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January 21, 2016

Mr. Russell Golden
Chair
Financial Accounting Standards Board
401 Merritt 7
P.O Box 5116
Norwalk, CT 06856-5116

Re: *Notes to Financial Statements (Topic 235) – Assessing Whether Disclosures Are Material*

Dear Mr. Golden,

CFA Institute,¹ in consultation with its Corporate Disclosure Policy Council (“CDPC”)², appreciates the opportunity to comment on the Financial Accounting Standards Board’s (“FASB” or “Board”) Proposed Accounting Standards Update, *Notes to Financial Statements (Topic 235) – Assessing Whether Disclosures Are Material* (“Notes Proposed Update”). Under separate cover, we have provided comments on the related *Proposed Amendments to Statement of Financial Accounting Concepts, Conceptual Framework for Financial Reporting – Chapter 3: Qualitative Characteristics of Useful Financial Information* (“Conceptual Framework Proposed Update”). Collectively, the Conceptual Framework Proposed Update and the Notes Proposed Update are referred to herein as the Proposed Updates.

CFA Institute is comprised of more than 130,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

¹ With offices in Charlottesville, New York, Hong Kong, London, Mumbai and Beijing, CFA Institute is a global, not-for-profit professional association of more than 133,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 151 countries, of whom more than 125,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 145 member societies in 70 countries and territories.

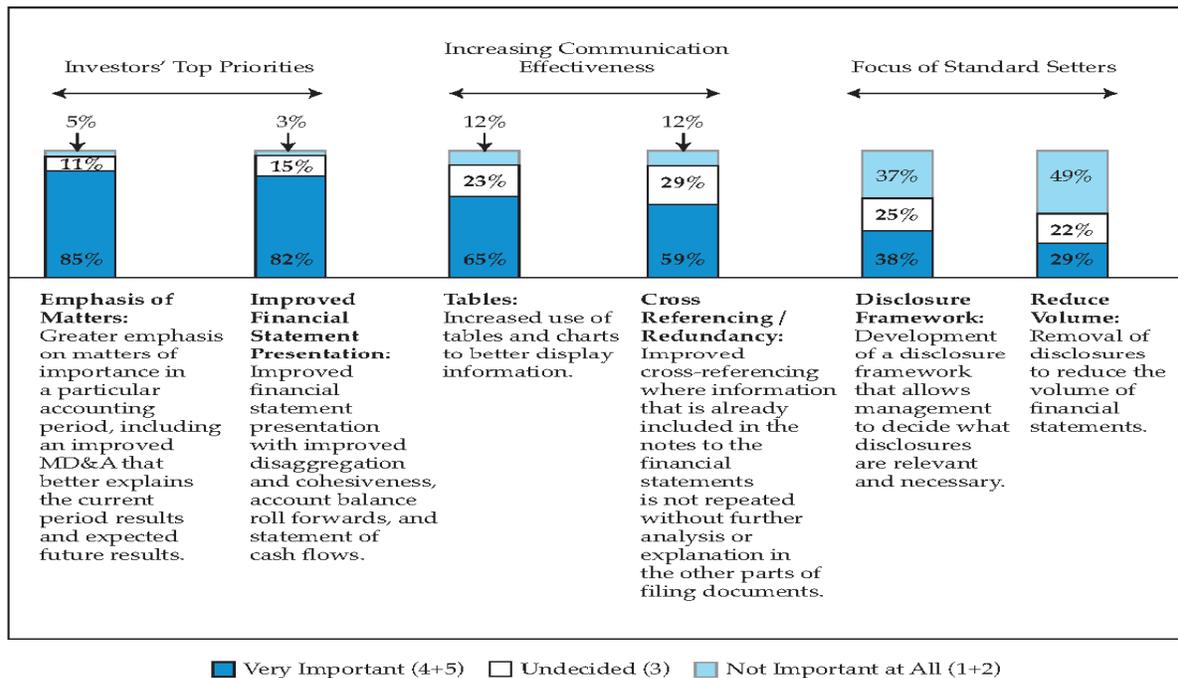
² The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners’ perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

Disclosure Overload: Investors See the Underlying Basis for Change Differently

Throughout the Proposed Updates there is a perception articulated that financial statements include a high degree of immaterial information and that the discretion being provided by the Proposed Updates, or at least the Notes Proposed Update, will remove this obfuscating and immaterial information and improve the perceived disclosure overload experienced by investors.

