications required by PCAOB Auditing Standard No. 16, *Communications with Audit Committees*.

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U.S. Securities and Exchange Commission

STRATEGIC PLAN
FISCAL YEARS 2014–2018

Protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation

This document presents the U.S. Securities and Exchange Commission's Strategic Plan prepared in accordance with the Government Performance and Results Act Modernization Act of 2010. The plan sets out the Commission's mission, vision, values, and strategic goals for fiscal years 2014 through 2018. Furthermore, it discusses the SEC's environment, details the strategic objectives the Commission seeks to achieve, presents the strategies and initiatives that will be undertaken to accomplish those objectives, and lists the performance goals that will be used to gauge the agency's progress.

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The U.S. Securities and Exchange Commission is an independent federal agency established pursuant to the Securities Exchange Act of 1934 (Exchange Act). It is headed by a bipartisan five-member Commission, comprised of the Chair and four Commissioners, who are appointed by the President and confirmed by the Senate. The Chair is responsible for the executive and administrative functions of the Commission. The SEC employs over 4,100 people.

MISSION

The mission of the SEC is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.

VISION

The SEC strives to promote a securities market that is worthy of the public's trust and characterized by:

- Transparent disclosure to investors of the risks of particular investments;
- Oversight of key market participants, including exchanges, brokers and dealers, investment advisers, and others;
- Focus on strengthening market structure and systems;
- Promotion of disclosure of market-related information;
- Protection against fraud and abuse; and
- Evaluation, development and maintenance of appropriate rules and regulations.

VALUES

Integrity: As the SEC is the independent federal agency entrusted with regulating and conducting enforcement for the U.S. securities markets; each member of the Commission's workforce has a responsibility to demonstrate the highest ethical standards to inspire confidence and trust.

Excellence: The SEC is committed to the highest standards of excellence in pursuit of its mission. The investing public and the U.S. securities markets deserve nothing less.

Accountability: The SEC embraces the responsibility with which it is charged. In carrying out its mission, SEC employees hold themselves accountable to the public and take responsibility for achieving SEC goals.

Effectiveness: The SEC strives to work creatively, proactively, and effectively in assessing and addressing risks to the securities markets, the public, and other market participants. The staff is committed to finding innovative and flexible approaches to the SEC's work and using independent judgment to explore new ways to fulfill the SEC's mission in the most efficient and effective manner possible.

Teamwork: The SEC recognizes that its success depends on a diverse, coordinated team committed to the highest standards of trust, hard work, cooperation, and communication. The staff is committed to working together and coordinating effectively with investors, business, governments, and other organizations in the U.S. and abroad.

Fairness: The SEC treats investors, market participants, and others fairly and in accordance with the law. As an employer, the SEC seeks to hire and to retain a skilled and diverse workforce, and to ensure that all decisions affecting employees and applicants are fair and ethical.

STRATEGIC GOALS AND STRATEGIC OBJECTIVES

Strategic Goal 1: Establish and maintain an effective regulatory environment

- **Strategic Objective 1.1**
  The SEC establishes and maintains a regulatory environment that promotes high-quality disclosure, financial reporting and governance, and that prevents abusive practices by registrants, financial intermediaries and other market participants.

- **Strategic Objective 1.2**
  The SEC promotes capital markets that operate in a fair, efficient, transparent and competitive manner, fostering capital formation and useful innovation.

- **Strategic Objective 1.3**
  The SEC adopts and administers regulations and rules that are informed by robust economic analysis and public comment and that enable market participants to understand clearly their obligations under the securities laws.

- **Strategic Objective 1.4**
  The SEC engages with a multitude of stakeholders to inform and enhance regulatory activities domestically and internationally.

Strategic Goal 2: Foster and enforce compliance with the federal securities laws

- **Strategic Objective 2.1**
  The SEC fosters compliance with the federal securities laws.

- **Strategic Objective 2.2**
  The SEC promptly detects and deters violations of the federal securities laws.

- **Strategic Objective 2.3**
  The SEC prosecutes violations of federal securities laws and holds violators accountable through appropriate sanctions and remedies.

Strategic Goal 3: Facilitate access to the information investors need to make informed investment decisions

- **Strategic Objective 3.1**
  The SEC works to ensure that investors have access to high-quality disclosure materials that facilitate informed investment decision-making.

- **Strategic Objective 3.2**
  The SEC works to understand investor needs and educate investors so they are better prepared to make informed investment decisions.

Strategic Goal 4: Enhance the Commission's performance through effective alignment and management of human, information and financial capital

- **Strategic Objective 4.1**
  The SEC promotes a results-oriented work environment that attracts, engages, and retains a technically proficient and diverse workforce, including leaders who provide motivation and strategic direction.

- **Strategic Objective 4.2**
  The SEC encourages a collaborative environment across divisions and offices and leverages technology and data to fulfill its mission more effectively and efficiently.

- **Strategic Objective 4.3**
  The SEC maximizes the use of agency resources by continually improving agency operations and bolstering internal controls.

ENVIRONMENTAL PERSPECTIVE & OUTLOOK

The SEC's goals and priorities are influenced by a number of external environmental factors, including the demands of fulfilling its mission in an increasingly complex and globally interconnected securities market and the statutory structure within which the Commission works. In recent years, this environment has changed dramatically. While this Strategic Plan attempts to anticipate various ways in which the markets, regulated industries and legislative requirements may evolve over time, no plan can anticipate all possible scenarios. The following discussion outlines the agency's perspective and outlook on the most significant environmental factors that have influenced—and are expected to continue to influence—the SEC's fulfillment of its mission.

Increasingly Dispersed and Complex Financial Markets

Driven by competition, technology, regulation and market participants' innovation, today's financial markets offer more products, services, strategies and opportunities than ever before. Investors are confronted by a growing number of increasingly complex product offerings. Sophisticated technology brings remarkable speed and efficiency to the financial markets, making both routine trades and complex transactions easier and less expensive to execute. At the same time, this technology brings new risks of accidental or intentional disruptions which are capable of spreading across markets, international borders and institutional firewalls. In addition, market structure has become highly fragmented as trading volume is dispersed among many highly automated trading centers that compete for order flow of securities.

New Aspects of the Agency's Jurisdiction

The SEC's role has significantly expanded in recent years, as historic legislation like the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and the Jumpstart Our Business Startups Act (JOBS Act) have increased the Commission's regulatory responsibility for advisers to hedge funds and other private funds, clearing houses, rating agencies, municipal advisers, crowdfunding portals and, together with the Commodity Futures Trading Commission (CFTC), the entire market structure surrounding swaps.

Actions designed to ease the acquisition of new capital by new and smaller enterprises—chiefly through crowdfunding and general solicitation—will increasingly demand SEC time and resources as well.

The Globally Interconnected Financial Markets

At the same time that domestic responsibilities are expanding, activities the SEC regulates increasingly have international implications. Traders in today's global financial market can move billions of dollars thousands of miles away in a fraction of a second; issuers can explore a whole world of choices as they decide where to list and raise new capital; and investor portfolios are more diverse and global than ever before. Engagement and appropriate coordination with foreign regulators, both bilaterally and multilaterally, on everything from enforcement strategies to swaps regulations, are necessary for the SEC to oversee today's markets, to combat fraud and to identify global risks that could impact U.S. securities markets.

Continuing Risks

Many of the initiatives outlined in this Strategic Plan are designed to address specific problems brought to light by the global financial crisis and its aftermath. Despite best efforts, however, it is impossible to predict and plan for all potential challenges. The degree of the SEC's success in achieving its goals and strategic objectives may depend upon factors such as those listed below.

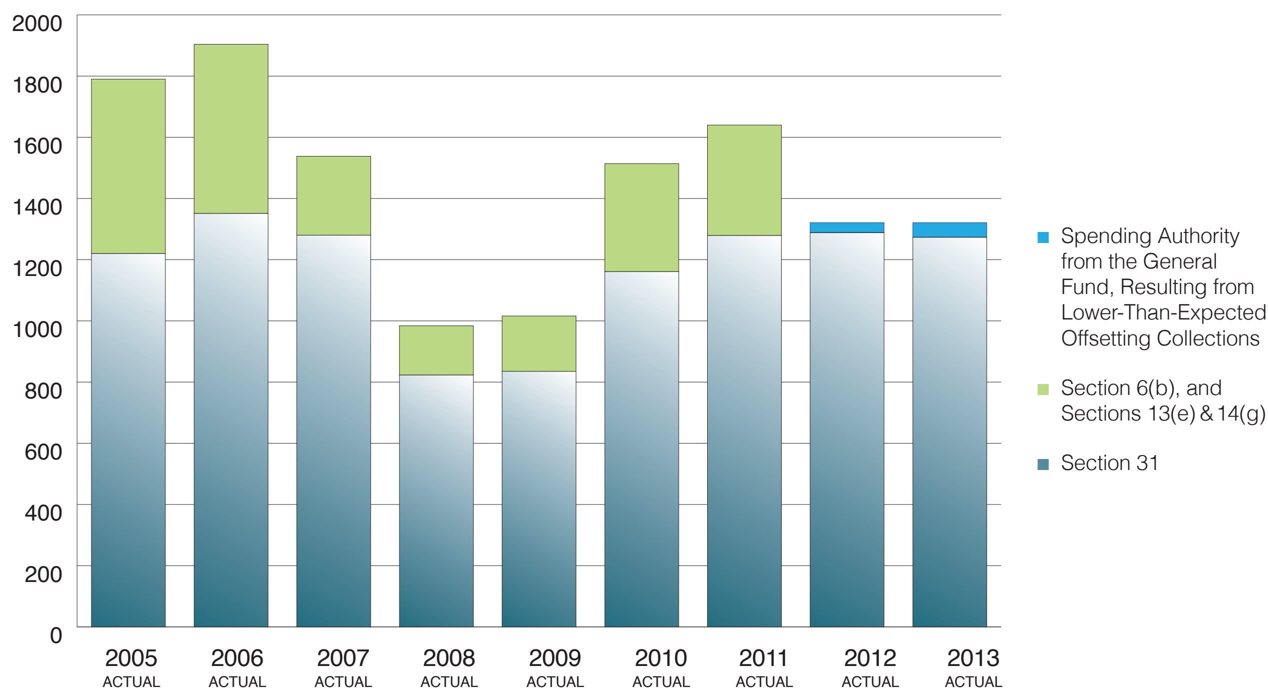
- The SEC's ability to meet its statutory mission and the performance goals and strategic objectives outlined in this Strategic Plan are inherently dependent upon the SEC obtaining sufficient resources, which the agency needs to keep pace with the growing size and complexity of the securities markets and the broad oversight and enforcement responsibilities. The SEC submits an annual budget request which outlines the funding it is seeking and the intended use of such funding. The appropriation that the SEC receives is fully offset by securities transaction fees and, accordingly, the SEC's funding is not borne by taxpayers. Budgetary constraints will impact the ability of the SEC to fulfill its goals and objectives as outlined in this Strategic Plan.
- Legislative and regulatory changes may not be successful in providing regulators with a comprehensive understanding of systemic risk or sufficient tools to manage that risk more effectively.
- Changes in financial industry regulation may unintentionally hamper behavior that would benefit the market and investors.
- Regulations may be perceived as a substitute for care and diligence on the part of investors in their own decision-making.
- Over-regulation or under-regulation may undermine the competitiveness of the U.S. capital markets in an increasingly competitive global marketplace.
- Over-regulation or under-regulation may chill innovation, entrepreneurship, and prudent risk taking.

