Consumer Federation of America

December 8, 2015

Technical Director
FASB
401 Merritt 7
Norwalk, CT 06856-5116

Re: "Materiality" and "Notes to Financial Statements (Topic 235)"
File Reference No. 2015-310 and 2015-300

Dear Sir or Madam:

We are writing on behalf of the Consumer Federation of America (CFA)[1] and Americans for Financial Reform[2] to express our opposition to the Financial Accounting Standards Board (FASB)'s recently proposed changes to its discussion of materiality and its guidance regarding how to assess the materiality of disclosures contained in the footnotes of financial statements. While FASB seeks to characterize these as a benign changes designed to "clarify materiality" and "help organizations improve the effectiveness of their disclosures," the general consensus among investor advocates is that the change will instead reduce the effectiveness of financial disclosures by reducing the amount of relevant information they contain. We share that concern. We therefore urge you to withdraw the proposed changes in order to reconsider whether any revisions are in fact needed and, if so, how they can be developed to serve the needs of investors and other users of financial statements.

FASB Has Shown No Evidence that the Proposed Changes are Necessary or Appropriate

As FASB states in its Conceptual Framework for Financial Reporting: "The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity." Given that focus, one would have expected FASB to ask, first and foremost, whether investors and other users of financial statements perceive that there is a problem

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[1] The Consumer Federation of America is a non-profit association of nearly 300 consumer groups that was established in 1968 to advance the consumer interest through research, advocacy, and education.

[2] Americans for Financial Reform is a nonpartisan and nonprofit coalition of more than 200 civil rights, consumer, labor, business, investor, faith-based, and civic and community groups. Formed in the wake of the 2008 crisis, we are working to lay the foundation for a strong, stable, and ethical financial system – one that serves the economy and the nation as a whole.

here that needs to be solved, and specifically whether they find that material disclosures are being obscured by excessive disclosure of immaterial information. FASB presents no evidence that this is the case. Instead, it simply accepts as a given that "communication would be more effective and material information would be more apparent if it was not obscured by immaterial disclosures" and that the best way to achieve that goal is to increase issuer "discretion" in determining whether information is material.

As accounting expert Jack T. Ciesielski points out in his recent article, "Materiality Matters," however, "investors usually want more facts, not less."[3] Ciesielski further notes that FASB's emphasis on encouraging preparer discretion "is disconcerting to investors. …Preparers have always had to exercise their judgment when it comes to applying accounting principles and standards, but 'discretion' has a different implication – one that carries a connotation of 'do what you want to do.'" Ciesielski concludes, as we do, that the proposals seem to be "aimed squarely in the interest of just one constituent of the standard setting body: the preparer community." That focus is evident as well in the questions FASB asks in the proposing release, which focus almost exclusively on the proposal's impact on issuers and auditors and ignore entirely its impact on the users of financial statements. Nowhere in either proposal does FASB assess, or even acknowledge, the countervailing risk that the proposed changes would make it easier for preparers to omit information that investors and other users of financial statements find useful. Nor does it appear to give any consideration to the possibility that existing guidance makes it too easy, rather than too hard, to omit information that investors view as relevant.

This exclusive focus on the concerns of preparers is, in itself, reason enough to justify a call for FASB to withdraw the proposals and to begin anew with a focus on what changes, if any, investors believe are needed to the discussion and application of materiality in order to provide disclosures that are, to use FASB's phrase, "decision-useful."

Proposed Changes to Materiality Would Likely Result in Less Useful Disclosures

FASB's proposed change to its discussion of materiality effectively eliminates current FASB guidance with regard to how to apply the concept of materiality to the preparation of financial statements. The current language achieves that goal by encouraging issuers to provide all the information that "could influence decisions that users make on the basis of the financial information of a specific reporting entity." In other words, where issuers are uncertain whether particular information would be considered useful by investors, it encourages them to err on the side of being inclusive. In its place, the proposal simply refers issuers to the Supreme Court language on materiality in the context of anti-fraud provisions. Instead of encouraging preparers to provide information that investors "could" find useful, the legal definition requires them to provide only that information where there is a "substantial likelihood" that a reasonable investor "would" view the information as significantly altering the total mix of information. As Ciesielski explains, "The basic premise of the proposed amendment: materiality is a legal concept, rather than an accounting concept. In effect, the FASB is saying that in evaluating materiality of information to be included or excluded from financial statements, preparers and auditors should look to current legal precedents regarding materiality for guidance, rather than looking for an answer in accounting literature."