Investor Views on Disclosures

As we note in our 2013 report, [Financial Reporting Disclosures: Investor Perspectives on Transparency, Trust & Volume](#), (the Disclosure Report) our investor members, based upon a 2012 survey, do not perceive there to be a disclosure overload problem. As the chart below illustrates, respondents to our survey see emphasizing matters of importance and improving financial statement presentation as the top priority of accounting standard-setters. They see that a disclosure framework to provide more discretion to management and reducing the volume of disclosures as the least important priority for standard-setters.



How important would each of the following potential financial reporting changes be to you in the use of financial statements? (N = 303)

As we have studied the issue, and as we consider the comments of our investor members, the disclosure issue of greatest concern to investors is not one of disclosure overload but the lack of disclosures related to the most important financial statement captions – revenues and expenses. Investors observe increases in disclosures which facilitate an understanding of balance sheet captions – and key topics which have been addressed by the FASB over the last two decades (e.g. stock based compensation, pensions, financial instruments, fair value, etc.) – but few disclosures related to revenues and expenses. Some argue that such disclosures cannot be made in financial statements because of anticompetitive concerns yet investors see such disclosures in other jurisdictions outside of the United States or on a selective basis through earnings releases and discussion of Non-GAAP measures. Investors see improving disclosures in such areas as a more significant priority than an assessment of materiality to establish discretion and eliminate potentially immaterial and obfuscating disclosures.

Investor Views on Immaterial Disclosures

In [Chapter 7 of the Disclosure Report](#) we addressed the issue of materiality. Through our member survey, we found that investors don't believe financial statements include substantial amounts of immaterial information. Respondents to the aforementioned survey note the following:

- 51% believe it is difficult to discern the impact any enhanced use of materiality in making financial reporting disclosures because the application of materiality is a matter of judgment;
- 76% do not currently observe the inclusion of obviously immaterial information in financial statements; and
- 82% would like the auditor to disclose how they assess materiality.

Technology to Address Disclosure Overload Perception

Our Disclosure Report (page 27) also highlights the need to bring the discussion of technology into the narrative on disclosure overload. If there is a perception that investors are losing key messages through obfuscating and immaterial disclosures, then investors believe that technology should be explored to emphasize matters of importance:

Investors believe the conversation about disclosures specifically and financial reporting more broadly needs to consider the vast changes in technology that have occurred in the past 10–20 years. The conversation needs to consider how technology can be effectively leveraged to provide the information investors need for investment decision making in a globally connected, data-driven economy. Investors do not seek a reduction in data or volume of disclosures as they have the ability to utilize technology to evaluate the data. Identifying ways to effectively capture, manage, analyze, present, and deliver financial data is the reform investors see as necessary. How technology can be harnessed to reform the financial reporting process end to end—not simply in the filing of documents with regulators as in the case of EDGAR and XBRL—is where investors believe the dialogue on disclosure reform should be focused.

With the rise in discussion of the use technology to improve business intelligence and decision-making, as well as the performance of the audit, the question for investors is: where is the discussion of the use of technology to enhance the provision of financial statement disclosures?



Empirical Study to Reconcile Investor & Preparer Views on Underlying Issue

We think it would be useful for the FASB to provide an empirical demonstration of the disclosure issues which they believe have led to the need for the Proposed Updates. Much of what has been written to date on the issue, as we describe more fully in the Disclosure Report, stems from anecdotal observations of the preparer community rather than comprehensive studies of representative stakeholders, including users of financial statements, or an empirical analysis of disclosures. If financial statements include extensive amounts of immaterial information this should be readily demonstrable to investors given the public nature of the financial statements.

Many times stock-based compensation is used as an illustration of a footnote where many immaterial disclosures are made – including in the Notes Proposed Update as the disclosure to be modified. We think the FASB could readily convince investors of the need to make changes to the Accounting Standards Codification (“ASC” or “Codification”) as noted in the Notes Proposed Update, if they could provide a demonstration of the perceived disclosure problem. Engagement of an academic to study a cross-section of public company stock-based compensation disclosures, for example, could be undertaken to illustrate the issues of immaterial and obscuring disclosures. Said differently, such a study could illustrate the problem attempting to be addressed by the changes in the Notes Proposed Updates.

Upon the issuance of the Conceptual Framework Proposed Update and the Notes Proposed Update, several investors have questioned the impact of the FASB’s new proposals on disclosures in financial statements. Such an empirical study could be extended to demonstrate how the Proposed Updates would result in the application of discretion which improves financial statements for the benefit of investors.