RESOURCES

The SEC is an independent federal government agency funded through annual appropriations enacted by Congress and the President. Until FY 2012, the agency's appropriations were offset by transaction and registration fees collected by the agency. The Offsetting Collections and Spending Authority chart below presents the SEC's budgetary authority derived from offsetting collections from transaction fees collected pursuant to Section 31 of the Exchange Act and registration fees collected under Section 6(b) of the Securities Act of 1933, Sections 13(e) and 14(g) of the Exchange Act and Section 24(f) of the Investment Company Act of 1940 during the period FY 2005 through 2011. Pursuant to the Dodd-Frank Act and beginning in FY 2012, registration fee collections are no longer offsetting collections, and are now either deposited into the Securities and Exchange Commission Reserve Fund or the U.S. Treasury General Fund. Thus, the columns for FY 2012 through FY 2013 reflect only Section 31 transaction fee collections.

The SEC's appropriation is deficit-neutral since, under the Dodd-Frank Act, the Commission's appropriation is matched by anticipated collections of Section 31 securities transaction fees. Thus, each year, Congress and the President can decide the size of the SEC's appropriation without diverting resources from other priorities or adding to the nation's debt. Since personnel and technology typically comprise about 70 percent of the SEC's appropriation, constraints on the Commission's budget can have a direct and significant impact on the staff and systems the Commission has available to enforce and implement the federal securities laws.

OFFSETTING COLLECTIONS AND SPENDING AUTHORITY (Dollars in Millions)



"Effective regulation of the U.S. financial system requires us to grapple with a global financial system that transcends boundaries. And it demands that we match our regulatory and enforcement priorities with those of scores of jurisdictions around the world."

CHAIR MARY JO WHITE

STRATEGIC GOAL 1

Establish and Maintain an Effective Regulatory Environment

THE SEC IS RESPONSIBLE FOR ESTABLISHING a regulatory environment in which the agency's mission can be met and sustained. Most securities laws and regulations flow from two central principles. First, all investors should have equal access to accurate, complete and timely information about the investments they buy, sell, and hold. Second, investors should be able to rely upon self-regulatory organizations (SRO), exchanges, broker-dealers, investment advisers, investment companies and other market participants to conduct investors' securities transactions efficiently and according to the informed choices made by investors.

The SEC has broad authority to shape the regulatory framework for the securities industry. Rulemaking often is required to remedy abusive practices, to respond to Congressional mandates, to address changing economic conditions, to address risks in advances in technology or novel products or services. In general, rulemaking and policies are designed to improve disclosure, facilitate the flow of important information to investors and the public, improve governance, promote high-quality accounting standards and financial reporting, enhance the responsibilities and accountability of financial intermediaries and other market participants and strengthen the structure of the trading markets, among other goals. When properly crafted, these rules serve to further the SEC's mission. In addition, when existing laws are not sufficient to achieve this mission, the SEC also has a duty to advise Congress about necessary corrective measures. The SEC recognizes that regular reviews of Commission regulations and its rulemaking processes are necessary to confirm that intended results are being achieved as well as to identify gaps and redundancies in regulation.

In addition to promulgating its rules and regulations, the SEC provides guidance when, among other things, it sets forth the views of the Commission or its staff on questions of current concern without stating them in the form of legal requirements. The most prevalent form of this guidance is publicly available staff statements on a particular legal or accounting issue or on an interpretation of a rule or regulation. The staff also responds to inquiries from individuals and companies about whether an activity, undertaken in a specified manner, would violate the securities laws. The

inquiries can take the form of written requests that the staff not recommend enforcement or other action to the Commission if the activity is completed as specified. The SEC also issues individual orders granting relief from provisions of the securities laws when the specific facts indicate that doing so is consistent with the protection of investors and the policy and purposes behind the laws. These orders can serve as a testing ground for useful innovation and may pave the way for rulemaking.

STRATEGIC OBJECTIVE 1.1

The SEC establishes and maintains a regulatory environment that promotes high-quality disclosure, financial reporting and governance, and prevents abusive practices by registrants, financial intermediaries and other market participants.

The investments of Americans and their families are dependent upon the maintenance of healthy capital markets. The greater availability of and access to investment opportunities can help Americans build their portfolios to create a better life for themselves and their children. Investment opportunities may include the potential for abuse by market intermediaries, and other market participants. Such abuses erode the investing public's trust and undermine investor confidence in markets as a whole.

To protect investors and to promote confidence in the integrity and fairness of the markets, the SEC uses its regulatory authority to deter potentially abusive behavior.

The federal securities laws entrust the SEC with authority to shape the regulatory framework so that investors are protected through the availability of high-quality disclosure about their investments. In addition, the agency develops regulations that promote and strengthen corporate and fund governance.

Initiatives

To accomplish this strategic objective, the SEC plans to implement the following initiatives:

- **Improve the quality and usefulness of disclosure:** The SEC will continue to evaluate and, where necessary, amend its requirements to improve the quality and usefulness of registrants' disclosures to investors, including continuing to modernize the collection and dissemination of timely, machine-readable, structured data to investors when appropriate. Areas of focus will include disclosure about registrants' financial condition, operations, risk management and executive compensation decisions and practices. Additionally, the SEC will continue to pursue data standards and methods that permit investors to more efficiently search for information within forms as well as aggregate and compare financial data across filers.

- **Engage in rulemaking mandated by Congress:** The SEC will continue to fulfill its obligations under the Dodd-Frank Act and the JOBS Act to develop and promulgate mandated rules and regulations with appropriate notice comment and economic analysis.
- **Analyze trends in new financial products and instruments, including exchange traded products, and market innovations:** The SEC will proactively seek out information from market experts both inside and outside the SEC to help inform the regulatory process, look for new risks, understand the impact of significant market events and ensure that rules and registrants' disclosures take into account the latest market environment and practices. When possible, the SEC will directly collect and analyze relevant market data to identify upcoming trends, patterns, or relationships among asset classes, instruments and market participants, and to identify areas of regulatory need. One area of focus will be to consider requiring mutual funds to provide additional information on portfolio holdings and other operations.
- **Strengthen proxy infrastructure:** The SEC will consider issues related to the mechanics of proxy voting and shareholder-company communications, including the role of proxy advisory firms.
- **Modernize beneficial ownership reporting:** The SEC will consider how to modernize its beneficial ownership reporting requirements to, among other things, address the disclosure obligations relating to the use of equity swaps and other derivative instruments.
- **Analyze regulatory structures for investment advisers and broker-dealers providing personalized investment advice:** The SEC will continue to analyze whether the different regulatory obligations that apply to broker-dealers and investment advisers providing personalized investment advice should be changed for the protection of investors.
- **Modernize the regulatory treatment and valuation of certain portfolio holdings of registered investment companies:** The SEC will consider regulatory initiatives and/or guidance needed to update and improve the current regulatory regime for the use of derivatives by mutual funds, exchange-traded funds and other registered investment companies. A related initiative is consideration of updated guidance for registered investment companies regarding the valuation of their portfolio securities and other assets.
- **Promote high-quality accounting standards:** The SEC will continue to promote the establishment of high-quality accounting standards by independent standard setters in order to meet the needs of investors. In overseeing the Financial Accounting Standards Board (FASB), the SEC will strengthen and support the FASB's independence and maintain the focus of financial reporting on the needs of

investors. Due to the increasingly global nature of the capital markets, the agency will work to promote higher quality financial reporting worldwide and will consider, among other things, whether a single set of high-quality global accounting standards is achievable.

- **Foster high-quality audits through the oversight of the accounting profession:** The SEC will continue to oversee the Public Company Accounting Oversight Board (PCAOB) and its regulation of independent auditors through the PCAOB's inspection and disciplinary programs. The SEC also will work closely with the PCAOB on the promulgation and interpretation of auditing standards to address current issues in the capital markets.
- **Enhance the regulation of broker-dealers, clearing agencies, and other major market participants:** The SEC will continue to enhance its oversight of broker-dealers, clearing agencies, and other major market participants by, among other things, evaluating the current regulatory structure related to financial responsibility, customer protection and governance.
- **Monitor disclosures related to asset-backed securities:** The SEC is considering revising its rules and forms to improve registration and disclosure requirements for asset-backed securities, and will monitor disclosures and compliance with current and any revised rules that have been promulgated by the Commission. The SEC will continue to fulfill its statutory mandate to work with other federal regulators in the promulgation of joint rules concerning credit risk retention in securitized transactions.
- **Strengthen oversight of municipal advisors and consider guidance for private fund advisers:** The SEC will continue to enhance the program for registration and oversight of municipal advisors, with a particular focus on registering municipal advisors under the permanent registration rules and reviewing rule filings by the Municipal Securities Rulemaking Board (MSRB) to implement the permanent municipal advisor registration rules. Another area of focus will be the application of rules under the Investment Advisers Act to private fund advisers and the need to provide guidance regarding the application of those rules.

Related Indicator

The following indicator is useful for understanding the SEC's activities, but should not be considered a performance metric. As this indicator is not used to assess performance, it does not require a target or timeframe.

INDICATOR	DESCRIPTION
Number of investor testing research projects	This metric tracks the number of research initiatives used to gather feedback from investors on the usefulness of disclosures and other input on SEC rulemaking.

STRATEGIC OBJECTIVE 1.2

The SEC promotes capital markets that operate in a fair, efficient, transparent, and competitive manner, fostering capital formation and innovation.

Through rulemaking and other initiatives, the Commission works to assure that investors have fair access to securities markets; that their orders are handled in an efficient and transparent manner throughout the order entry, execution, clearing, and settlement process; that securities laws and regulations do not promote regulatory arbitrage; and that U.S. securities markets remain vibrant, competitive and resilient. These efforts help to promote markets in which investors have the necessary information to make investment decisions, the price discovery process is fair and free from manipulation, and trades can be executed efficiently. The Commission also fosters capital formation by facilitating market access for novel products and innovative and competitive investment company structures when consistent with investor protection.

