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December 7, 2015

Technical Director
Financial Accounting Standards Board
P.O. Box 5116
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File Reference No. 2015-300, 2015-310

Dear Director,

I appreciate the opportunity to comment on the two proposals referenced above. My understanding is that they are an extension of the Board's efforts to improve disclosure effectiveness.

"Disclosure effectiveness" is something that exists in the eye of the beholder: I think it defies being defined in an absolute way that everyone can agree upon. I can frame it only from the viewpoint of a financial statement user. My overall impression is that neither of these proposals do anything to improve disclosure effectiveness. There seems to be a certain strain of paternalism present in these proposals, something along the lines of: "Investors can't handle immaterial disclosures, and we have to find a way to let preparers reduce them." This is contrary to the experience of many investors: if a disclosure doesn't merit their attention, they'll pass it by. Most of the time, investors want more disclosures, not less. "Disclosure overload" is a view of disclosure effectiveness that is more of a preparer view – and that's what these proposals seem to be trying to fix, by giving managements more discretion in determining materiality of disclosures. For instance, in the proposed Accounting Standards Update, the word "discretion" appears 17 times in a 17-page document. In contrast, "user" or "users" appears only 7 times.

If the Board – and the SEC – want to truly improve "disclosure effectiveness" from the investor point of view, here's a suggestion. Try to craft disclosure requirements – or enforce them at the SEC level – so that a mere copy/paste from the Accounting Standards Codification won't pass as adequate disclosure. For an example, look at a random sampling of accounting policy footnotes for revenue recognition. Frequently, the language used for much of the revenue recognition policy note is taken from the codification. A company may have multiple revenue recognition policies, because it has multiple segments – but it's unusual to see any cohesive explanation of which policies relate to which segments, or to what degree the revenue of a particular segment relates to a specific revenue recognition policy.

For some additional views on disclosure effectiveness versus disclosure overload, I have attached as an appendix an excerpt from a recent report my firm published on these two proposals.

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I will now address some of the questions from the two proposals, starting with the proposal to amend Concept Statement 8. The exposure draft has only one question for respondents: Do the proposed amendments improve Concepts Statement 8? If so, how? If not, why?

Answer: The proposed amendment does not improve Concepts Statement 8. First, the existing definition:

"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. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude or both of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation."

That definition sounds like a workable concept: it's not clear why it won't work in the FASB's conceptual framework. The proposed amendment does not make clear how or why it's an improvement to the conceptual framework. The only apparent reason it's considered an improvement by FASB is that it clarifies that materiality is a legal concept.

At first, the proposed definition seems to make sense. Upon reflection, it becomes less sensible:

- **Investor-useful financial statements are based on economics, and not legal theory.** Why does materiality have to have a legal definition spliced into a framework that should be designed to produce investor-useful information about a firm's economics? Would the FASB have preferred to introduce revenue recognition principles from the tax code - a legal concept - into its own revenue recognition standard? Of course not. There is no apparent reason that materiality needs that kind of treatment. There is no apparent reason that there has to be symmetry between an accounting concept of materiality and a legal concept of materiality.
- **The FASB decides what belongs in financial statements and in its conceptual framework.** Referencing materiality as a legal concept is offloading a part of the conceptual framework to a profession outside of the accounting standard-setting world.
- **Accountants are not lawyers.** When considering how to assess materiality because it is a legal concept, will they now have to venture into territory they're not trained to handle – or seek additional legal counsel? Neither option is appealing, and certainly does not “clarify” materiality matters. It actually could make it harder for practitioners to apply materiality concepts.
- **The thrust of the change has been to change the concept of materiality for the preparer community.** The revised definition does not refer to users of financial statements – yet they are the ones for whom financial statements are prepared and are the most affected by materiality.

Rather than answer each question from the proposed amendment, I will only answer the first two. I would note, however, that determining materiality – whether through the preferable existing guidance, or by the FASB's new outsourced legal definition – is a policy decision. It's ironic that the amendment to the disclosure requirements doesn't require disclosure of the determination of materiality thresholds. If the Board goes ahead with this proposal, they should require such a disclosure. Putting the determination of the policy into print might force managers to think harder about how they plan to apply their discretion in determining materiality.

Question 1: Would assessing materiality subject to the proposed changes to paragraphs 235-10-50-7 through 50-8 be any easier than under current GAAP? If yes, please explain why.

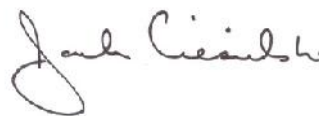
I do not think it would be easier. I think it will force accountants to either act like lawyers or do more legal work to determine materiality. I do not believe that this is what FASB intends.

Question 2: Would applying the amendments in this proposed Update significantly increase or reduce costs of preparing the notes to financial statements? Why or why not?

I believe it would increase costs; see answer to Question 1.

If you have any questions regarding this letter, please do not hesitate to contact me. Best regards.

Sincerely,



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Appendix: The “Disclosure Overload” Myth

It’s repeated so often by the preparer community, it’s accepted as dogma: financial reporting requirements have become so onerous that annual reports, 10-Ks and 10-Qs are unreadable and unusable to investors. Disclosure overload exists, and it discourages investors from doing their jobs as financial analysts. On the other hand: If you say something long enough and loud enough, people automatically accept it as true –whether it is or not.