As a result of developing such an empirical demonstration, we believe a more tangible discussion of the perceived disclosure issue addressed by Proposed Updates could be had with investors. ***We believe it is important to reach consensus on the underlying disclosure problem before stakeholders can reach agreement on whether a change in the articulation of materiality within Codification is the most appropriate way forward.***

Field Study: Engagement of User/Investor Community

Paragraph BC 8 – BC 10 of the Notes Proposed Update explains the nature of the FASB’s field study noting that some participants were provided with instructions related to “materiality” while others were provided with instructions related to “entity specific relevance” – a concept based upon the assessment of cash flow prospects from investments in the entity. The preparers and auditors involved in the field study were then asked to evaluate the necessity of disclosures based upon these instructions.

The Basis for Conclusion paragraphs within the Notes Proposed Update indicate that while participants noted both applications (materiality and entity specific relevance) were useful, that:

- entity specific relevance was believed to be an interpretation of materiality;
- disclosures based upon entity specific relevance could conflict with materiality;
- application and general understanding of entity specific relevance was not consistent across participants; and
- both resulted in the reduction of immaterial disclosures.

The field study was based upon the application of these concepts to the existing notes to the financial statements. What’s unanswered for investors is how an alignment of the accounting definition of materiality to a legal definition of materiality in the field study could reduce disclosures given the legal definition of materiality currently stands within the regulatory disclosure regime. The incorporation of the legal definition of materiality into U.S. GAAP, does nothing to change the ultimate evaluation process for public companies under [Staff Accounting Bulletin 99 – Materiality](#)³ – as it remained unchanged and already in effect. The field study raises the question, regarding whether the issue of materiality is one of inclusion in U.S. GAAP or understanding and application of the concepts of materiality by preparers and auditors.

The Notes Proposed Update indicates preparer and auditor views on materiality assessments. Investor perspectives would also be useful to obtain as their views may be instructive not only to the Board but to the participating auditors and preparers. Preparers and auditors have limited interaction with investors and limited training in financial analysis and valuation (including cash flow prospects as required and evidenced by the discussion of entity specific relevance). Accordingly, investor participation might provide such stakeholders with insight on investor materiality perspectives.

To garner the support of investors, it would be useful to engage the investor and user community in the field study process – specifically in the analysis of outcomes. ***If investors, are the ultimate arbiters of the notion of materiality, we think it would be instructive to include them in the field study process because it is their views, rather than those of auditors and preparers, which the legal concept of materiality requires be evaluated in making materiality judgements and conclusions.***

As we state in [Chapter 7 of the Disclosure Report](#), the biggest challenge between investors and preparers, and their auditors, on this topic is a lack of communication regarding how materiality is assessed. Investor engagement might facilitate investor dialogue on the topic of materiality

³ Also referred to as [SAB Topic 1.M](#) in the Codification of Staff Accounting Bulletins.

and enhance appreciation of the objectives of the Notes Proposed Update within the investment community.

Codification Topic 105: Provisions of Codification Not Applicable to Immaterial Items

The Notes Proposed Update indicates that some participants involved in the field study were not aware of the provisions of Topic 105-10-05-6 which states: The provisions of the Codification need not be applied to immaterial items. The Notes Proposed Update also indicates that some are not aware of how such provisions should be applied to disclosures⁴.

This provision has been in the Codification – and has been the threshold for the application of generally accepted accounting principles, including disclosures – for many years. Because of this, and the existence of Staff Accounting Bulletin 99, many investors seek: a) greater understanding as to why the topic of materiality has received increased focus as of late, and b) more substantial justification for why the Board perceives a need to address the issue of materiality – only as it relates to disclosures – within the Codification as this time.

Investors wonder whether this perceived materiality related disclosure issue stems from:

- a) a lack of understanding and application of the legal concept of materiality;
- b) an inappropriate articulation of materiality within U.S. GAAP and the Codification; or
- c) a reduction in the exercise of the judgement when making materiality decisions as a result of the exogenous factors set forth on page 2 of the Notes Proposed Update.

We believe that the provisions of Topic 105 are sufficient to address the application of materiality with in Codification. If cross-referencing to specific disclosure sections of the Codification is necessary, we would support this change in the Codification. We believe this may be sufficient to address the confusion regarding whether materiality should be applied to disclosures.