Self-regulation is a fundamental component of the regulation of U.S. securities markets and market intermediaries. SROs must balance multiple interests and responsibilities. The SEC oversees SROs to ensure that securities markets operate in a fair, efficient and orderly manner; that they are competitive; and that they promote capital formation. The SEC has authority over the rulemaking and other activities of SROs, which include national securities exchanges, the Financial Industry Regulatory Authority (FINRA) and clearing agencies. In approving SRO rules, the SEC must determine, among other things, that these rules are designed to prevent fraudulent and manipulative practices, promote just and equitable principles of trade, and foster cooperation in the clearing and settling of trades, and that they do not impose an unnecessary or inappropriate burden on competition. At the same time, SROs face unique challenges balancing their regulatory responsibilities with business and other interests. In this respect, the SEC's oversight over SROs provides it with the ability to monitor conflicts of interest by, among other things, ensuring that an SRO's rules,

as well as any changes to those rules, assure a fair representation among members and participants in the selection of an SRO's directors and administration of its affairs, and also are not designed to permit unfair discrimination between customers and other participants.

Initiatives

To accomplish this strategic objective, the SEC plans to implement the following initiatives:

- **Foster a fair and efficient market structure:** The SEC will continue to pursue initiatives that promote the goals of the national market system in the trading of securities, such as enhancing price transparency, facilitating best execution, assuring fair access to trading systems and fostering fair competition. These may include:
  - Reviewing the impact of algorithmic and other automated trading on the markets, including its potential contribution to market volatility and, if warranted, developing an appropriate policy response;
  - Strengthening the incentives for investors to display trading interest, and thereby contribute to the price discovery process;
  - Enhancing the post-trade transparency of alternative trading systems (including dark pools) in order to address market fragmentation and facilitate best execution;
  - Continuing and expanding a comprehensive review of equity market structure; and
  - Considering a comprehensive review of the structure and operation of the listed options markets to promote fair, efficient, transparent, and competitive markets.
- **Oversee the system of self-regulation:** Through its review of SRO proposed rule changes, ongoing dialogue with SROs, and rulemaking and other initiatives, the SEC will appropriately oversee the system of self-regulation. This is particularly important in light of conflicts of interests.
- **Enhance the technological resilience of securities markets:** The SEC is working with securities markets, securities firms and other key market participants to ensure the development of adequate policies and procedures with regard to their automated systems and to guard against technological failures. The SEC recently proposed rulemaking to require securities markets, clearing agencies, and plan processors to assure that their systems have adequate levels of capacity, integrity, resiliency, availability and security to maintain their operational capability and

that those markets operate in the manner intended. The SEC anticipates continuing its work on this rulemaking proposal and continuing its dialogue with securities markets to assure a robust and sound U.S. market infrastructure.

- **Reduce reliance on credit ratings references in SEC rules:** The SEC will continue to work to implement the credit rating reference removal provisions required by the Dodd-Frank Act and insert appropriate substitutes as required by law.
- **Enhance oversight of derivatives:** The SEC will continue to implement the derivatives provisions of Title VII of the Dodd-Frank Act, including through cooperative measures with foreign counterparts. The SEC will work with the CFTC to seek to harmonize futures and securities laws for economically equivalent instruments.
- **Help prevent market manipulation:** As part of this initiative, the SEC will review recent changes to the regulation of short sales to assess their effectiveness and determine whether additional modifications are warranted. The agency also intends to explore ways to enhance the transparency of trading activities to better deter and detect manipulation. In addition, the SEC will pursue initiatives to update and enhance the anti-manipulation rules that address the activities of underwriters, issuers, selling security holders and others in connection with securities offerings, as well as update and enhance the anti-manipulation rules that address issuer repurchases and timely public notice of dividends and other distributions.
- **Improve transparency and oversight of small capitalization securities:** The SEC will pursue initiatives focused on the special characteristics of the market for small capitalization securities, in order to enhance the transparency of this market and promote vigorous oversight. Goals of these initiatives will include assuring appropriate investor protections and promoting market efficiency. The SEC also will review its rule that governs the publication of quotations for securities that are not listed on a national securities exchange, to ensure that it adequately addresses securities and situations most likely to raise concerns about fraud and manipulation.
- **Consider implementing further money market fund reforms:** The SEC plans to consider final amendments to its rule regulating money market funds (MMFs), which would be designed to reduce their susceptibility to runs, improve their ability to manage the effects of high levels of shareholder redemptions in times of stress, increase the transparency of risk in MMF portfolios and preserve, as much as possible, the benefits of MMFs for investors and the short-term financing markets.
- **Enhance the market structure for fixed income securities:** The SEC plans to pursue many of the recommendations highlighted in the July 2012 Report on the Municipal Securities Market through a combination of SEC, MSRB, and FINRA initiatives, in an effort to enhance the market structure for all fixed income securities,

including taxable and tax-exempt securities. This effort will include initiatives aimed at promoting transparency and the development of new mechanisms to facilitate the provision of liquidity, as well as initiatives to improve the execution quality of investor orders.

- **Consider streamlining the process for introducing new exchange-traded funds:** The SEC will consider whether or not to permit certain exchange-traded funds to be introduced to the market without first submitting an application under the Investment Company Act of 1940 and receiving an exemptive order from the Commission.
- **Improve clearance and settlement:** The SEC will pursue initiatives to develop registration practices that facilitate appropriate access to U.S. financial markets for different types of clearing agencies and transfer agents, and supervisory resources and practices that allow the SEC to appropriately consider the systemic and other risks of registered and exempt clearing agencies and transfer agents performing payment, clearance and settlement activity in the U.S. and for U.S. persons. The SEC also will consider whether and how to modify existing rules covering clearing agencies and transfer agents to enhance the safety and efficiency of securities clearance and settlement practices and ensure that such practices are harmonized with the broader U.S. financial system.

Performance Goal

The SEC intends to use the following performance metric to gauge its progress in achieving this strategic objective:

PERFORMANCE GOAL	DESCRIPTION
Time to complete SEC review of SRO rules that are subject to SEC approval	The SEC reviews SRO rule proposals for consistency with the Exchange Act standards of investor protection, fair and orderly operation of the markets and market structure, as well as other statutory requirements. This metric gauges the timeliness of those reviews.

Related Indicators

The following indicators are useful for understanding the SEC's activities, but should not be considered performance metrics. As these indicators are not used to assess performance, they do not require targets or timeframes.

INDICATOR	DESCRIPTION
Percentage of SRO rule filings submitted for immediate effectiveness	This indicator gauges the proportion of SRO rule proposals that are submitted for immediate effectiveness.
Percentage of transaction dollars settled on time each year	This indicator measures the efficiency of the U.S. clearance and settlement system for equity securities.
Percentage and number of market outages at SROs and electronic communications networks (ECNs) that are corrected within targeted timeframes	Market outages reflect problems in the systems underlying the securities markets that could have an adverse effect on the markets' ability to function as required. The SEC assesses the reliability and resiliency of these systems to minimize the number and duration of outages. This indicator gauges how quickly outages are resolved, so that market activity can resume.

STRATEGIC OBJECTIVE 1.3

The SEC adopts and administers regulations and rules that are informed by robust economic analysis and public comment and that enable market participants to understand their obligations under the securities laws.

The process of developing and administering rules and regulations is one of the primary functions of the SEC and involves staff from virtually every division and office. One of the agency's primary objectives is to maintain a regulatory framework that enables market participants to understand their obligations.

The success of this strategic objective requires collaboration and coordination among staff members who bring a variety of different perspectives, with appropriate tools and support. In addition, the agency must continually reevaluate its regulatory framework so that it provides sufficient protections to investors as new products and services enter the market. In addition to drafting its own rules, the SEC often coordinates with other federal regulators in joint rulemaking to ensure consistency and clarity throughout the market.

The SEC's economic analysis supports a wide spectrum of activities, including policy-making and rulemaking. The SEC integrates robust economic analysis into the rule-making process and rule releases, so that its rules and regulations are appropriately informed by economic reasoning and impacts. The SEC also identifies developing risks and trends in the financial markets and engages in long-range planning and training to address such developments.

The SEC plans to continue to encourage investor participation and comments on proposed rules, regulations and other issues materially affecting investors through a variety of methods, including supporting the work of the Investor Advisory Committee, staffing the Office of the Investor Advocate and working with the Office of Investor Education and Advocacy to highlight issues that may be of particular interest to investors.

Initiatives

To accomplish this strategic objective, the SEC plans to implement the following initiatives:

- **Improve agency-wide coordination of the rulemaking process:** The SEC will seek additional ways to foster greater and earlier collaboration among divisions and offices on rulemaking initiatives. The agency will establish collaboration tools to more effectively gather and analyze data from across the SEC and manage rulemaking activities.
- **Enhance the process for no-action, interpretive, and exemptive regulatory requests:** The SEC will continue reviewing its process for handling written requests for no-action, interpretive, and exemptive relief, so that the agency's responses are completed in a timely and efficient manner.
- **Respond accurately and promptly to informal guidance requests from market participants and others:** The SEC will strive to respond to informal requests for guidance regarding the laws and rules it administers to provide appropriate informal guidance as quickly as possible.

Performance Goals

The SEC intends to use the following performance metrics to gauge its progress in achieving this strategic objective:

PERFORMANCE GOAL	DESCRIPTION
Length of time to respond to written requests for no-action letters (NAL), exemptive applications, and written interpretive requests	The SEC staff responds to requests for guidance from individuals and market participants about specific provisions of the federal securities laws. These queries may seek interpretations of the securities laws or regulations, or assurances that no enforcement action will be taken if the individual or market participant engages in a specified activity. The staff also reviews applications for exemptions from the securities laws. Written responses to such requests for guidance, when provided, generally are publicly available, as are applications and related notices and orders, when issued. This metric gauges the timeliness of initial comments issued by the Divisions of Trading and Markets, Investment Management, and Corporation Finance.
Timeliness of responses to requests for informal guidance received by the Devision of Trading & Markets dedicated hotline or email box	The Division of Trading and Markets maintains a dedicated phone line and an email account to provide market participants with avenues to request information and informal guidance regarding the Exchange Act and rules thereunder. This metric will reflect the timeliness of the staff's responses to these requests.

Related Indicators

The following indicators are useful for understanding the SEC's activities, but should not be considered performance metrics. As these indicators are not used to assess performance, they do not require targets or timeframes.

INDICATOR	DESCRIPTION
Number of amendments to national securities exchange registrations (Form 1)	This indicator provides information about the volume of material filed with the SEC that involves amendments to exchange registrations.
Number of Alternative Trading System registrations (Form ATS)	This indicator provides information about the volume of material filed with the SEC that involves filings related to ATS registrations.
Number of new investment product submissions	This indicator provides information about the volume of material filed with the SEC that involves new product submissions pursuant to Rule 19b-4(e) of the Exchange Act.
Number of published economic reports	This indicator gauges the number of economic reports that staff of the Division of Economic and Risk Analysis publishes annually on the SEC's website.

STRATEGIC OBJECTIVE 1.4

The SEC engages with a multitude of stakeholders to inform and enhance regulatory activities domestically and internationally.

