

Heads Up

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Food for Thought

SEC Staff Suggests Ingredients for Effective Disclosures

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Introduction

Over the past 18 months, the SEC and accounting standard setters have frequently questioned whether registrants are using the “right recipe” for effective disclosures — that is, whether their compliance with disclosure requirements and their disclosures of material and relevant information are optimally balanced.

To help registrants refine their recipes, the SEC has embarked on a disclosure effectiveness project.¹ While the SEC seeks to reduce or eliminate outdated, redundant, and overlapping disclosures, Keith Higgins, director of the Division of Corporation Finance, recently emphasized that “reducing the volume of disclosure is not our objective — we want to put better disclosure into the hands of investors. Although we believe that these efforts can reduce the costs and burdens on companies, updating the requirements may very well result in additional disclosures.”²

The project is in its initial stages, and amendments to rules may ultimately be required. However, the SEC staff has emphasized that rather than waiting for changes in rules or interpretive guidance, registrants can take steps now to improve the effectiveness of their disclosures. For example, in his April 2014 “[call to action](#),” Mr. Higgins informed registrants that “[t]here is a lot that you . . . can do to improve the focus and navigability of disclosure documents in the absence of rule changes. You can step up your game right now.”

This *Heads Up* discusses the SEC staff’s views and recommendations about steps registrants can take today to improve their disclosures. The [appendix](#) outlines various types of disclosures and the SEC’s suggestions for improving them.

Elements of Effective Disclosure

The SEC staff has stated that effective disclosures are those that are clear and concise and focus on matters that are both material and specific to the registrant. Appropriate emphasis is also critical. Effective disclosures emphasize matters the registrant believes to be the most relevant and material, and they deemphasize — or exclude entirely — matters that are not. Consequently, registrants are encouraged to continually reevaluate their disclosures and modify them when the nature or relevance of information has changed.

¹ In December 2013, as required by Section 108 of the Jumpstart Our Business Startups Act, the SEC staff issued a [report](#) to Congress on improving disclosure requirements. In its report, the staff recommended that it conduct a comprehensive review of Regulations S-K and S-X for broad-based improvements rather than perform a limited review that focused exclusively on emerging growth companies. Shortly thereafter, SEC Chair Mary Jo White instructed the staff to commence the broad-based review, which has become known as the SEC’s “disclosure effectiveness project.” For background and additional information related to the SEC’s, FASB’s, and IASB’s disclosure effectiveness activities, see Deloitte’s August 26, 2014, [Heads Up](#).

² For additional information, see Mr. Higgins’s October 3, 2014, [speech](#).

Mr. Higgins suggested that in their reevaluation of current disclosures, registrants focus on:

- Materiality.
- Eliminating or reducing redundant disclosures.
- Tailoring disclosures.
- The ongoing relevance of disclosures.

Materiality

In recent speeches, SEC staff members have questioned whether registrants are truly concentrating on disclosing material matters. Acknowledging that “materiality is not an easily applied litmus test,” Mr. Higgins stated in his April 2014 speech, “If there are any gray areas . . . the company is likely to include the disclosure in its filing” and asked whether registrants are therefore including “too many items in the obviously immaterial category.” In an October 2013 [speech](#), SEC Chair Mary Jo White reminded registrants that the Supreme Court addressed the problem of disclosure overload and materiality approximately 35 years ago. She noted that the Court rejected the notion that “a fact is ‘material’ if an investor ‘might’ find it important” and instead “held that a fact is ‘material’ if ‘there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.’”

Eliminating or Reducing Redundant Disclosures

The SEC staff is also encouraging registrants to improve the quality and overall effectiveness of their disclosures by reducing or eliminating redundancies in their filings. For example, in his April 2014 speech, Mr. Higgins noted that registrants often repeat the significant accounting policy disclosures from their financial statement footnotes verbatim in their MD&A discussions of critical accounting estimates. He stated that “if there were ever a place in a report that cried out for a cross reference — and there are likely plenty of them — this is near the top of the list.” While the SEC’s call to action does not relieve registrants from complying with disclosure requirements under U.S. GAAP and SEC rules and regulations (e.g., Regulations S-K and S-X), Mr. Higgins encourages them to “[t]hink twice before repeating something.”

Tailoring Disclosures

The SEC staff often objects to “boilerplate” or general disclosures that could apply to any registrant. Disclosures about risk factors are a prime example. Whether the result of Congressional actions or, as Ms. White noted in her October 2013 speech, the “safe harbors [that] encouraged companies to share more ‘soft’ information with investors,” there has been a marked increase in the amount of non-registrant-specific risk-factor disclosures, which often span several pages in registrants’ filings. Mr. Higgins suggested that rather than viewing risk-factor disclosures as “insurance policies,” registrants could work to limit such disclosures to those that are the most relevant to their operations and be specific in detailing how the risk factors “would affect the company if they came to pass.”