We question the need to include a materiality definition for disclosures without a similar addition for recognition and measurement. This seems to create an asymmetry in guidance for preparers of financial statements. If a definition of materiality is being added for disclosures, it would seem necessary to include such a definition within Codification for recognition and measurement as the note disclosures are meant to support and describe the recognition and measurement decisions made in the basic financial statements.

⁴ As investors we have observed instances where companies have articulated the removal of disclosures due to their immaterial nature. For example, Chubb has not made pension disclosures in recent years because of they have deemed immaterial.

Codification Topic 235: Assessing Whether Disclosures Are Material

The Notes Proposed Update indicates the amendments to Topic 235 would:

1. State that materiality is applied to quantitative and qualitative disclosures individually and in the aggregate in the context of the financial statements taken as a whole; therefore, some, all, or none of the requirements in a disclosure section may be material.
2. Refer to materiality as a legal concept.
3. State specifically that an omission of immaterial information is not an accounting error.

As it relates to amendments noted above, we would make the following observations:

Application of Materiality (Item #1) – We agree with the notion that materiality is to be applied to quantitative and qualitative disclosures and that it should be applied individually and in the aggregate in the context of the financial statements taken as a whole. We would concur with the observations in Paragraphs BC 17 to BC 19 as it relates to Staff Accounting Bulletin Topic 1.M (*Financial Statements – Materiality*)⁵ and the application of materiality being made individually and in the aggregate.

In Paragraph BC 16, we would observe that many in the field study were challenged to assess the materiality of qualitative disclosures. While we recognize this is challenging, we would note that many disclosures, such as legal contingency disclosures, are mostly – if not solely – qualitative. When investors seek greater quantification of such disclosures there is substantial pushback on providing such information and investor are told that qualitative disclosures are sufficient. Increasingly techniques such as natural language processing are being used to assess qualitative textual information provided by management to investors. In such analysis, investors are classifying qualitative language as positive versus negative and evaluating the distancing nature of the language to measure negative sentiment and uncertainty. This assists in assessing the significance of the disclosures. We believe management – which has certain quantitative information behind such disclosures – can surely make judgements of the materiality of the omission of qualitative disclosures.

The portion of this proposed provision which is of concern to investors is not the “quantitative vs. qualitative” or the “individually and in the aggregate” language but the latter part of this sentence which states: “therefore, some, all, or none of the requirements in a disclosure section may be material.”

As we illustrate in the chart which follows under the heading Source of Discretion, and in the description of the Practical Considerations/Consequences section, this language raises concerns for investors because the degree of discretion it provides in allowing preparers to include some all or none of certain disclosures seems quite high.

⁵ Staff Accounting Bulletin Topic 1.M (Financial Statements – Materiality) is the same as Staff Accounting Bulletin 99.

Materiality as a Legal Concept (Item #2) – We would reference the discussion in our separate letter on the Conceptual Framework Proposed Update regarding our overall views on the inclusion of materiality as a legal concept within the Conceptual Framework – including that the framework is non-authoritative, meant to guide the Board rather than preparers, and may be best suited to the notion of relevance.

Heretofore, materiality has not been defined within the Codification – only in the Conceptual Framework. As a matter of practicality, the legal definition of materiality has always been applied in the decision-making process regarding recognition and measurement as well as in the assessment of disclosures – particularly in light of the existence of Staff Accounting Bulletin Topic 1.M (*Financial Statements – Materiality*)⁶

As we consider Paragraphs BC 14 and BC 15 and BC 21 and BC 22 of the Basis for Conclusion, we concur with the Board’s view that U.S. GAAP does not define or interpret materiality. Accordingly, we don’t see that the proposed addition alters practice or why it should be included at this time – particularly because it relates only to disclosures not the recognition or measurement decisions these disclosures are meant to support. It is not clear why the Board sees this as a necessary improvement to U.S. GAAP and how it improves the quality of financial reporting – given that this definition has existed and been applied for many years.

Omission of Immaterial Information Is Not an Accounting Error (Item #3) – As noted above, the Notes Proposed Update would include a statement that the omission of immaterial information is not an “accounting error”. The basis for this decision is included in Paragraph BC 20. The Notes Proposed Update asks the following question related to this decision:

Question 7: Do you agree with the proposed amendment that would explicitly state that the omission of an immaterial required disclosure is not an accounting error? Why or why not?

The term “accounting error” does not appear in the Codification glossary or the text of Codification. Investors need to have a better understanding of the meaning and consequence of this term and its conclusion within the Notes Proposed Update to be able to comment meaningfully on this element of the proposal. We think this term, and its lack of definition, are likely to present implementation problems.