In today's markets, capital can cross jurisdictional boundaries with the click of a mouse. It is more important than ever to coordinate with other U.S. and foreign regulatory authorities and stakeholders on the best regulatory responses to the changing market landscape. Failure to effectively coordinate can significantly hamper the SEC's ability to achieve its policy objectives or avoid significant unintended consequences.

Domestically, the Chair of the SEC will continue to participate actively in the Financial Stability Oversight Committee (FSOC) with the heads of others FSOC member agencies, such as the Board of Governors of the Federal Reserve, the Department of the Treasury and the CFTC.

The SEC also will actively participate in international multilateral organizations, including the International Organization of Securities Commissions (IOSCO), the Financial Stability Board, the Organization for Economic Cooperation and Development, and the Financial Action Task Force. These efforts will be complemented by direct bilateral consultations with foreign regulatory counterparts on enforcement and regulatory cooperation matters. In addition, the SEC continues to promote international coordination and cooperation through its technical assistance programs for foreign regulators.

The SEC will continue to coordinate with domestic stakeholders including investors, industry representatives, technical experts and other market participants. The SEC will also continue to work with the Investor Advisory Committee on a variety of regulatory issues.

Initiatives

To accomplish this strategic objective, the SEC plans to implement the following initiatives:

- **Collaborate with other authorities on enforcement and market oversight matters:** In order to create a more effective and coordinated regulatory environment, the SEC will partner with U.S. federal and state regulatory authorities to share data, information, and expertise on regulatory issues as appropriate. The SEC will similarly utilize arrangements to share appropriate and relevant data, information, and expertise with foreign authorities about cross-border issues.

- **Continue global coordination and assistance:** The SEC will continue to work closely with its regulatory counterparts abroad, as well as with relevant international organizations, to promote high-quality securities regulation worldwide and regulatory convergence where appropriate. The SEC will conduct technical assistance programs that promote emerging and recently-emerged markets' capacity to take steps to minimize the likelihood of regulatory arbitrage and promote cross-border enforcement and supervisory assistance.
- **Facilitate input from stakeholders in rulemaking initiatives:** The SEC will continue to seek input from stakeholders to inform its rulemaking initiatives through a variety of methods including, as appropriate to the initiative, meeting with investors, industry representatives, technical experts and other market participants, holding roundtables and issuing concept releases.
- **Coordinate closely with the Investor Advisory Committee:** The SEC will continue to work closely with the Investor Advisory Committee, which was established to present the views and experience of a wide variety of investors and to advise the Commission on regulatory priorities and practices. The Investor Advisory Committee is authorized by statute to submit findings and recommendations to the Commission for review and consideration.

Performance Goals

The SEC intends to use the following performance metrics to gauge its progress in achieving this strategic objective:

PERFORMANCE GOAL	DESCRIPTION
Supervisory cooperation requests from foreign authorities for SEC assistance and SEC requests for assistance on supervisory cooperation from foreign authorities	The SEC makes requests to foreign authorities for supervisory cooperation assistance and responds to such requests from foreign regulators both through formal mechanisms, such as supervisory memoranda of understanding, and on an ad hoc basis.
Number of non-U.S. regulators trained	This metric shows the reach of the SEC's technical assistance programs for regulators around the world. The SEC conducts these training sessions to assist countries in developing and maintaining robust protections for investors and promoting cross-border enforcement and supervisory assistance.

"The ability to identify and bring timely, high-quality enforcement actions when violations of the federal securities laws occur is integral to the SEC's core mission. The SEC must enhance its enforcement function not only to send strong messages to wrongdoers that misconduct will be swiftly and aggressively addressed, but also to adapt to the highly automated, high-speed markets of today and tomorrow."

CHAIR MARY JO WHITE

STRATEGIC GOAL 2

Foster and Enforce Compliance with the Federal Securities Laws

FOSTERING COMPLIANCE WITH FEDERAL SECURITIES LAWS is interwoven through all of the Commission's programs and is central to fulfilling its mission of protecting investors; maintaining fair, orderly and efficient markets; and facilitating capital formation. Through disclosure reviews and examinations of broker-dealers, investment advisers, SROs and other market participants, the SEC seeks both to detect violations of the securities laws and rules and to foster strong compliance and risk management practices within these firms and organizations.

When violations do occur, the SEC strives to take prompt action to stop the misconduct, penalize the wrongdoers and, where possible, return funds to harmed investors. These actions span the broad spectrum of the securities laws including, among others, matters of financial reporting, disclosure, accounting fraud, securities offerings, insider trading and market manipulation. These critical investor protection functions contribute to investors' confidence in our capital markets.

The SEC will continue to enhance its National Examination and Enforcement programs. As discussed further below, these improvements include expanding the SEC's training programs, hiring staff with new skill sets, streamlining processes, enhancing information-sharing, leveraging the knowledge of third parties, improving the processing of the thousands of tips the agency receives annually and improving risk assessment techniques. These, and other significant efforts, contribute to the SEC's objective of creating an enduring structure for improved protection of investors and markets.

STRATEGIC OBJECTIVE 2.1
The SEC fosters compliance with the federal securities laws.

While detecting violations of the federal securities laws is an integral aspect of the SEC's programs (see Strategic Objective 2.2), working to prevent future violations can be even more important to protecting investors and enhancing market integrity. The SEC's goal is to encourage regulated entities and reporting companies to do all that they reasonably can to identify possible compliance pitfalls and take preventive action before a violation occurs.

Initiatives designed to foster greater compliance with securities laws run throughout this Strategic Plan. They include efforts designed to provide investors with information they need so that they can wisely select and monitor their investments and professional intermediaries (see Strategic Objective 3.1); to ensure that rules are written in an understandable way, so that those charged with compliance clearly understand their responsibilities (see Strategic Objective 1.3); to create, as appropriate, prophylactic rules that prevent abusive trading or marketing practices (see Strategic Objective 1.2); and to deter regulated entities and reporting companies from engaging in unlawful conduct (see Strategic Objective 2.2).

The SEC seeks to encourage within organizations of all sizes that participate in the securities markets a strong "culture of compliance"—an environment that fosters, from top leadership down, ethical behavior and decision-making. This philosophy should underpin all that the organization does, so that when employees make decisions, large and small, they are guided by a culture that reinforces acting in both a legal and ethical manner.

Initiatives

To accomplish this strategic objective, the SEC plans to implement the following initiatives:

- Expand outreach efforts for promoting compliance practices: The SEC will enhance efforts to promote compliance by engaging in more proactive communications with registrants and their personnel, including chief compliance officers, senior executives and board members. These efforts will include expanding participation in compliance outreach events; disseminating targeted materials to firms by means of risk alerts; detailing areas where examiners have identified significant compliance deficiencies, best practices identified by examiners or industry groups, and rule changes; and raising registrant awareness of the seriousness of certain exam findings by holding post-examination compliance conferences.

Performance Goals

The SEC intends to use the following performance metrics to gauge its progress in achieving this strategic objective:

PERFORMANCE GOAL	DESCRIPTION
Number of industry outreach and education programs targeted to areas identified as raising particular compliance risks	Targeted communication with industry participants on topics shaping the examination program is intended to enhance compliance practices and prevent violations before they occur. This metric identifies the number of major outreach efforts conducted including the SEC's national and regional compliance outreach events, published risk alerts, and other educational programs and initiatives.
Percentage of firms receiving deficiency letters that take corrective action in response to all exam findings	At the conclusion of examinations, the staff communicates identified deficiencies to registrants in the form of a deficiency letter. Registrants are then given a chance to respond to staff findings and often take action to remedy any problems and potential risks, including monetary compensation to clients and enhancements to disclosures, policies and procedures. Most often, registrants respond that they have corrected the deficiencies and implemented measures to prevent recurrence.

STRATEGIC OBJECTIVE 2.2

The SEC promptly detects and deters violations of the federal securities laws.

Violations of the securities laws have a tremendous impact on investors. Accordingly, prompt detection of potential securities law violations is important in limiting the harm caused to investors. By identifying violations early, the SEC seeks to punish wrongdoers promptly, correct violative behavior in the financial markets before it proliferates, stop fraud and manipulation before it affects a large number of investors, and locate and preserve investors' assets before they are lost or dissipated.

Detecting violations of the federal securities laws is a difficult but critical function, and one in which the agency continuously seeks to enhance its efforts. In the midst of constantly evolving financial markets, the SEC seeks to strengthen its oversight of the large number of registrants by focusing its resources on the areas of greatest risk. This risk-based approach, which the Commission continually seeks to refine, is implemented across agency programs through various methodologies aimed at identifying, assessing and managing risks to investors.

In addition, each year the SEC receives thousands of tips and complaints, as well as referrals from SROs, that staff analyze to determine matters requiring investigation. The Commission works closely with others—SROs, the Department of Justice and other criminal authorities, and state, federal, and foreign regulators—to maximize the breadth and depth of its combined efforts. As described below, the SEC will continue working to improve its detection and deterrence efforts.

Initiatives

To accomplish this strategic objective, the SEC plans to implement the following initiatives:

- **Enhance surveillance and risk assessment capabilities:** The SEC will continue to enhance the methods and tools for more effectively identifying and assessing risks in the markets and focusing surveillance efforts on entities, persons, and practices that pose a high risk to investors and financial markets. As part of this effort, the SEC will seek to obtain greater access to data and insights from a variety of sources including data from registrants, SROs, commercial vendors, and other sources. In addition, the SEC will expand the use of analytics to enhance the ability of examination and enforcement staff to detect potentially violative activity.
- **Improve management of tips, complaints, and referrals:** The SEC will enhance the process for receiving, processing, and acting upon tips, complaints and referrals so they can continue to be handled consistently and appropriately, including through examinations or enforcement investigations. This effort will also enhance the SEC's data on tips, complaints, and referrals, to help the agency spot trends and patterns about potential issues or violations that may warrant further Commission action.
- **Build upon the establishment and successes of the Office of the Whistleblower:** The SEC will continue to encourage individuals and entities with timely, credible and specific information about potential securities law violations to provide information to the Commission to further investigations and promote more efficient use of the Commission's limited resources. Pursuant to the Dodd-Frank Act, the SEC is required to compensate eligible whistleblowers with an award of 10 to 30 percent of amounts collected as a result of original information provided by a whistleblower that leads to a successful enforcement action resulting in monetary sanctions exceeding $1,000,000.
- **Bolster the expertise of SEC staff:** The SEC will continue to develop and implement specialized teams focusing on particular market issues that directly affect investors and the functioning of the markets, by enhancing the expertise of SEC staff through targeted training in critical and emerging areas, and enabling staff to obtain additional training resulting in certifications, such as "Certified Fraud Examiners" and "Chartered Financial Analysts."

