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Technical Director
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Via email:

September 22, 2021

Subject: Agenda Consultation File Reference No. 2021-004

Dear Technical Director,

On behalf of the California Public Employees' Retirement System (CalPERS), I write to express our responses to several of the questions posed in the Financial Accounting Standards Board's (FASB's) request for public input on FASB's Agenda Consultation.

CalPERS is the largest public defined benefit pension fund in the United States, managing approximately $490 billion in global assets. We work constantly to improve our ability, and that of the broader investor community, to identify both investment risks and opportunities in support of our mandate to provide retirement benefits for our two million members. We seek long-term, sustainable, risk-adjusted returns through efficient capital allocation and stewardship aligned with our fiduciary duty. We are guided by our Investment Beliefs[1] which recognize that "Long term value creation requires effective management of three forms of capital: financial, physical and human."[2] Accordingly, we seek fair, accurate, timely, and assured financial reporting about how companies manage financial, physical, and human capital to generate sustainable returns, and how they identify, monitor, and mitigate risks to those three forms of capital.[3]

It is critical that investors like us have access to relatively consistent and digestible financial disclosures that enhance our ability to effectively allocate capital. Effective disclosures facilitate informed decision-making by providing investors transparent and relevant data on the economic performance and condition of portfolio companies. This data helps shareowners more easily identify, assess, and manage risks and opportunities to properly allocate capital, vote equity securities, provide debt, and engage companies, regulators and standard setters on important issues. We rely on regulators and standard setters to assure public companies provide integrated representations of their operational, financial, environmental, social, and governance

[1] CalPERS Investment Beliefs, https://www.calpers.ca.gov/page/about/organization/calpers-story/our-mission-vision#investment-beliefs.
[2] Id.
[3] CalPERS Sustainability Principles, https://www.calpers.ca.gov/docs/forms-publications/governance-and-sustainability-principles.pdf

performance through both financial statement and non-financial statement results and prospects. However, the current disclosure regime for financial reporting must improve to meet the needs of long-term investors. In short, companies must disclose better information in regulatory reports. In order to get there, we need standard setters to consider investors' needs.

We commend the FASB for making available an opportunity to provide input on its work plan. We believe work plans are an important part of the standard setting process, but too few investors take the opportunity to share their views, expecting the standard setters to fairly protect their interests. This belief appears to be well placed when examining the mission of the FASB. The mission of the FASB is to "establish and improve financial accounting and reporting standards to provide decision-useful information to investors and other users of financial reports."[4] Investors rely on the FASB to comply with its mission to provide useful information to investors. The FASB should make certain its work plan reflects its mission.

To that end, we further urge the FASB to further review important developments in international standard setting. For instance, the International Accounting Standards Board (IASB) has issued guidance that promotes including relevant climate risk consideration in financial statements.[5] Moreover, the International Financial Reporting Standards (IFRS) Foundation has initiated a discussion around the creation of an International Sustainability Standards Board (ISSB). These are important developments internationally and some that U.S. policymakers and the FASB should consider in relation to financial reporting in the U.S. We understand that the FASB and IASB are not parallel organizations, yet the IASB approach currently appears to better harmonize with market developments and investor needs.

We appreciate the opportunity to provide comments and express our ongoing support for the FASB mission. Our detailed responses to certain questions are provided in the attached appendix.

Please contact Anne Simpson, Managing Investment Director, at anne.simpson@calpers.ca.gov, if you have any questions or would like to discuss our response.

Sincerely,

Marcie Frost
Chief Executive Officer

Attachment

cc: Anne Simpson

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[4] What we Do: FASB https://www.accountingfoundation.org/jsp/Foundation/Page/FAFSectionPage&cid=1351027541293#:~:text=The%20mission%20of%20the%20FASB%20is%20to%20establish,to%20investors%20and%20other%20users%20of%20financial%20reports

[5] Anderson, N. 2019. IFRS Standards and Climate Related Disclosures. https://www.ifrs.org/content/dam/ifrs/news/2019/november/in-brief-climate-change-nick-anderson.pdf

Appendix B—Questions for Respondents Overall

Question 1: Please describe what type of stakeholder you (or your organization) are from the list below, including a discussion of your background and what your point of view is when responding to this ITC:

b. Investor, other allocator of capital, or other financial statement user, such as: 12. Other. CalPERS is the largest public defined benefit plan in the country. Note: We recommend that the FASB include a pension fund category in future ITCs.