For example, as written, the proposed change would suggest that a conclusion is made regarding all omitted immaterial disclosures individually without considering the aggregate impact of the increased application of discretion and the aggregate impact of omitting many immaterial disclosures.

While we understand from Paragraph BC 20 that this provision is meant to keep immaterial disclosures from being included on the “summary of disclosure audit differences” we are not clear how the FASB can include within the Codification a conclusion regarding whether something constitutes an accounting error when financial statement disclosure errors need to be assessed individually and in the aggregate based upon the legal concept of materiality which they articulate is beyond their purview. The determination regarding whether something is an error is a matter of judgement in the application of materiality on an entity-specific basis. It seems inconsistent for the Board to state that they cannot make a conclusion regarding materiality but

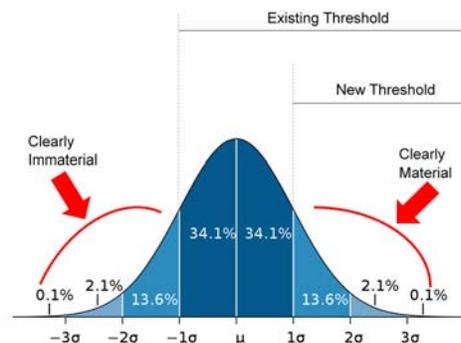
⁶ Staff Accounting Bulletin Topic 1.M (*Financial Statements – Materiality*) is the same as Staff Accounting Bulletin 99.

can articulate a conclusion regarding whether something is an accounting error when it relates to the omission of “immaterial” disclosures. How does the FASB reach a conclusion on something being “immaterial” while indicating an inability to determine what is “material.”

Companion Changes to Each Disclosure Requirement – The Notes Proposed Update also indicates that stakeholders observed inconsistencies between promoting discretion and the way in which disclosure requirements are written. To be consistent with the amendments in this Notes Proposed Update, the Board is proposing to make the following changes to existing disclosure requirements in each disclosure section within the Codification:

1. Each Accounting Standards Codification Topic would state that an entity shall provide required disclosures if they are material.
2. Each disclosure Section would refer readers to Topic 235, Notes to Financial Statements, as amended by this proposed update, for discussion of the appropriate exercise of discretion.
3. Existing phrases like “an entity shall at a minimum provide,” which may make it difficult to justify omitting immaterial disclosures, would be replaced with less prescriptive language.

Immaterial vs. Material (Item #1) – As we consider the language in the Notes Proposed Update this proposed provision may present one of investors’ most significant concerns. Topic 105 states that provisions of Codification need not be applied to immaterial items. This change indicates that disclosures are only required if they are material. While some suggest that if something is not material that it is then immaterial, many do not see the two as complements or reciprocals of one another given the high degree of judgement in making these decisions. Consider the normal distribution presented below:



As we state in our Disclosures Report, certain items are clearly material and certain items are clearly immaterial⁷ but many items are subject to a high degree of judgement. Investors are concerned that shifting the disclosure threshold from not disclosing items that are immaterial to only disclosing items which are material moves the disclosure threshold too far. Investors worry that this language will leave certain disclosures on the cutting room floor where their materiality will not be evaluated fully.

⁷ As we articulate elsewhere herein, disclosures can be immaterial at some times and material at others. For example, credit losses can be more material at certain points in the credit cycle than at other times. Energy prices may be relatively more important currently than at other times.

Reference to Topic 235 (Item #2) – We don’t have an issue with a cross-reference to a materiality consideration, but we do have the aforementioned concerns with the articulation in Topic 235. We are not against reminding entities that materiality should be considered in the application of disclosures, but as we note above, we believe this can be accomplished through a cross-reference to Topic 105 rather than creating Topic 235.

An Entity Shall At a Minimum Provide (If Material) (Item #3) – While we understand that some may perceive the language “an entity shall at a minimum provide” as meaning that all disclosures even if immaterial shall be provided, we think this can be rectified with the aforementioned reference to Topic 105. It has always been our understanding that disclosure provisions were only applicable if the disclosure was more than immaterial given the existence of Topic 105.