- **Build upon Enforcement's Cooperation Program:** The staff will use a variety of tools—including cooperation agreements, deferred prosecution agreements and non-prosecution agreements—to encourage individuals and companies to promptly report violations and provide assistance to the agency.
- **Enhance sharing, cooperation, and joint initiatives both within the agency and with other regulators:** The SEC will focus on improving the sharing of information between divisions and offices of the Commission and with other regulators. This type of communication will help ensure that expertise is shared and that areas of mutual interest are addressed in an efficient and effective manner. This includes continuing the use of joint specialized working groups within the agency that are focused on market issues and entities presenting significant risks. This would also include continuing efforts to collaborate and share information with other regulators, such as FINRA, state regulators, the CFTC, international counterparts and many others.

Performance Goals

The SEC intends to use the following performance metrics to gauge its progress in achieving this strategic objective:

PERFORMANCE GOAL	DESCRIPTION
Percentage of investment advisers, investment companies, and broker-dealers examined during the year	This metric indicates the number of registrants examined by the SEC or an SRO as a percentage of the total number of registrants. This metric includes all types of examinations: risk priority examinations, cause inspections to follow up on tips and complaints, limited-scope special inspections to probe emerging risk areas, oversight examinations of broker-dealers to test compliance and the quality of examinations by FINRA.
Percentage of compliance exams that are concluded in accordance with the Office of Compliance Inspections and Examination's (OCIE) statutory deadline	The staff conducts examinations each year of registered entities, including investment advisers, investment company complexes, transfer agents, and broker-dealers. The staff strives to complete its examinations and communicate findings in the most efficient and effective manner and within its statutory deadline. This metric reflects the percentage of examinations concluded within the statutory deadline.
Number of joint exams, information sharing agreements, and formal meetings with other regulators	The SEC attempts to coordinate and collaborate with other regulators on areas of mutual interest. This helps to ensure that all regulators are informed of ongoing risks and issues related to broad market practices as well as specific entities of mutual interest. This cooperation is critical to the exam program to ensure that certain higher risk firms and activities are addressed in the most efficient and effective manner. This metric tracks critical cooperation activities that are occurring between the SEC's exam program and other regulators.

Related Indicators

The following indicators are useful for understanding the SEC's activities, but should not be considered performance metrics. As these indicators are not used to assess performance, they do not require targets or timeframes.

INDICATOR	DESCRIPTION
Percentage of exams that identify deficiencies, the percentage that result in a "significant finding," and the percentage referred to the Division of Enforcement	Examiners find a wide range of deficiencies during examinations. Some of the deficiencies are more technical in nature, such as failing to include all information that is required to be in a record. However, other deficiencies may cause harm to customers or clients of a firm, have a high potential to cause harm, or reflect recidivist misconduct. The latter deficiencies are among those categorized as "significant." This indicator identifies the percentage of exams that identified deficiencies, that resulted in significant deficiency findings, and that were referred to Enforcement.
Number of cause exams that result from tips, complaints and referrals	Analysis of a tip can support the request for a cause exam. This indicator would identify the number of SEC cause exams that result from tips collected through outreach efforts.
Number of rule-making initiatives assisted by the National Exam Program	The examination program interacts with registrants on a regular basis and this work provides feedback critical to ensuring effective and practical rulemaking and policy efforts. This indicator tracks how frequently the examination program assists with rulemaking initiatives.
Number of investigations or inquiries originating from a tip or complaint	Analysis of a tip or complaint can result in the need for an enforcement investigation. The indicator identifies the number of SEC investigations that result from tips and complaints received by the SEC.
SEC investigations in which requests for access to information were granted by the SEC to other authorities, such as SROs or other state, federal, and foreign enforcement authorities	The SEC works closely with other regulators and authorities. This metric identifies the number of investigations in which the SEC granted one or more authorities access to information concerning an investigation during the fiscal year. This may include requests for access to SEC investigative files concerning investigations that the SEC continues to pursue, as well as those in which the SEC has completed its investigation.
Requests from foreign authorities for SEC assistance and SEC requests for assistance from foreign authorities	Each year, the SEC makes hundreds of requests for enforcement assistance to foreign regulators, while responding to hundreds of such requests from other nations. To facilitate this type of assistance, and encourage other countries to enact laws necessary to allow regulators to cooperate with their foreign counterparts, the SEC has entered into bilateral information-sharing arrangements, as well as the Multilateral Memorandum of Understanding, an information-sharing arrangement negotiated through IOSCO.

STRATEGIC OBJECTIVE 2.3

The SEC prosecutes violations of federal securities laws and holds violators accountable through appropriate sanctions and remedies.

Investors are not truly protected unless those who prey on them are swiftly and appropriately sanctioned. The enforcement staff strives to obtain swift and firm sanctions, while remaining fair and reasonable. The breadth of the enforcement program's capabilities in this area derives, in part, from its close cooperation with the other SEC divisions that perform regulatory functions and also have deep knowledge of the market and its participants.

To improve the quality and efficiency of its investigations, the SEC is committed to streamlining internal processes wherever possible. In pursuing potential violations of the securities laws, the SEC regularly works closely with other regulators and law enforcement agencies. The enforcement program also has seen a dramatic increase in its coordination efforts with foreign authorities, including requests for assistance to and from foreign regulators under bilateral and multilateral information-sharing arrangements. These efforts also include requests to trace proceeds of fraud to foreign countries, and actions to obtain asset freezes. The SEC is committed to further expanding its coordination with these entities in order to strengthen the Commission's ability to hold wrongdoers accountable.

Initiatives

To accomplish this strategic objective, the SEC plans to implement the following initiatives:

- **Continue utilizing specialty groups within the enforcement program:** The SEC will continue to use specialized groups and task forces to move quickly and to centralize expertise on the most critical issues emerging in the markets. As market conditions and market events dictate, Enforcement will evaluate the need to add, eliminate or implement changes to specialized groups and task forces.
- **Enhance timeliness of distributions to wronged investors:** The SEC will improve timeliness and efficiency of its efforts to return money collected in enforcement actions to harmed investors.
- **Enhance communications among SEC divisions and offices and the enforcement program:** The SEC will improve communication and sharing of information between the enforcement program and other divisions and offices to bring to bear the collective expertise of the Commission in a timely and efficient manner, such as continuing meetings of the Cross-Border Working Group.

- **Review approach for enforcement penalties:** The SEC will continue to assess its approach to the use of penalties in connection with enforcement recommendations/ actions so that penalties have the appropriate punitive and deterrent effect, having in mind avoiding unnecessary harm to shareholders.
- **Broaden the range of enforcement sanctions:** The SEC will develop alternative approaches to sanctions to gain greater flexibility in bringing actions to conclusions that benefit investors.

Performance Goals

The SEC intends to use the following performance metrics to gauge its progress in achieving this strategic objective:

PERFORMANCE GOAL	DESCRIPTION
Percentage of enforcement actions in which the Commission obtained relief on one or more claims	This metric identifies, as to all parties to enforcement actions that were resolved in the fiscal year, the percentage against whom the Commission obtained a judgment or order entered on consent, a default judgment, a judgment of liability on one or more charges, and/or the imposition of monetary or other relief. The Division of Enforcement is currently assessing this metric, and evaluating how to incorporate qualitative considerations of the results of its enforcement actions.
Percentage of first enforcement actions filed within two years of the opening of an investigation	This metric concerns the pace of investigations that lead to the filing of enforcement actions. Specifically, this metric captures the rate at which the first enforcement action arising out of an investigation was filed within two years of the opening of the investigation. If the investigation was preceded by a matter under inquiry, the metric draws on the date of the opening of the matter under inquiry. In conducting investigations, the Enforcement program continually strives to balance the need for complete, effective and fair investigations with the need to file enforcement actions in as timely a manner as possible.
Average months between opening a matter under inquiry or an investigation and commencing an enforcement action	This metric captures the average number of months between the opening of an investigation and the filing of the first enforcement action arising out of that investigation. If the investigation was preceded by a matter under inquiry, the metric draws on the date of opening of the matter inquiry. In conducting investigations, the enforcement program continually strives to balance the need for complete, effective, and fair investigation with the need to file enforcement actions in as timely a manner as possible. While not all investigations result in the filing of enforcement actions, this metric provides information concerning the pace of investigations that do lead to such actions and supplements the previous goal, which measures the percentage of first enforcement actions filed within two years.

PERFORMANCE GOAL	DESCRIPTION
Percentage of debts where either a payment has been made or a collection activity has been initiated within 180 days of the due date of the debt	The SEC can seek a wide range of remedies for failure to comply with the securities laws. These remedies include civil monetary penalties and disgorgement. When the remedies are imposed by the SEC or the federal district court, payments must be made by a certain date. This metric identifies the percentage of debts where debtors have made payments or the SEC has initiated a collection activity within 180 days of the due date. Such collection activities include, among other things, demand letters, negotiation of payment plans, enforcing the payment of the debt through the courts or other judicial remedies.
Percentage of Fair Fund and disgorgement fund plans that have distributed 80 percent of the available funds for distribution within twenty four (24) months of the approval of the distribution plan	In addition to other types of relief, the SEC may seek orders requiring parties to disgorge any money obtained through wrongdoing. The SEC also is empowered to seek civil penalties for violations of the securities laws. Where appropriate, the SEC has sought to return disgorged funds to harmed investors and, as a result of the Fair Funds provisions of the Sarbanes-Oxley Act and the Dodd-Frank Act, to combine amounts paid as penalties with disgorged funds, or to create a Fair Fund from penalties only, to reduce losses to injured parties and to maximize funds available for distribution. This metric identifies the percentage of distribution plans that reached a critical mass during the fiscal year and within twenty four (24) months of the approval of the distribution plan. The distribution plan includes the timeline and procedures required to return the funds to injured investors. This reflects Commission-wide efforts to implement plans to return money to investors quickly. Any funds not returned to investors are sent to the U.S. Treasury or the Investor Protection Fund established pursuant to Section 21F(g) of the Securities Exchange Act of 1934. Neither disgorgement nor penalties are used for the SEC's own expenses.

Related Indicators

The following indicators are useful for understanding the SEC's activities, but should not be considered performance metrics. As these indicators are not used to assess performance, they do not require targets or timeframes.