Question 2: Which topics in this ITC should be a top priority for the Board? Please explain your rationale, including the following:
a. Why there is a pervasive need to change GAAP (for example, what is the reason for the change)
b. How the Board should address this topic (that is, the potential project scope, objective, potential solutions, and the expected costs and benefits of those solutions)
c. What the urgency is of the Board completing a project on this topic (that is, how quickly the issues need to be addressed).

There is a need to adjust U.S. GAAP to better reflect the needs and desires of investors. The FASB should address:

(1) Intangibles;
(2) Sustainability; and
(3) the cash flow statement.

A substantially larger portion of firm value is now represented by intangibles than in previous years, and investors have a greater interest in long-term sustainability. However, U.S. GAAP provides little clarity on intangibles and even less on sustainability. Regarding cash flow, the current system does not provide sufficient data addressing investors' needs. Investors want more transparency around these issues, and the need for greater transparency is at an all-time high.

Additionally, there should be better representations of climate risk and human capital in the financials. The FASB should ensure that financial reporting requirements are fit for purpose given the elevated relevance of sustainability factors and other risk factors that may impact long-term company performance. Each project should adequately ensure that estimations, assumptions, judgments, and measurements are standardized in a way that best allows for investors to properly allocate capital. Existing U.S. GAAP provides room for some preparers to manage reality. This leads to improper allocation of capital. The pendulum needs to swing more in favor of the needs of investors whether those investors can precisely identify and communicate particular changes to U.S. GAAP.

Question 3: Are there topics in this ITC that the Board should not address as part of its future standard-setting efforts? Please explain your rationale, such as there is no pervasive need to change GAAP, the scope would not be identifiable, or the expected benefits of potential solutions would not justify the expected costs.

We support continuing the projects that are already underway, except for those that focus on simplifying or eliminating existing requirements without providing any benefits to investors. In Appendix A, we note an absence of substantial projects like credit losses, leases, or revenue recognition. Moreover, there is a project to remove references to Concept Statements, but projects that would benefit investors have not been included. There are also technical projects focused on particular topics or subtopics, and it is not clear where the project sits or what investor input is needed given the nature of the project. We hope that the FASB includes projects that would be more relevant to investors, in addition to the current projects.

Question 4: Are there any financial reporting topics beyond those in this ITC that should be a top priority for the Board to address? Please describe:
a. The nature of the topic
b. The reason for the change
c. Whether the topic is specific to a subset of companies, such as public companies, private companies, or NFPs, or specific to a certain industry
d. How the Board should address this topic (that is, the potential project scope, objective, potential solutions, and the expected costs and benefits of those solutions)
e. What the urgency is of the Board completing a project on this topic (that is, how quickly the issues need to be addressed).

The FASB should prioritize projects on (1) sustainability, (2) intangibles, and (3) cash flow. Investors have been focused on sustainability for a long time. We acknowledge that the FASB and the IASB are not parallel; they have different remits and political structures. However, the IASB appears to be more responsive to investors' needs for better standards on these issues. For example, the new chair of the IASB, Andreas Barckow, highlights two potential priorities, intangibles and sustainability in a Wall Street Journal Article printed September 6, 2021.[6] With regard to intangibles, Chair Barckow states:

> [I]intangible assets [such as brands and patents] is a topic that has come up several times. Intangibles are growing in importance. Many jurisdictions have moved from a manufacturing world to a service-oriented world. The second reason I would cite is the growing gap between book value and market value for many service-oriented firms. Providing more clarity and transparency as to what is really driving a company's value would be helpful for a start.

When emphasizing the importance of sustainability, Barckow adds:

> While I realize that this is not a core issue for a financial reporting standard-setter, you may be well aware that our trustees are considering setting up [the International Sustainability Standards Board], a sister board to the IASB. It will be concerned with setting standards for sustainability-related financial disclosures. Now, you could say, 'Let them take care of ESG and concentrate on your core stuff.' But a message that we are also hearing very consistently from jurisdictions is you should not really separate the two domains, as they go hand in hand. It could very well mean we're tackling standards together from an ISSB and an IASB perspective.

[6] The New Head of the International Accounting Standards Board Chair Outlines His Priorities

We encourage the FASB to move in a similar direction within its remit. The IASB has been further along in considering intangibles, but we appreciate signs from the IASB that intangibles will be considered more fully. It is important to note that the IASB had resisted entertaining focusing on sustainability for years. It is time that FASB adjusts its posture and applies its technical expertise to focus on intangibles and sustainability related disclosures in financial reports.