Investors see this language (“an entity shall at a minimum provide”) as necessary when a transaction or balance is material as it necessitates that preparers provide a comprehensive set of disclosures which facilitates a complete understanding of the balance or transaction – not just elements of the transaction or balance. Investors worry that if a transaction or balance is deemed material, but this language is altered, then preparers may pick and choose elements of the disclosure which may result in a lack of cohesive understanding of the transaction. For example, if elements of a rollforward are not material, but they facilitate an understanding of how the balance moved from period to period – and how the elements of the transaction connect through the financial statements –, they may provide important context and cohesiveness to the disclosure which is lost through partial disclosure. Certainly if there are zero balances then leaving blanks or omitting captions⁸ is appropriate so long as the connectedness and cohesiveness of the disclosures hangs together.

Question #6 to the Notes Update seeks input on this change to the disclosure requirements as noted below:

Question 6: Should the Board eliminate from the Accounting Standards Codification phrases like “an entity shall at a minimum provide” and other wording that could appear to limit an entity’s discretion to omit immaterial disclosures? Are there particular Topics or Sections in which those changes should not be made? Are there additional paragraphs within the Accounting Standards Codification in which the wording is particularly restrictive and is not identified in Appendix B of this proposed Update? If so, please identify them.

For the reasons articulated above, we are concerned with the removal of the language: “an entity shall at a minimum provide” as we believe allowing elements of such disclosure to be excluded may obscure or reduce the meaningfulness of the totality of the disclosure. See also discussion of Practical Considerations/Consequences below.

Flexible Disclosure Requirement Example

We have reviewed the illustrative “flexible disclosure requirement example” – which is meant to illustrate the changes in the preceding example – and the discussion in Paragraph BC24 and BC25 regarding the basis for the changes. We would consider changing the title, as it connotes a degree of flexibility and discretion to be applied that has the effect of concerning investors.

⁸ Omitting captions or including captions some periods but not others without an ability to see the balance reconcile from one period to the next has the effect of eliminating the usefulness of rollforwards and their comparability between periods.

Assessing Materiality Changes: How Much Discretion Has Been Created?

Purpose of the Notes Proposed Update: Facilitating Appropriate Use of Discretion

The Board states the purpose⁹ of the Notes Proposed Update is to create the appropriate use of discretion because stakeholders noted inconsistencies between promoting discretion and the way in which the disclosure requirements are written¹⁰. The Board has proposed the changes noted above with the objective of promoting discretion¹¹.

Factors Impacting Ability to Omit Immaterial Disclosures:

How Do the Proposed Changes Alter Factors Which Impede Discretion?

The Notes Proposed Updates also outlines several factors which impede the use of discretion in the exclusion of immaterial information as noted below:

Some of the often-cited obstacles in the current system that may affect an entity's incentive and ability to omit immaterial disclosures include:

1. The requirement to communicate omissions of immaterial disclosures as errors to audit committees
2. Litigation concerns
3. Possible internal control changes required to support discretion in the preparation of information provided in disclosures
4. Possible U.S. Securities and Exchange Commission (SEC) staff comment letters about omitted disclosures.

In particular, many participants in the field study stated that they would be reluctant to eliminate immaterial disclosures if the omission is required to be communicated to the audit committee as an error. A few stated that, in some cases, providing an immaterial disclosure would require less time and effort than defending a decision to omit it.

Another finding from the field study was that consideration of materiality usually focuses almost entirely on the magnitude of monetary amounts even though qualitative factors are important in determining materiality, especially in the context of disclosures.

⁹ The purpose of the Notes Proposed Update is stated as:

Achieving the objective of improving the effectiveness of notes to financial statements includes:

1. *The development of a framework that promotes consistent decisions by the Board about disclosure requirements*
2. *The appropriate exercise of **discretion** by reporting entities.*

*The amendments in this proposed Update would **promote the appropriate use of discretion** by reporting entities. (p.1)*

¹⁰ The Notes Proposed Update indicates the addition of discretion is necessary because:

*Respondents to the FASB Invitation to Comment, Disclosure Framework, and the proposed FASB Concepts Statement, Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements, requested that facilitating **discretion** and assessments of materiality be addressed in the FASB Accounting Standards Codification®. (p.1)*

*Stakeholders also noted inconsistencies between promoting **discretion** and the way in which disclosure requirements are written. (p. 2)*

¹¹ The Notes Proposed Update indicates the following changes are being added to promote discretion:

*Because **the Board is trying to promote the use of discretion**, it wants the Accounting Standards Codification to state requirements in a way that would not impede the use of materiality in assessing whether an entity must provide disclosures. Therefore, the Board decided that the following changes should be made to the requirements in the disclosure Sections of the Accounting Standards Codification:*