[3] Jack T. Ciesielski, CPA, CFA, "Materiality Matters," *The Analyst's Accounting Observer*, Vol. 24, No. 12, Nov. 30, 2015.

To suggest, as FASB does in both proposals, that "materiality is a legal concept" does not lead to the inevitable conclusion that the accounting literature should be silent on how to apply that concept. After all, the notion of full and fair disclosure is also a legal concept, but we still need the accounting standards to interpret how that goal is to be achieved. Moreover, as the Supreme Court stated in the seminal decision on materiality, *TSC Industries, Inc. v. Northway*, determining whether a particular fact is material is "a mixed question of law and fact, involving as it does the application of a legal standard to a particular set of facts." FASB's standards can play a useful role in helping preparers assess how to weigh those questions in order to ensure that their disclosures provide "decision-useful information to investors and other users of financial reports." That goal is unlikely to be promoted through an approach that encourages preparers to use their discretion in order to provide the bare minimum information necessary to avoid violating the fraud standard.

There is no question in our mind that the proposed change would be seized on by some companies to justify reducing the amount of information they provide to investors and other users of financial reports. This concern is reinforced by the fact that encouraging greater preparer discretion in determining what information to disclose and reducing "obstacles" preparers face when they seek to omit information are stated goals of the related proposal on assessing materiality of footnote disclosures. As Ciesielski explains, "The emphasis on discretion, and on omission of disclosures, makes it hard to expect that preparers would not view any final standard as anything other than a license to attack whatever disclosure overload they believe is causing them pain." But what FASB, and the preparers whose interests it is promoting with these proposals, view as obstacles, investors are likely to view as necessary to ensure accountability around issuer decisions about what information to disclose. Since investors are at far greater risk when preparers exclude information that is material than when they include information that is not, those "obstacles" to omitting information can serve a useful purpose. One would have expected FASB to at least consider that benefit in its discussion of these issues in the exposure draft, but no such discussion appears.

FASB Could Address Any Confusion That May Exist Through Less Extensive Changes

FASB justifies this proposed change on the grounds that it is needed to eliminate confusion and to ensure that "the materiality concepts discussed are consistent with the legal concept of materiality." But, FASB provides no evidence that any "confusion" that may exist is the result of differences between its discussion of materiality and the language in the Supreme Court decision rather than the inherently subjective nature of materiality decisions. The examples it provides in its exposure draft on footnote disclosures – the quantitative focus of preparers and the "perception that all disclosures mentioned in a particular Topic are required if that Topic addresses a matter that is material to the reporting entity" – do not demand a retooling of the Board's approach to materiality. The first issue regarding consideration of quantitative and qualitative factors is already thoroughly addressed both in the accounting literature and in court cases based on the current standard.[4] In light of that extensive guidance, any preparer who remains confused on this point is unlikely to suddenly achieve enlightenment through the changes proposed here. Instead, they are likely to take away the message that they can justify whatever approach they prefer based on their "discretion" in applying the

[4] Securities and Exchange Commission, 17 CFR Part 211, [Release No. SAB 99], Staff Accounting Bulletin No. 99; Ganino v. Citizens Utility Company, U.S. Court of Appeals, Second Circuit, Docket No. 99-7904, Argued April 10, 2000 - September 06, 2000; Litwin v. Blackstone Group, L.P., U.S. Court of Appeals, Second Circuit, August 25, 2010, Argued; February 10, 2011, Decided, Docket No. 09-4426-cv.

materiality standard. If the second point is genuinely an area of confusion, it could be addressed through a simple clarification of this one point.