Ongoing Relevance

Effective disclosures are not static but change over time. Registrants are encouraged to continually reevaluate their facts and circumstances to determine whether the information they are disclosing is material and relevant, including information originally disclosed as a result of an SEC staff comment. For example, a registrant may no longer need to disclose a material risk or an uncertainty related to a contingency that was subsequently resolved or became immaterial. Conversely, a registrant would need to disclose any additional information it has gained about a material contingency.

The SEC staff is encouraging registrants to improve the quality and overall effectiveness of their disclosures by reducing or eliminating redundancies in their filings.

Editor's Note: In speeches, Mr. Higgins and other SEC staff members have asked registrants to carefully consider whether their decisions to disclose information are based solely on industry-specific or other SEC comment trends that are identified as "hot button" issues. Moreover, an SEC comment letter can be viewed as the "beginning of . . . a dialogue" rather than as an indication that the staff has "concluded the requested information is material" and should therefore be disclosed. Mr. Higgins reminded registrants to consider relevance, applicability, and materiality before adding (or agreeing to add) disclosures to their filings.

Next Steps

Instead of waiting for the SEC's comprehensive list of ingredients for effective disclosures, registrants are encouraged to start testing their own recipes. In his October 3, 2014, speech, Mr. Higgins noted that the SEC staff wants "to encourage companies to . . . experiment with the presentation [in their periodic reports], reduce duplication and eliminate stale information that is both outdated and not required." He stated that if "companies have ideas to improve their disclosures and want to talk with us about them, although we won't pre-clear specific disclosures we are certainly happy to discuss potential changes."

Appendix — Disclosure Effectiveness Considerations

The following table outlines the SEC’s recent suggestions for improving registrants’ disclosures:³

Disclosure Type	Disclosure Considerations
Critical accounting estimates in MD&A	<ul style="list-style-type: none"> • Reduce or remove from MD&A redundant information related to an accounting policy itself and instead cross-refer to the financial statement footnotes. • Focus the MD&A discussion on the nature of estimates and assumptions and any material impact on liquidity and operations.
Legal and other contingencies in Regulation S-K, Item 103, “Legal Proceedings”	<ul style="list-style-type: none"> • Consider that the requirements of ASC 450⁴ and Item 103 are not identical. • Reduce or remove redundant information in complying with Item 103 and, if appropriate, cross-refer to the financial statement footnotes. • Comply with incremental requirements in Regulation S-K.
Disclosing the impact of recently issued accounting pronouncements under SAB Topic 11.M ⁵	<ul style="list-style-type: none"> • Consider whether disclosure is necessary by assessing the estimated impact of the future guidance on the entity. • Disclose the specific impact to the entity and quantify if possible. • Consider excluding discussion if the known or expected impact is immaterial.
Risk factors	<ul style="list-style-type: none"> • Limit risk factors to those that are relevant and material to the entity. • Tailor the discussion to registrant-specific facts and circumstances; consider how the registrant would be affected if the risk materializes. • Continually monitor and update risk factors.
Disclosure resulting from past SEC comment letters	<ul style="list-style-type: none"> • Assess disclosures resulting from previous SEC comments and provide updates on the basis of materiality and relevance. • Consider removing disclosures that are no longer relevant.
Disclosure of historical information	<ul style="list-style-type: none"> • Continually reassess existing disclosures for relevance. • Add, expand, or eliminate disclosures on the basis of changes in a registrant’s facts and circumstances.
SEC best practices or changes in interpretive guidance	<ul style="list-style-type: none"> • Evaluate the nature and extent of disclosures in light of the SEC’s recommendations for improvement.
Nature and extent of information disclosed in MD&A	<ul style="list-style-type: none"> • Assess disclosures on the basis of materiality and relevance. • Include analysis underlying changes from the financial statements (e.g., for liquidity disclosures, avoid only restating numerical changes from the statement of cash flows).

³ Most suggestions are summarized from Keith Higgins’s April 2014 speech; others are from SEC staff remarks in venues such as the December 2013 AICPA National Conference on Current SEC and PCAOB Developments and the February 2014 “SEC Speaks in 2014” Conference.

⁴ FASB Accounting Standards Codification Topic 450, *Contingencies*.

⁵ SEC Staff Accounting Bulletin 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.”

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