- a. *Each Topic would state that an entity should provide required disclosures if they are material.*
- b. *Each disclosure Section would refer readers to Topic 235 on notes to financial statements, as amended by this proposed Update, for discussion of the appropriate exercise of **discretion**.*
- c. *Existing phrases like “an entity shall at a minimum provide,” which make it difficult to justify omitting immaterial disclosures, would be replaced with less prescriptive language.*



The key question for investors is whether and how the changes in the Notes Proposed Update alter and mitigate these exogenous factors or constraints. Said differently, how do the proposed changes specifically alter these exogenous factors? Such constraints will persist post these amendments. Some investors worry that the increased exercise of discretion is meant to reduce the posting and accumulation of disclosure differences to audit difference sheets upon which judgements must be made and will be evaluated.

Source of Discretion: Where Added in Notes Proposed Update?

For investors, the central question is: What provisions of the Notes Proposed Update are adding discretion and how much discretion has been added? Some suggest the change in the Conceptual Framework Proposed Update and the movement from “could” to “would” will add discretion. As we note in that letter, we do not see that change as adding discretion for companies in the preparation of financial statements. Rather, we see it as impacting the items which may be considered for disclosure by the Board in the development of new accounting standards. As we analyze the aforementioned changes to Topic 235 and to the individual note disclosures we see discretion emerging as synthesized below:

TOPIC 235		CHANGE TO INDIVIDUAL NOTE DISCLOSURES	
New Requirement	Investor Perspective	New Requirement	Investor Perspective
1. State that materiality is applied to quantitative and qualitative disclosures individually and in the aggregate in the context of the financial statements taken as a whole; <i>therefore, some, all, or none of the requirements in a disclosure section may be material.</i>	Discretion – Believe this creates discretion and may lead to partial disclosures.	1. Each Accounting Standards Codification Topic would state that an entity shall <i>provide required disclosures if they are material.</i>	Discretion – Moves threshold for accumulation from clearly immaterial to clearly material.
2. Refer to materiality as a legal concept.	No Substantial Impact – Already required in practice.	2. Each disclosure Section would refer readers to Topic 235, Notes to Financial Statements, as amended by this proposed Update, for discussion of the appropriate exercise of discretion.	Topic 105 Reference Would Suffice – Believe a reference to Topic 105 would suffice. As it stands, reference would incorporate notions of discretion and conclusions on discretion from Topic 235 #1 and #3 to the left.
3. State specifically that an omission of immaterial information is not an <i>accounting error.</i>	Results in Conclusion About Application of Discretion – As noted above: <ul style="list-style-type: none"> ▪ Accounting error is not defined. ▪ Believe language could result in individual accounting errors not being aggregated. ▪ Seems counter to argument that FASB doesn’t determine materiality but can make conclusion regarding when something is an accounting error. 	3. <i>Existing phrases like “an entity shall at a minimum provide,”</i> which may make it difficult to justify omitting immaterial disclosures, <i>would be replaced with less prescriptive language.</i>	Discretion – As with Topic 235 #1 and #1 above, believe this is likely to result in partial disclosures and increased discretion.

From our perspective, the discretion in the Notes Proposed Update arises from the following, in order of priority:

- 1) Item #1 under the Change to the Individual Note Disclosures moves the threshold for inclusion and accumulation from clearly immaterial to clearly material. See item noted in red in preceding chart.
- 2) Item #1 under Topic 235 and Item #3 under the Change to the Individual Note Disclosures concerns investors as we believe such changes may allow preparers to make parts of disclosures which – as we discuss below – may leave an incomplete picture. See item noted in red in preceding chart.
- 3) Item #3 under Topic 235 is also concerning to us in that, as we note in our analysis above, we don't believe an accounting standard can conclude something is an accounting error – and the term accounting error remains undefined. See item noted in yellow in preceding chart.

We don't see the acknowledgement of materiality as a legal concept under Topic 235 Item #2 as a significant change. We believe this is what already occurs in practice. As we note above, we do wonder why the addition of materiality as a legal concept is being added to Codification as it relates to disclosures but not for recognition and measurement. Further, we don't see the addition of a materiality cross reference as proposed under Item #2 of the Change to the Individual Note Disclosures as a problem. We do, however, believe a cross reference to existing Topic 105 would suffice.

Are Codification Materiality Changes Material to Investors?