INDICATOR	DESCRIPTION
Percentage of filed enforcement actions reflecting characteristics that present enhanced risk to investors and markets, as measured by the nature of the investigation, conduct, parties and impact.	This indicator assesses the quality of the cases filed by the Division of Enforcement. The indicator focuses on cases filed by the SEC that involve factors reflecting enhanced risk to investors and markets. Such cases may involve: (i) those identified through risk analytics and cross-disciplinary initiatives to reveal difficult-to-detect or early stage misconduct, thus minimizing investor loss and preventing the spread of unlawful conduct and practices; (ii) particularly egregious or widespread misconduct and investor harm; (iii) vulnerable victims; (iv) a high degree of scienter; (v) involvement of individuals occupying substantial positions of authority, or having fiduciary obligations or other special responsibilities to investors; (vi) involvement of recidivists; (vii) high amount of investor loss prevented; (viii) misconduct that is difficult to detect due to the complexity of products, transactions, and practices; (ix) use of innovative investigative or analytical techniques; (x) effective coordination with other law enforcement partners; and/or (xi) whether the matter involves markets, transactions or practices identified as an enforcement priority, or that advances the programmatic priorities of other SEC divisions or offices.
Total amount distributed within the fiscal year, and the number of Fair Funds from which those distributions came	In its enforcement actions, the SEC may seek to return funds to harmed investors through disgorgement of ill-gotten gains or through the Fair Funds provision of the Sarbanes-Oxley Act. This provision permits the SEC to combine amounts paid as penalties with disgorged funds, or to create a Fair Fund from penalties only, to reduce losses to injured parties. This reflects the SEC's efforts to return funds to injured investors. This indicator identifies the total amount distributed within the fiscal year, and the number of Fair Funds from which those distributions came. This indicator may increase or decrease in dollar amount and number of distribution funds based on the number of SEC enforcement actions brought involving distributions, amounts ordered and paid in those actions, and other factors. Due to the variation in reporting timelines established for each individual distribution, reported amounts are based on the agency's best available information. Reported amounts do not include those funds distributed through receiverships. Any funds not returned to investors are sent to the U.S. Treasury or the Investor Protection Fund established pursuant to Section 21F(g) of the Securities Exchange Act of 1934. Neither disgorgement nor penalties are used for the Commission's own expenses.

INDICATOR	DESCRIPTION
Percent of enforcement actions filed that arose out of national priority investigations	The Division of Enforcement brings many enforcement actions each year that can be characterized as high impact and of national priority. High impact or national priority investigations include those investigations which are significant for one or more of the following reasons: (i) presents an opportunity to send a particularly strong and effective message of deterrence, including with respect to markets, products and transactions that are newly developing, or that are long established but which by their nature present limited opportunities to detect wrongdoing and thus to deter misconduct; (ii) involves particularly egregious or extensive misconduct; (iii) involves potentially widespread and extensive harm to investors; (iv) involves misconduct by persons occupying positions of substantial authority or responsibility, or who owe fiduciary or other enhanced duties and obligations to a broad group of investors or others; (v) involves potential wrongdoing as prohibited under newly-enacted legislation or regulatory rules; (vi) concerns potential misconduct that occurred in connection with products, markets, transactions or practices that pose particularly significant risks for investors or a systemically important sector of the market; (vii) involves a substantial number of potential victims and/or particularly vulnerable victims; (viii) involves products, markets, transactions or practices that the Division of Enforcement has identified as priority areas (i.e., conduct relating to the financial crisis; fraud in connection with mortgage-related securities; financial fraud involving public companies whose stock is widely held; misconduct by investment advisers; and matters involving priorities established by particular regional offices or the specialized units); and/or (ix) provides an opportunity to pursue priority interests shared by other law enforcement agencies on a coordinated basis.
Criminal actions related to conduct under investigation by the SEC	In some instances, conduct may involve both civil and criminal violations and may be investigated by both the SEC and the criminal authorities. This indicator identifies the number of criminal actions that are related to conduct under investigation by the SEC.
Disgorgement and penalties ordered and the amounts collected	In addition to other types of relief, the SEC may seek orders requiring parties to disgorge any money obtained through wrongdoing. The SEC is also empowered to seek civil penalties for violations of the securities laws. In some cases, the SEC will seek to obtain large monetary sanctions even in instances where the prospects of collecting on a judgment are slight. The rationale for seeking monetary relief in these circumstances is that such relief, even when likely uncollectible, might become collectible in the future based on the defendant's changed circumstances, and also because such relief can serve to deter others from violating the securities laws. Where appropriate, the SEC has sought to return disgorged funds to harmed investors. Funds not returned to investors are sent to the Treasury or the Investor Protection Fund established pursuant to Section 21F(g) of the Securities Exchange Act of 1934. This indicator lists disgorgement and penalties ordered as a result of SEC cases and the amounts collected in those actions. This indicator could increase or decrease based on various factors.

"Increasing investor understanding should always be one of our primary goals. But it is not enough merely to make accurate, timely, and useful information available; we also have to make it accessible. We have to provide information in the ways that investors want to receive it. Investor outreach is crucial to success. Finding out what is on investors' minds will improve the overall quality of the information we provide."

CHAIR MARY JO WHITE

STRATEGIC GOAL 3

Facilitate Access to the Information Investors Need to Make Informed Investment Decisions

THE FEDERAL SECURITIES LAWS require that corporations, investment companies, and other entities provide investors with timely and meaningful information about, among other things, their operations and financial condition. Because an educated and informed investor ultimately provides the best defense against fraud and costly mistakes, these laws place great emphasis on providing material information to the investing public.

The SEC promotes informed investment decisions through two main approaches. The first is to require that investors have accurate, useful, and timely public access to disclosure materials that can be easily understood and analyzed. The second is to implement a variety of investor education initiatives aimed at providing investors with a better understanding of the operations of the nation's securities markets.

In administering its disclosure program, the SEC requires reporting entities to disclose financial and non-financial information to the investing public, thereby providing a common pool of knowledge for all investors to use to judge for themselves whether a security is an appropriate investment. Similarly, SEC rules require that investors have access to certain information about the financial intermediaries they rely upon for investment advice and other services. SEC staff reviews the disclosure and other filings that corporations, investment companies, and other entities submit to assess whether the disclosures appear adequate and accurate under the relevant rules and regulations.

The goal of the SEC's investor education program is to give investors the information they need to evaluate current and potential investments, while also providing agency staff with critical insight about emerging trends and factors shaping investor decision-making. The SEC staff aims to collect investor-focused data from a variety of sources and use it both to track trends in the securities industry and to identify, among other things, problematic brokers, investment advisers, firms, and sales practices.

STRATEGIC OBJECTIVE 3.1

The SEC works to ensure that investors have access to high-quality disclosure materials that facilitate informed investment decision-making.

Investors who have access to information and know what questions to ask are more likely to invest wisely, and to choose professional intermediaries that will best meet their objectives. The SEC understands that not all investors need the same information and that those needs are affected by their backgrounds, resources and goals. The SEC seeks to structure disclosure requirements so that investors are armed with timely and useful information they need to make informed investment decisions.

As technology and the complexity of financial instruments change, so too do the needs of modern day investors. Providing investors with information in concise, easy-to-use formats that are tailored to their needs helps investors to help themselves. On a recurring basis, the Commission examines its filing review program to explore whether its disclosure requirements, review criteria, approach to comments, and professional and technology resources provide maximum impact to benefit investors. As described below, the SEC will engage in a number of initiatives to further enhance its programs in this key area.

Initiatives

To accomplish this strategic objective, the SEC plans to implement the following initiatives:

- **Update disclosure and reporting requirements to reflect the informational needs of today's investors:** The SEC will continue its efforts to enhance disclosure requirements for the benefit of investors, including a reassessment of current core corporate disclosure requirements. In proposing changes for the Commission to consider, the staff will seek to modernize disclosure requirements and eliminate redundant reporting requirements. The staff's efforts will continue to include a review of proxy voting and shareholder communications to identify ideas and proposals for potential improvement to those rules.
- **Evaluate the effectiveness of filing review programs for reporting entities so that investors receive material information in a timely manner without imposing undue regulatory burdens on filers:** The staff will continue to evaluate the Commission's filing review processes and make changes in response to evolving trends or market developments. The staff will also work to ensure that the SEC has reliable risk management tools to identify material issues in offering documents and periodic reports for review, and obtain enhancements in disclosure. This assessment will explore the criteria used to identify filings for review, the process of issuing comments to reporting entities and new ways for technology to help improve the Commission's programs.

- **Design and implement new disclosure regimes for specialized categories of issuers so that investors in these products have relevant and useful information to make informed investment decisions:** The SEC will continue to evaluate and improve the disclosure requirements for securitized financial products and other complex financial instruments. The SEC plans to consider rules designed to provide variable annuity investors with more user-friendly disclosure and to improve the delivery of information about variable annuities through increased use of the internet and other electronic means of delivery. In addition, the SEC will continue work on proposed amendments to its advertising rules that would require target date retirement funds' marketing materials to provide investors enhanced information about those funds.
- **Design and implement enhancements to EDGAR and SEC.gov to facilitate investor and market participant access to and utilization of disclosure documents and other information:** The SEC will continue to modernize its IT systems and the dissemination and rendering of electronic disclosure documents to improve investor access to relevant information and the ease of interacting with the SEC. The SEC is working on enhancements to data standards and XBRL filing requirements that improve the quality of structured data and reduce burdens on filers.

Performance Goals

The SEC intends to use the following performance metrics to gauge its progress in achieving this strategic objective:

PERFORMANCE GOAL	DESCRIPTION
Percentage of public companies and investment companies with disclosures reviewed each year	The Sarbanes-Oxley Act requires that the SEC review, at least once every three years, the disclosures of all companies and investment company portfolios reporting under the Exchange Act. These reviews help improve the information available to investors and may identify possible violations of the federal securities laws. This metric gauges the number of public companies and investment companies reviewed each year.
Time to issue initial comments on Securities Act filings	The target of 30 days or less has become a de facto industry standard for issuers and underwriters' expectations for the maximum time to receive initial comments on Securities Act registration statements. This metric will measure the Commission's frequency in meeting this 30-day target.
Percentage of investment company disclosure reviews for which initial comments are completed within timeliness goals	For initial registration statements, the SEC's goal is for staff to issue initial comments within 30 days after they are filed (60 days for registration statements of insurance product separate accounts and related mutual funds). The SEC also aims for staff comment on post-effective amendments within 45 days and preliminary proxy statements within 10 days after they are filed. This metric will show how often the Commission is meeting this goal.

Related Indicator

The following indicator is useful for understanding the SEC's activities, but should not be considered a performance metric. As this indicator is not used to assess performance, it does not require a target or timeframe.

INDICATOR	DESCRIPTION
Total digital audience including website, social media and mobile media	Digital media has become the dominant channel for investors seeking to access information. These statistics will help evaluate the extent to which investors are turning to the SEC, identify the channels they use, and quantify the amount of information they receive.

STRATEGIC OBJECTIVE 3.2

The SEC works to understand investor needs and educate investors so they are better prepared to make informed investment decisions.

Understanding the interests and concerns of investors is critical to carrying out the Commission's investor protection mission. The SEC advances this mission by regularly communicating with investors, responding to their complaints and inquiries, and providing educational programs and materials.

The SEC will obtain more comprehensive information about the views and perspectives of investors. It will seek more robust information regarding the behavioral characteristics of investors and the types of information investors need and use as they make informed investment decisions. It will compile and provide this information to the Commission to help in the development of rules and educational programs that address investors' views and concerns.

The SEC is exploring ways to encourage investor input by presenting investors with clear, easily understandable explanations of Commission rules and rule proposals and other activities through a variety of communication channels, including social media. These efforts will complement those of the Investor Advisory Committee, which was constituted to present the views and experience of a broad spectrum of investors, and which will serve as an additional source of information concerning investors' priorities and perspectives on the Commission's regulatory agenda.