The problem for investors is that the FASB has bought into the disclosure overload myth, at least with the issuance of proposals like these two. Neither FASB proposal explicitly mentions “disclosure overload,” yet they broadly emphasize expanding the *discretion* of preparers to omit disclosures, depending on their materiality. 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.

It would be useful for companies, investors and regulators to step back and view the disclosure overload dogma through different lenses.

Is every increase in disclosure an “overload?” (Or, are all disclosure increases unjustified?) The term “overload” is itself a loaded word; it connotes something overstuffed and about to break. Using the term in discussions about changing disclosure levels presumes that increases are unsustainable. The label itself sets an argument. Maybe some real-world examples, in place of rhetoric, might provide some helpful parameters about disclosure frequency and levels.

It’s not an exhaustive example, but look at the table below. It shows page count information from the most recent 10-Ks of the three largest companies in the Dow Jones Industrial Average, as of the end of October, 2015, and the page count information from their 10-Ks issued twenty years ago.

Where Pages Grew, 1994-2014

Company	Market Capitalization, October 31 (\$ in Millions)			Pages in 2014 Financial Statements		Pages in 2014 MD&A (including Risk Factors)		Financial Statements: Change in Pages		MD&A: Change in Pages	
	1995	2015	% Change	2014	1994	2014	1994	% Change	% Change		
Apple Inc.	\$4,464	\$666,661	14836%	30	17	15	8	13	76%	7	275%
Microsoft Corp.*	59,000	420,383	613%	47	11	24	4	36	327%	20	1075%
Exxon Mobil	94,858	344,441	263%	51	19	20	4	31	168%	15	400%

*R.G. Associates, Inc. holding. See note on back page.

“Pages in the Financial Statements” are the page count for the full package of GAAP-basis financial statements (income statement, balance sheet, statement of stockholders’ equity, comprehensive income and cash flow statements) plus all footnotes, and excluding auditor’s reports; “Pages in MD&A” refer to all pages in the Management’s Discussion & Analysis, including the listed “Risk Factors.”

Some observations:

- Page count of the essential financial statements grew, of course. The percentage change in page count grew even more significantly. And so did the market capitalization of the companies: it would make sense that if they grew, perhaps their financial information became more complex. Their financial information also might become relevant to a broader swath of institutional investors, or to more gigantic, sophisticated institutional investors, or both.

It’s hard to expect that the companies were no different in terms of operations or complexity in 2014 than they were in 1994. Why wouldn’t their financial statements also be longer in order to convey more to their investors – who also have probably increased in their sophistication and size - about operations or complexity? Those promoting the disclosure overload argument might also have difficulty accepting the theory of evolution.

- In percentage terms, the MD&A grew more spectacularly than the financial statements. That’s probably because of the low base for MD&A pages set in 1994. It seems incredible today that an MD&A for any one of those three firms could have been measured in the single-digit range of pages.

In sum, if the volume of financial reporting has increased and become more complex, it’s not just because FASB – and the SEC – require more disclosures. It’s because the companies themselves become more complex and take part in new activities that investors need to understand.

Are investors as helpless as alleged by companies? Has there ever been a time when investors read every word of every filing – even twenty years ago when the financial statement packages were much smaller? It’s amusing to recall now, but twenty years ago, the SEC was giving serious consideration to permitting companies to publish “abbreviated financial statements” – ones streamlined to make them easier to understand for investors.¹ Of course they would have been easier to understand – there would have been less information to comprehend.

Even with the “voluminous” level of information now published, the ability of investors to sift through it has increased as well: who doesn’t use the “find” function in Adobe or Word when they’re interested in just one particular exposure in a company?

Disclosures aren’t the only reason the length of statements has increased. Some growth is due to new standards. Why do new standards develop? Because they bring consistency and adequate information about activities that are themselves new. Was there much information about derivatives activities in the financial statements twenty years ago? No. Was there much information about stock compensation activities in the financial statements twenty years ago? No. Did fair values of non-traded financial instruments matter much 20 years ago? No, but they matter now.

These and other financial reporting issues have soared in frequency in the last twenty years. As their abundance has increased, so have the relevant disclosures. The driver of disclosure volumes may be the volume of transactions requiring disclosure – not the abundance of disclosure requirements. Think of it this way: if managers didn’t get paid so heavily with equity-based compensation, would there be as much to disclose? Of course not – but the equity-based pay keeps increasing, and with it, the pages of disclosures about such plans increases as well.

Disclosure overload is a convenient target. Nobody wishes for a more complicated life, and when firms target disclosure “overload” to be remedied, it resonates well with most players. It’s just good politics: the real target might be to reduce disclosures so they show less, but if you can convince constituents – whether they be standard setters or investors – that reducing “overload” is needed, they’re likely to agree with you.

Again, it goes back to that loaded term – disclosure overload and its implication of “too much” and “ready to burst.” If the issues were framed as “disclosure improvement,” which is what the discussion should be about, nobody would sign on.

Disclosure overload has a populist ring to it, and the desire to simplify is always a compelling one. Not everything that should be simplified can be simplified, however. Otherwise, there would be do-it-yourself brain surgery kits on sale at Wal-Mart. Financial reporting and disclosure is nowhere near as complex or demanding as brain surgery, however. The opponents of disclosure should be held accountable when they eliminate disclosures that would otherwise inform. The market does its share to hold them accountable (see Valeant). It’s not encouraging for investors to see the FASB try making it easier to eliminate disclosures.

¹ You could look it up – right here: <https://www.sec.gov/rules/proposed/33-7183.txt>