The ITC tees up a broader discussion on cash flow. We hope that it is pushed forward with a substantial focus on the needs of investors.

Intangibles, sustainability, and cash flows are important to the entire market and not just a subset of companies. The FASB should begin to address these issues in a robust way.

Question 5: The objective of this ITC and the related 2021 Agenda Consultation process is to ensure that the FASB continues to allocate its finite resources to standard-setting activities that fulfill its primary mission of improving financial accounting and reporting standards and that are of the highest priority to its stakeholders. Therefore, feedback on the prioritization of projects on the FASB's technical agenda (see Appendix A) would be helpful. Do you have any feedback on the FASB's technical agenda, including the following:

a. Which projects on the FASB's agenda should the Board prioritize completing? Please explain.
b. Which projects, if any, should the Board deprioritize or consider removing from the agenda? Please explain.
c. Which projects, if any, need to be redefined to improve the objective and/or scope? Please explain.

We would prioritize the items that promote transparency and deemphasize the items that appear to provide relief for only a small number of vocal preparers and auditors. We see nothing in Appendix A to give special emphasis. Companies now have access to much better technology and are able to provide more information. Users have the ability to consume the information in new ways as well. There is no need to reduce information. Projects that reduce transparency should be deprioritized.

Question 6: Greater disaggregation and granularity of the types of financial reporting information described in Chapter 1 have been identified as decision useful to investors. The following insights would be helpful to the FASB when considering this area:

a. Investors and other financial statement users—Which, if any, of the areas described in Chapter 1 should be a top priority for the FASB to consider requiring greater disaggregation—on the income statement, the statement of cash flows, or the notes to financial statements? Would this information be most useful in the financial statements or in the notes to financial statements? How would this information be used to analyze a company and make capital allocation decisions?
b. Preparers—What requests or questions does your company receive from analysts on the areas described within Chapter 1? Please explain any requests or questions your company has received.

The ITC does an excellent job of highlighting disaggregated information that investors want in the bulleted items on page 7. The additional information would help investors make allocation decisions, but it would also aid in making voting and engagement decisions. The additional granularity would give investors more insight into whether management is managing resources well. We have actively advocated for more sustainability information, especially on climate and human capital, but we have also advocated for country-by-country tax reporting.[7] We believe that there could be much better reporting around cost of sales and selling, general, and administrative expenses. This information would be useful to investors.

Question 7: Investors and other financial statement users—What cash flow information, if any, required for your analysis is missing in a statement of cash flows prepared using the indirect method? How would this information influence your decisions and behavior? Please explain.

The indirect method obfuscates reality and reduces the potential for comparisons. The direct method provides more information on a company's operations which provides better information on future operating results which would promote better allocation decisions by investors.

Question 14: Are there common financial KPIs or metrics—either widely applicable to all companies or industry specific—that would provide decision-useful information if they were defined by the FASB? Please explain.

The FASB should focus on the key performance indicators (KPI) used by managers to drive performance. Once such KPIs can be identified, they should be integrated into financial reporting. In other words, the FASB should seek to identify the value drivers, measure them, and then have companies disclose them on a mandatory basis.

Question 15: If the FASB were to define certain financial KPIs or metrics, should all companies be required to provide those metrics or should providing those metrics be optional?

Yes, the metrics should be mandatory to preserve comparability.

Question 16: If the Board were to pursue a project on the recognition and measurement of government grants, should the FASB leverage an existing grant or contribution model (such as the models in IAS 20 or Subtopic 958-605) or develop a new model? If you prefer leveraging an existing model, which would be most appropriate and why? If the FASB were to develop a new model, what should the model be?

The FASB should pursue a project on government grants. IAS 20 could be a starting point. The pandemic highlights that having good standards in place is better than pursuing perfect standards. The focus should be on investor needs.

Question 17: The FASB has encountered challenges in identifying a project scope that can be sufficiently described for government grants. If the Board were to pursue a project on the

[7] Testimony before the U.S. House of Representatives, Committee on Financial Services, Subcommittee on Investor Protection, Entrepreneurship and Capital Markets; https://corpgov.law.harvard.edu/2019/07/15/testimony-before-the-u-s-house-of-representatives-committee-on-financial-services-subcommittee-on-investor-protection-entrepreneurship-and-capital-markets/

recognition and measurement of government grants, what types of government grants should be included within the scope and why (for example, narrow or broad scope)?

This should be a broad scope project and include recognition, measurement and disclosure.