More comprehensive data about investors also will drive the Commission's investor education efforts. Working in partnership with other federal and state agencies, financial industry associations, consumer groups and educational organizations, the SEC will develop investor education initiatives that are targeted to specific audiences.

Initiatives

To accomplish this strategic objective, the SEC plans to implement the following initiatives:

- **Use feedback from individual investors to improve investor education resources:** In addition to responding to investor complaints and inquiries and conducting in-person outreach, the SEC will use informational surveys to evaluate whether investors are engaging in prudent investing behaviors and to gauge the usefulness of its investor education materials and responsiveness of its investor assistance program.
- **Inform rulemaking with investors' views:** The SEC will use investor testing and other outreach efforts, as appropriate, to gather input from investors on rulemaking initiatives and better understand their informational needs.
- **Address Investor Advisory Committee input:** The SEC will consider information and respond to recommendations from the Investor Advisory Committee regarding investors' perspectives and priorities.
- **Expand collaborative partnerships:** The SEC will partner with other federal and state agencies, securities regulators and non-profit organizations to shape and target educational initiatives to maximize their impact on specific communities of interest.
- **Promote investor awareness:** The SEC staff will issue Investor Alerts and other educational materials designed to both arm investors to be their own first line of defense against fraud and assist them in understanding new products and the role of financial intermediaries.

Performance Goals

The SEC intends to use the following performance metrics to gauge its progress in achieving this strategic objective:

PERFORMANCE GOAL	DESCRIPTION
Number of page views of online investor education content, and number of in-person events, including those with specifically targeted communities and organizations	The Office of Investor Education and Advocacy (OIEA) initiates investor education campaigns on key strategies for making informed investment decisions, including publicizing online resources for researching investment professionals and investments, understanding fees, and identifying fraud. OIEA staff also participates in in-person events for investors generally and those targeted to specific investors, such as seniors, service members, and other affinity groups. This metric tracks page views of SEC online investor education materials and the number of investor events in which OIEA staff participated.
Timeliness of responses to investor contacts	OIEA serves the tens of thousands of investors each year who contact the SEC with investment-related complaints and questions. The staff aims to close out as many new investor assistance matters as possible within seven and thirty business days.
Customer satisfaction rating of OIEA's online investor education resources	This metric gauges the effectiveness, helpfulness, and usability of OIEA's online investor education resources.
Number of new investor education materials designed primarily to help investors protect themselves from fraud	Through OIEA, and often in conjunction with other organizations, the staff issues Investor Alerts and other forms of educational material that inform investors about different permutations of fraud, new investment products, and other topical issues. This metric measures the number of new investor education materials issued by OIEA.

Related Indicators

The following indicators are useful for understanding the SEC's activities, but should not be considered performance metrics. As these indicators are not used to assess performance, they do not require targets or timeframes.

INDICATOR	DESCRIPTION
Number of investor testing research projects	This indicator tracks the number of research initiatives used to gather feedback from investors on the usefulness of disclosures and other input on SEC rulemaking.
Number of sets of recommendations prepared by the investor advisory committee	This indicator tracks the recommendations from the Investor Advisory Committee regarding investors' perspectives and priorities.

"The SEC's hardworking and dedicated staff is the core component of the agency's strength."

CHAIR MARY JO WHITE

STRATEGIC GOAL 4

Enhance the Commission's Performance Through Effective Alignment and Management of Human, Information, and Financial Capital

THE PUBLIC AND THE SECURITIES MARKETS are best served by an efficient, effective, and agile SEC. Given the immense size of the securities markets the SEC regulates, the SEC's success in fulfilling its mission and in achieving the goals and objectives outlined in this Plan is highly dependent upon whether it's adequately funded and its ability to continually direct its resources towards the most productive uses. The SEC also is extremely mindful of its responsibility to optimize the use of its resources because it is a government agency entrusted with public funds.

The SEC continuously strives to enhance its performance by making sound investments in human capital and new technologies and by employing strong financial management and operational risk management practices. With respect to its workforce, the SEC must be able to attract and retain high-performing staff, continually update their skills so they are abreast of the latest developments in the industry and create organizational structures and work processes that are efficient and effective. The Commission's information technology environment must give employees the tools they need to view, analyze and act upon the enormous volume of financial data and other information relevant to oversight of the securities markets. The SEC must demonstrate a continued commitment to maintaining strong internal controls to support effectiveness and efficiency of Commission operations. Finally, the SEC must continually direct its financial resources to their highest and best use, always subject to strong internal controls.

STRATEGIC OBJECTIVE 4.1

The SEC promotes a results-oriented work environment that attracts, engages, and retains a technically proficient and diverse workforce, including leaders who provide motivation and strategic direction.

The SEC is committed to being an employer of choice by consistently attracting, hiring, developing, and retaining a high-quality, diverse, and results-oriented workforce. The SEC is continually refining a series of programs to enhance its human capital, such as rewarding high performance, promoting high employee satisfaction and updating staff skills.

The SEC continues to build and maintain an effective training program to deepen expertise and skills, not only in the rapidly evolving nature of the markets, but also in areas of new responsibility for the Commission. The training supports development for employees directly involved in examinations, investigations, fraud detection, litigation, and other core mission responsibilities of the SEC. The training consists of specialized in-depth topics concerning new trends in the securities industry and changing market conditions, as well as analytics and forensics. It also allows staff to obtain certain specialized financial certifications and regulatory credentials, as well as the advanced continuing education credits required for maintaining legal and financial credentials.

The SEC's success at fulfilling its strategic goals depends upon effective leadership at all levels. From branch chiefs to the Commission's senior leadership, the SEC's leaders must not only motivate and manage employees effectively, but also play a critical role in identifying the key areas on which staff should focus their attention to generate the greatest benefit for investors. Through leadership and employee development programs, the Commission seeks to maintain a diverse cadre of technically proficient leaders that can conduct their supervisory responsibilities effectively and meet the dynamic challenges of market oversight.

Initiatives

To accomplish this strategic objective, the SEC plans to implement the following initiatives:

- **Increase employee engagement and retention:** To retain high caliber and diverse talent, the SEC will implement programs and initiatives focused on employee engagement and retention. In response to employee viewpoint survey results, the SEC has conducted numerous interviews and focus groups with its workforce at every level. The recommendations derived from this information will form the basis for action plans aimed at improving the Commission's organizational climate and workforce morale. These plans will be implemented and evaluated in a manner designed to promote continuous improvement. Improvements in organizational climate and workforce morale should lead to greater employee engagement and increased retention, particularly of high-performing employees.
- **Enhance employee development program:** For the SEC to fulfill its mission it must attract and select a diverse cadre of highly talented and accomplished people and provide them with opportunities to develop the knowledge and skills to achieve high levels of performance and address changes in market conditions, securities laws, federal regulations, best practices and technology. The Office of Human Resources (OHR) will work to identify training and learning needs within each division and office and to procure or develop high-quality training that will develop employee skills. OHR will utilize, encourage and monitor the use of individual development plans so that employee-specific needs are met and that progress can be tracked.
- **Leadership development program:** To ensure the SEC has the caliber of leadership commensurate with its mission, the SEC will continue the construction and implementation of a comprehensive leadership development program that will address the needs of a diverse group of supervisors, managers, and leaders. Specific aspects of the program include improving training for new supervisors, building skills in change management, enhancing cultural awareness and inclusiveness, increasing the number and scope of developmental opportunities for all leaders, and instituting a succession planning program to prepare non-supervisors to assume supervisory roles and supervisors to assume key executive positions.

Performance Goals

The SEC intends to use the following performance metrics to gauge its progress in achieving this strategic objective:

PERFORMANCE GOAL	DESCRIPTION
Turnover	When employee morale and engagement are high, high-performing employees tend to remain in the organization. Although turnover can fluctuate based on a variety of factors, the SEC aims to keep its turnover rate relatively low, below 8% per year.
Expanding staff expertise	Internal training and hiring programs are designed to help the agency recruit and develop a diverse and qualified staff with the key skills, industry knowledge, and expertise to support the SEC mission. In particular, there is a need to train examiners, attorneys, economists, and other experts for subject matter expertise relevant to the marketplace and investment and trading practices. This metric tracks whether certain areas requiring significant training are being addressed. The agency will track the number of SEC staff participants in mission-focused training and development programs and will report on specific items through the use of post-course evaluations to assess the impact and results of this training on a five-point scale.
Number of diversity-related partnerships/alliances	Increased numbers of diversity-related partnerships or alliances with professional associations and educational organizations provide opportunities to educate students about the SEC's work and to recruit career professionals from all segments of society. The SEC will track the number of partnerships and/or alliances with diverse professional associations and educational organizations.
Survey rankings	Annual and other rankings, together with other metrics and indicators of federal government agencies will be used as one kind of metric to determine the SEC's overall success in improving employee morale and employee engagement.
Bench strength	To maintain mission effectiveness, it is essential that attrition in the leadership ranks is quickly addressed by having a highly qualified and diverse pool of candidates ready to assume those critical roles. Success is measured by the percentage of key leadership positions for which the SEC has identified a pool of qualified candidates.

STRATEGIC OBJECTIVE 4.2

The SEC encourages a collaborative environment across divisions and offices and leverages technology and data to fulfill its mission more effectively and efficiently.

The SEC's divisions and offices collaborate in a variety of ways, both formal and informal, to advance the Commission's mission. Such coordination is essential for any organization as large and complex as the SEC to bring together different perspectives, decide on the best course of action, and implement that course in the most effective way. Given the importance and complexity of the SEC's mission, it is imperative that the Commission continuously improve its ability to break down silos, share information and work jointly towards a common purpose.

Information technology plays a crucial role in the mission of the SEC and its ability to share information and data both internally and externally. The SEC gathers a wide variety of data and other information from a variety of sources, including corporate disclosures, equity exchange feeds, investigations and examinations, tips, complaints, and referrals, and commercial vendors. The SEC is working to develop systems that will allow more of this information to be quickly shared, analyzed, and joined with other information about the same entity or individual. These efforts should save staff time, provide better information about the firms the SEC regulates and enhance the ability to uncover hidden risks to investors.

The increasing size and complexity of the U.S. markets require that the SEC continue to leverage technology to improve its productivity, as well as identify and address the most significant threats to investors. Information technology is an increasingly vital function to the SEC in modernizing filing practices, disseminating the vast quantity of regulatory filings, managing the large number of internal business processes and work products and protecting the Commission's information assets.

