

MEMORANDUM

FROM Moshe S. Levitin

TO Board, JTB, GRH, EJM, GJS, RKS

SUBJECT Final Report of Advisory Committee
on Corporate Disclosure



Financial Accounting
Standards Board

DATE November 28, 1977

This memorandum summarizes the major conclusions and recommendations contained in the Digest of the Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission previously distributed to you by Reed Storey.

The Advisory Committee was formed in January 1977 to evaluate the present disclosure system as administered by the SEC and to assess the cost-benefit relationship of the system. The Advisory Committee met for 18 days between February 1976 and September 1977 and conducted a comprehensive questionnaire and interview survey of the primary participants in the corporate disclosure system.

The three most noteworthy conclusions are:

- 1) The present disclosure system does not need any major changes.
- 2) Financial statement disclosures should be geared toward the sophisticated investor.
- 3) The SEC is better able to deal with emerging problems than the FASB. (See paragraph 17 below.)

A summary of the Advisory Committee's conclusions and recommendations are presented below. They are stated in the order presented in the Report and do not necessarily reflect the order of significance.

1. Present system - Basics of present disclosure system should be continued. No major changes in federal securities laws are needed.
2. Market forces - Market forces alone are insufficient to cause all material information to be disclosed.
3. Present filing requirements - SEC's filing requirements, although often not the source of new information, assure that information disclosed is reliable and accessible to the public.
4. Function of SEC - Statement of SEC's objectives: The Commission's function in the corporate disclosure system is to assure the public availability in an efficient and reasonable manner and on a timely basis of reliable, firm-oriented information material to informed investment, and corporate suffrage decision-making. The Commission should not adopt disclosure requirements which have as their principal objective the regulation of corporate conduct.

5. Information to be disclosed - Information should be geared to reasonably knowledgeable investors willing to make the effort needed to study the disclosures, leaving to disseminators to develop simplified formats and summaries usable by less sophisticated investors.
6. Materiality - It is not possible to develop an objective definition of materiality that will have general applicability to all fact situations. Management has major responsibility for determining what is material.
7. Monitoring - SEC should monitor the extent to which its new rules yield the benefits expected; academic research should be encouraged to assist in the monitoring process.
8. Industry Guides - SEC should develop disclosure guides for specific industries, to (1) minimize disclosure requirements not meaningful to a particular industry and (2) to be better able to apply uniform requirements in a particular industry.
9. Projections and forecasts - SEC should actively encourage inclusion of "soft", forward-looking and analytical information in company reports to shareholders and in Commission filings. To adopt safe-harbor rule. Forecasts should be included on a voluntary basis, with proper disclosure of assumptions, etc.
10. Management analysis of financial data - The numerical tests should be deleted. Management should be required to discuss situations where reported results are not indicative of future results of operations or financial condition, and a letter signed by the chief financial officer should state that due regard was given to all aspects of the requirements.
11. Segment reporting - Endorsement of SFAS No. 14; the SEC should develop an industry by industry basis for standardized product line classification for presentation of both dollar and unit sales of each product line; and to require unaudited segmented financial statement disclosures in Form 10-Q quarterly reports.
12. Social and environmental information - Should be required only when material to financial decision-making or if required by laws other than federal securities laws.
13. Proxy documents - (1) Shareholders should be given information about the nominating committee (if any) of Board of directors; (2) companies should be required to file with the Commission a director's letter of resignation if the director so requests.
14. Form CD - New "Form CD" to be used for 1933 and 1934 Act filings. For 1933 Act purposes, companies should be classified into 3 levels. Level 3 - Companies that have not reported under the 1934 Act for 3 years should file information currently required in Form S-1; Level 1 - Companies meeting certain size and earnings tests to use short-form and incorporate 1934 Act reports by reference; Level 2 - All other companies - to file information now required in Form S-7.

15. Uncertainty in financial statements - Financial statement disclosures should highlight (1) economic assumptions underlying asset valuation and liabilities subject to greatest uncertainties, (2) information that will enable investors to evaluate the potential impact upon income from operations resulting from changes in those economic assumptions, and the likelihood of such changes; and (3) amounts included in the current year's income statement that are adjustments of estimates included in prior years' income statements.
16. Evaluating accounting standards - SEC and FASB should consider, among other things, the adequacy of disclosures (i) regarding the uncertainties inherent in the measurement process; (ii) concerning the amounts and timing of historical cash flows; and (iii) that are useful in assessing the liquidity of the entity.
17. Differences between Regulation S-X and GAAP - SEC should eliminate such differences. If, because of an emerging problem, an extension beyond GAAP disclosures are required, reasons for the extension and the underlying accounting issues involved should be stated. The SEC should then ask FASB to consider the issue. The Advisory Committee believes that the SEC can deal quicker with emerging problems than the FASB can.
18. Special problems of small companies - Public hearings should be held to determine whether (1) "small companies" should be defined (2) if definition is possible, to what extent should reporting requirements be reduced for such companies.
19. Availability of financial information - SEC should convert its public files from a statutory basis to a "company" basis and maintain a "current" file on each reporting company. All 1934 Act filings should be available to shareholders upon request and to non-shareholders at a reasonable cost. Company reports available to equity holders should also be available to debt holders.
20. Dissent of Homer Kripke - Homer Kripke supports recommendations regarding monitoring, and the inclusion of projections and other soft information but dissents from remainder of Report. He dissents to, among other things, the proposal to subordinate the SEC's requirements on accounting disclosure to those of the FASB. His major objection to the Report is his belief that the Committee did not accomplish and did not even attempt to accomplish its intended purpose.