Question 18: The FASB has encountered challenges in identifying a project scope that can be sufficiently described for intangible assets. If the Board were to pursue a project on intangible assets, what types of intangible assets should be included within the scope and why? Within that scope, should a project on intangible assets be primarily focused on improvements to recognition and measurement or to disclosure?

The FASB could identify which intangibles to address first. There is a need to begin to address the growing gaps in market value and book value. The project should involve recognition, measurement and disclosure. Like others, we favor adding a project targeted on the accounting for development costs, which are generally incurred with the specific objective of creating a product that will generate future revenues and which may be material to the reporting entity. The FASB should consider going beyond just aligning with the guidance in International Accounting Standard (IAS) 38, *Intangible Assets* and just focusing on software. We note that several commenters have added cryptocurrency to this list given the existing markets that value such instruments, and the FASB should examine this with input from the SEC.

Question 24: How helpful would it be in evaluating disclosure materiality if the materiality guidance in paragraph 105-10-05-06 that "the provisions of the Codification need not be applied to immaterial items" was repeated in the Disclosure Section of each Codification Subtopic? Please explain.

It would be disruptive and make it more likely that companies will omit material information, and we are concerned that company boards and auditors will be unable to adequately identify and remedy these omissions. There is no practical need to restate the guidance. Investors want greater transparency and have not asked for this. Investors believe that technology makes providing such transparency easier for preparers, and technology makes it easier for investors to consume disclosures.

We highlight a few important materiality related points to further illustrate our concerns:[8]

- Given technological advancements since 1976, transparency is easier to promote than ever.
- Technology enables preparers to be more precise. SAB 99 warned against managed earnings, and the proposed change modifies standards to make managing earnings more likely.
- We are aware of a 2013 field study conducted by the FASB staff indicating a focus on "reducing or eliminating **irrelevant** disclosures." It appears that the FASB would like to substitute immaterial for irrelevant. Further, emphasizing immateriality does nothing except reduce disclosures while giving preparers and auditors additional protection.
- There are a number of instances where reducing precision might violate materiality standards, including when the omission (1) masks a change in earnings, (2) changes a loss

[8] CalPERS Response to File No. 2015-300 , and CalPERS Response to File No. 2015-310

to income, (3) hides a failure to meet analysts' consensus expectations, or (4) increases management compensation. These issues are less likely to be focused on once disclosures are reduced.

In addition, adding the phrase in each Subtopic would create a "double materiality" problem. This is often raised in mergers and acquisitions (this should not be confused with the current double materiality in the sustainability context). In the mergers and acquisitions context, when there is a general materiality standard stated (as in 105-10-05-06) and an additional materiality standard stated for a particular disclosure, as suggested above for each Subtopic, some argue that there is a higher materiality threshold, as in it must be extra-material in order to be disclosed. This means that, under the proposed new construction, companies would need to disclose less than they currently disclose. If they fail to disclose, they are protected. In any event, investors are given less information. When challenged, preparers will point to the general materiality standard for protection as well as the additional materiality standard in the Subtopic. Some argue that, as a practical matter, it does not make a difference. However, these arguments persist when potential violations arise in other contexts, and we fear that the request is made to create the confusion found in other contexts. If it really makes no difference, there is no need to add the requirement. If it makes a difference, investors are harmed, and there is no reason to add the requirement.

Finally, investors desire greater transparency, and companies too often rely on materiality to enhance the information gap and avoid providing a higher level of precision desired by investors. We only support additional measures to improve transparency.

Question 25: Which, if any, of the FASB processes described in Chapter 4 of this ITC could be improved? Please explain your rationale for each, including the following:
a. Why that process needs improvement
b. How the FASB should improve that process
c. What the urgency is of that process improvement.

The Codification is especially cumbersome for non-paying users. An early commenter to this ITC points out the prohibitive costs of accessing materials relative to how such materials would be used.[9] There should be some adjustments to provide greater market access to U.S. GAAP. The FASB generates revenue by selling the information, but the existing process has its costs in that it limits accessibility for certain users. The FASB should review access to the Codification.

The cost benefit analysis should not be linear because it could prevent getting things right. An example can be found in the discussion around the direct or indirect method. One is more intuitive and practical for investors, and the other is the one that is commonly used. Changing would have definite costs, but the more investor friendly and intuitive method should have been used in the first place. Investors should have primacy, in accordance with the mission of the FASB, however, the cost analysis focuses on the preparer, and the benefit to the investor is always assumed to be elusive. If the mission is to provide useful information to investors, this process needs to change, giving investors greater primacy.

[9] ITC Comment of Marc Porter