Initiatives

To accomplish this strategic objective, the SEC plans to implement the following initiatives:

- **Work smarter to achieve the SEC mission:** A multi-year technology transformation plan called "Working Smarter" will ensure the SEC's business processes are streamlined, integrated, and implemented with the best technology to reduce costs and increase efficiencies and effectiveness; deliver better services to both employees and the public; and provide greater accountability, transparency, and security. Leveraging modern, reliable, and innovative technologies and predictive analytics will transform the way the SEC performs its mission and provide a proactive view into how technology impacts capital markets. By ensuring people "work smarter," the SEC will derive significant and measurable performance improvements in core operations and increase value through the use of automated processes.
- **Make disclosure information more useful for analysis:** Disclosure documents are submitted to the Commission electronically and, as appropriate, disseminated electronically to the investing public. This initiative will review the current disclosure systems and processes and identify ways to optimize the use of technology to improve the way disclosure documents are constructed and submitted with more emphasis on data collection. A new filing system that is optimized for data retrieval and analysis will provide features that help users create filings that are appropriate to their purpose and that allow computers to extract data from the filings for automated analysis. The system will be more flexible, so that, as new disclosure documents are defined, they can be implemented much more quickly, with all of the features of a modern, web-based filing system. Eventually, new filings structured for automated data retrieval and analysis will replace all filings submitted through the EDGAR system.
- **Improve SEC's information management and analysis functions:** The SEC aims to provide its staff with the access to information and effective analytical capabilities needed to perform their duties. To accomplish this outcome, the SEC will work on several fronts to improve its abilities to acquire, store, manage, and deliver data and information in support of its critical business functions. Among the steps in this effort are standardization of enterprise-wide platforms, knowledge management, seamless integration of structured and unstructured data sources, cloud computing, modernization of SEC.gov and EDGAR filer systems, cataloging the SEC's data and its interrelationships in an electronic data warehouse (EDW); ensuring data quality; and establishing new methods for capturing information, including from SEC staff themselves as they conduct examinations, investigations, and other activities.

- **Enhance workflow and document management:** Virtually all business processes within the Commission involve the acquisition, creation, review, and editing of documents. These processes are conducted informally, without the benefit of automated tracking, notification and auditing capabilities. Under this initiative, the SEC will assess its critical business processes and apply document management tools to increase productivity, enhance collaboration and create a shared repository of essential documents and data. Among the business areas that would benefit from this effort are enforcement case management, disgorgement and penalties, examination management, management of Commission actions, filing of administrative proceedings and rulemaking.
- **Enhance the SEC's electronic discovery program:** The SEC must have the technical capability to electronically organize and retrieve an extraordinary volume of documents obtained in the conduct of investigations. Under this initiative, the SEC will enhance its current electronic discovery tools and improve its document storage, organization, and analytic capabilities. The SEC also will create a repository of documents and data that is more widely available across cases and with other Commission business functions as appropriate.
- **Enhance operational resiliency:** The SEC will support a reliable computing environment that provides high performance, security and cost effectiveness. The Commission also will enhance the computing infrastructure, including through server virtualization and clustering, to eliminate down time if systems at one site fail, enhance security, and achieve cost savings.
- **Enhance internal communications to staff:** Led by the Offices of Public Affairs and Chief Operating Officer, the SEC will track and recognize exceptional staff achievements, awards and other successful outcomes to promote a sense of pride and accomplishment throughout the Commission. Additionally the SEC will initiate a program leveraging technology and best practices to centralize all administrative, technology, financial, procurement, human capital and other operational information, news and resources so that staff can easily "self-service" and find the tools, forms, guidance and support they need.

Performance Goals

The SEC intends to use the following performance metrics to gauge its progress in achieving this strategic objective:

PERFORMANCE GOAL	DESCRIPTION
Ensure SEC's systems and applications are available	The SEC aims to enhance its computing infrastructure to eliminate down time if systems at one site fail, among other objectives. This metric will capture the percentage of systems and applications that can fail over or within 8 hours.
Equip the SEC with an enhanced enterprise infrastructure	The SEC aims to promote collaboration and information sharing across the enterprise. To improve efficiency and knowledge management, the SEC will consolidate and centralize its collaborative technologies to a commonly used enterprise set by 2020. This metric will measure the percentage of the SEC's offices and divisions that utilize centralized enterprise collaboration solutions.
Expand the SEC's video teleconferencing (VTC) capabilities to support an increasingly geographically dispersed workforce	The SEC seeks to develop a state-of-the-art video tele-conference solution that allows users to conduct a video/teleconference meeting between HQ, regional offices and multiple endpoints simultaneously; collaborate and share presentation materials; and use VoIP technology to host video teleconferences from their offices/workspaces with other SEC users or conference rooms. This metric will measure the average "uptime" or availability of all VTC systems.
Pursue continuous technology cost reductions and efficiencies	Recent technology enhancements- e.g., data center consolidation, virtualization and maintenance contract reductions- are producing technical efficiencies and cost savings. This metric will measure the amount of these costs savings.
Enhance the SEC's enterprise data warehouse infrastructure and performance	The Enterprise Data Warehouse (EDW) infrastructure will enable the provisioning of data to Commission staff for search and analysis through a virtual data warehouse platform. This metric will measure the availability of EDW and data sources.

STRATEGIC OBJECTIVE 4.3

The SEC maximizes the use of agency resources by continually improving agency operations and bolstering internal controls.

As an agency of the federal government entrusted with public funds, the SEC must always strive to enhance the value for investors it creates from every budget dollar. The SEC continually strives to allocate the resources approved by Congress and the President towards the highest and best use. The SEC also constantly reevaluates its operations to identify cost savings and maximize their benefit.

The SEC will strive to maintain strong financial management practices and robust internal controls. The SEC is placing great emphasis on bolstering its processes and systems in its budgeting, accounting, and internal control functions over operations. In addition, the SEC continues to focus on delivering complete, concise, and meaningful information about the financial and operating performance of the Commission that supports management decision-making.

Initiatives

To accomplish this strategic objective, the SEC plans to implement the following initiatives:

- **Better integrate data from SEC operational functions into management decisions:** To accomplish the SEC's mission it is essential that management decisions are based on the best available information from multiple sources. This requires SEC leaders to consider information from human resources, financial management, information technology and support operations functions when making management decisions. To improve decision-making and reporting capabilities, the SEC will examine its data collection, analysis and reporting methods to determine areas for improvement.
- **Further enhance financial systems to achieve operational efficiency and effectiveness:** The SEC is in the early stages of building a financial datamart as part of a broader Commission-wide EDW initiative. The datamart is expected to integrate data from various systems to provide more comprehensive management and financial reporting on a regular basis, to facilitate better decision-making. The SEC also will participate in the federal government-wide deployment of a new travel system, work to replace the system supporting budget execution and formulation, and focus on reforming the systems related to filing fees and registrant deposits.

- **Continue enhancing internal controls:** Although the SEC has made significant progress in strengthening internal controls over financial reporting, the Commission is still focused on further optimizing its controls to enhance financial accounting, reporting and operations. Many of these areas are interdisciplinary and involve collaboration between different offices within the SEC. Such areas include accounting for property and contract obligations, as well as disgorgements, penalties, and filing fees. The SEC also will continue to focus on areas that are highly manual and therefore more at risk for error, with a view towards further automation where possible.
- **Further enhance management assurance to achieve operational efficiency and effectiveness via an agency-wide operational risk management program:** The SEC will continue to build its Operational Risk Management program to manage internal risks that may impact its ability to successfully fulfill its mission. Risk management processes and procedures will be institutionalized and consistently applied within all operating units to ensure that internal operating risks are identified, analyzed, and managed at all levels of the organization. The SEC is in the early stages of formalizing governance structures through the Operational Risk Management Oversight Committee (RMOC). The RMOC will provide oversight of the development and implementation of operational risk policies, framework, methodologies, and provide leadership and monitoring of Commission-wide operational risks.
- **Enhance consideration of diverse sources in SEC's business activities:** For the SEC to enhance the diversity of its suppliers to ensure that it is procuring the best goods and services to meet its contracting needs, the SEC actively will engage in outreach to diverse vendors to evaluate and consider their capabilities, and publicize procurement opportunities in diverse sources.

Performance Goals

The SEC intends to use the following performance metrics to gauge its progress in achieving this strategic objective:

PERFORMANCE GOAL	DESCRIPTION
Financial audit results	Under the Accountability of Taxpayer Dollars Act of 2002, the SEC is required to meet all proprietary and budgetary accounting guidelines for federal agencies and to undergo annual audits. The SEC's audits are conducted by the Government Accountability Office (GAO).
Assurance statement on internal control over operations	In accordance with OMB A-123 and Section 961 of the Dodd-Frank Act, the SEC conducts an annual assessment of the effectiveness of internal controls. The SEC will continue to develop its Operational Risk program and enhance cross-organizational processes to support all division and office management assurance statements. Success is measured by the quality of risk and control assessments and management self-identification and resolution of improvement opportunities.
Timely completion of corrective action on Office of Inspector General (OIG)	Timely completion of audit recommendations is an important SEC priority. This metric measures how well the Commission is doing in completing corrective action on OIG audit recommendations within established timeframes.

PROGRAM EVALUATION

The SEC values independent, high-quality assessments of the agency's performance against its goals and desired strategic objectives. Such assessments are critical to the Commission's ability to evaluate its work, refine its programs and redirect resources accordingly. The more than 150 audits, studies, and evaluations of SEC programs and securities industry-related issues completed since the release of the agency's previous Strategic Plan have served as an important resource in the development of this Strategic Plan. Over the next five years, the SEC will continue to draw on evaluations from a variety of sources to improve its programs.

Annual Performance Report

In February 2013, the SEC published an Annual Performance Report (APR) describing the agency's accomplishments and presenting the results of the agency's performance metrics for FY 2012. The most recent version of the SEC's APR can be found on the agency's website, at http://www.sec.gov/about/secreports.shtml.

Consultation with Outside Groups

The SEC frequently seeks the input of investors, industry groups, academia, and other experts to gain outside perspectives about its programs and various issues in the securities industry. These efforts include the SEC's Investor Advisory Committee; Commission-sponsored roundtables focused on specific issues; the agency's Annual Government-Business Forum on Capital Formation, focused particularly on the needs of new, small, medium-sized, and independent businesses; the SEC's annual conference with the North American Securities Administrators Association; and solicitations of public comments on Commission rule proposals.

Government Accountability Office

The Government Accountability Office conducts dozens of studies or investigations related to the SEC's programs every year. In FY 2013, GAO's reports covered internal supervisory controls, requirements and costs associated with newly developed SEC rules, and the criteria for qualifying as an accredited investor, among other areas. In addition, GAO performs an annual audit of the SEC's financial statements and internal controls over financial reporting.

Office of the Inspector General

The Office of Inspector General (OIG) is an independent office within the SEC that conducts audits of programs and operations of the Commission and investigations into allegations of misconduct by staff or contractors. The mission of the OIG is to detect fraud, waste and abuse, and to promote integrity, economy, efficiency and effectiveness in the Commission's programs and operations.

U.S. SECURITIES AND EXCHANGE COMMISSION

100 F STREET NE | WASHINGTON, DC 20549 | WWW.SEC.GOV