A third point raised in the exposure draft is that "omissions of immaterial disclosures are currently deemed to be accounting errors, and auditors are compelled to inform audit committees of their existence. In turn, the audit committee needs to consent to their omission."[5] We believe it is highly appropriate for independent auditors to discuss such disclosures with the audit committee, including decisions the auditors have reached as to why a particular disclosure may be deemed to be immaterial to investors. The FASB has provided no tangible evidence that audit committees and investors have been ill served by discussing why a particular disclosure is, or is not, considered immaterial. If the Board nonetheless believes clarification is needed in this area, we agree with Ciesielski that "the better answer is to change the auditing literature so that foregone disclosures are called 'forgone disclosures,' instead of errors, and brought to the attention of the audit committee as a 'last chance' to review them for inclusion."

Finally, on the broader question of confusion around the meaning of materiality more generally, if FASB feels it needs to provide clarification that its discussion of materiality does not conflict with the legal definition, it could do so simply by clarifying that its discussion is not intended as a substitute for the legal definition but as an explanation of how best to apply that concept to the preparation of financial reports in order to arrive at disclosures that are "decision-useful." FASB indicates in its exposure draft on footnote disclosures that it considered "including guidance that would have stated that when an entity cannot determine whether the information is material (that is, a close call), the information should be included." It decided against this approach, however, because it "believes that such decisions are made most appropriately by preparers of financial statements in the context of the regulatory, legal, and governance environment in which they operate." This reflects a flagrant double-standard, in which the Board is apparently reluctant to express an opinion that would encourage more inclusive disclosures, but shows no such reluctance to express views that would encourage less inclusive disclosures.

As noted above, this clear bias toward the interests of preparers, when its own literature identifies users of financial reports as the primary beneficiaries of accounting standards, is sufficient reason to justify a call for FASB to withdraw these proposals and start from scratch with a new focus on the needs of the users of financial reports.

Additional Recommendations

Our strong preference is that the Board withdraw this proposal in its entirety. If it is determined to move forward, however, it should at the very least incorporate the following additional changes. Indeed, we believe the following changes should be adopted regardless of whether the Board moves forward with this particular proposal.

1. The Board should adopt in its standard, the language in the securities laws and regulations which states: "In addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not

[5] Ciesielski, "Materiality Matters."

misleading."[6] After all, if the point of this proposal is that materiality is a legal standard, rather than an accounting standard, this is an essential component of that legal standard.

2. The Board should require preparers to disclose their accounting policy with respect to how materiality is determined and what amount is considered material. Determination of materiality is among the most significant accounting policies, yet the Board does not currently require disclosure of this policy. That is a significant flaw in its accounting disclosure standards that should be rectified immediately.
3. The Board should clarify, consistent with SEC Staff Accounting Bulletin No. 99, that intentional accounting and disclosure errors may well be, and often are in fact, material.

Conclusion

Weakening the materiality standard and increasing regulatory deference to issuer and auditor judgments has long been a goal of the preparer community. These efforts have been strongly resisted by investors and investor advocates. It is disappointing, to say the least, to see FASB put forward a proposal that is so clearly intended to advance this anti-investor, anti-transparency agenda. For all the reasons discussed above, we urge you to withdraw the current proposals and start from scratch with an assessment of whether, from the point of view of users of financial reports, there is even a problem here that needs to be addressed. Any such evaluation must give due consideration to the question of whether existing standards for applying materiality are too lax, rather than too rigorous. To the extent that the Board finds that problems with application of materiality exist, we urge you to adopt an approach that focuses on the needs of users of financial reports and prioritizes full and fair disclosure over reduced disclosure.

Respectfully submitted,

Barbara Roper, Director of Investor Protection
Consumer Federation of America

Lisa Donner, Executive Director
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[6] Part 240 – General Rules and Regulations, Securities Exchange Act of 1934, 240.12b-20, and Section 11a of the Securities Act of 1933