We have assessed above the areas where we think, as investors, discretion has been added to the Codification. The challenge for investors, however, is to what degree has discretion been added and what disclosures will be eliminated because of this additional discretion. It would be helpful if the Board would articulate which provisions it believes are statements of existing guidance or practice and which of the aforementioned proposals add the greatest degree of the discretion which they say they are attempting to create.

The Notes Proposed Update asks the following questions with respect to the consequence or effects of the application of the proposed changes.

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.

Question 3: Would the amendments in this proposed Update change the information you otherwise would include in the notes to financial statements? Why or why not? If yes, how would that increase, diminish, or otherwise change the notes' usefulness to investors, creditors, and other financial statement users?

Question 4: Do you expect regulatory, legal, or audit consequences that would affect your ability to consider materiality when selecting information to be disclosed in notes to financial statements? Please explain.

Questions #1 and #4 are focused on preparers assessment of the impact of the proposed changes and Question #3 ask preparers what they think the impact will be on the usefulness of the changes on the information they will provide users. The Notes Proposed Update does not query what investors views are on the impact of the proposed changes.

As we highlight above, investors are challenged to assess the impact of the changes. As we note in the first section of this letter, investors see a need for greater empirical research which supports the basis for a change. They believe an effects analysis which demonstrates the impact of the changes would be useful in guiding their ability to assess the significance of the changes.

Obtaining investors' support for changes as suggested in the Notes Proposed Update, is likely to need to include empirical demonstration of the need for, and the effect of, the changes.

Practical Considerations/Consequences

While we can't assess entirely the degree of discretion added by the proposal, as we consider the nature and impact of the changes in the Notes Proposed Update, several practical considerations emerge from the proposed changes which may reduce the usefulness of disclosures:

- 1) *Omitting Parts of Package of Disclosures* – As noted above (i.e. Item #3 of Change to the Individual Note Disclosures) the question arises regarding how discretion will be applied to eliminate elements of a disclosure package – that taken together provides a complete understanding of the transaction or its effects on the financial statements. For example, what if elements of a rollforward are not made as they are not material? The objective of a rollforward is to include a reconciliation between periods and such an omission, due to the application of discretion, may reduce or eliminate the usefulness of the disclosure. While discretion may suggest elements of the disclosure are not material, the key basis for the disclosure may be lost by failure to include the full disclosure¹².
- 2) *Reconciliation of Disclosures to Amounts Presented in Basic Financial Statements* – Similarly, the question arises as to whether the application of discretion to omit disclosure of immaterial pension plans, for example, may result in the pension disclosure not reconciling to the basic financial statements. While this may reduce disclosure costs, it has the impact of making the disclosure substantially less meaningful as it is not contextualized by the basic financial statements.
- 3) *Changes in Materiality Over Time* – Materiality changes over time and the lack of a material item in one period does not mean that over time the trend communicated by this disclosure is not necessary¹³. Further, the failure for a particular item to appear in the financial statements might not meet with investor expectations and the lack of a balance. Question #5 of the Notes Proposed Update asks:

Question 5: How would you disclose information in comparative financial statements if your assessments of materiality differed in different years?

Trends are important, possibly more important, than absolute amounts. They are integral to financial analysis and investment decision-making. As such, we think that if amounts are not material, but have the potential to be material or distort a trend, they need to be disclosed. What is not disclosed can be as important to investors as what is disclosed.

Investors worry that not including key guidelines or overriding principles about disclosures such as: a) rollforwards should include all elements to provide a meaningful reconciliation between periods; b) disclosures should reconcile to amounts presented in the basic financial statements for context; or c) disclosures should be made even if immaterial if they distort or communicate key trends; will because of the use of discretion, reduce the usefulness of disclosures.

We think these overarching principles are important for the Board to address as it redeliberates these proposals.

¹² See also footnote 8.

¹³ Even a zero balance may be material if it aids forecasting. For example, the fact that foreign exchange effects were zero in a period does not mean they will be zero in all future periods.



Scope & Transition

The Notes Proposed Update asks the following question with respect to transition as discussed in Paragraphs BC 31-32:

Question 9: Should the proposed amendments be effective upon issuance?

Applying the provisions of the Notes Proposed Update prospectively or retrospectively will likely communicate information to investors regarding management's perception of materiality. It would appear unusual to cease making disclosures prospectively as it may raise more questions regarding why the amounts were included in prior but not current periods – particularly if amounts are not substantially different. Because of the lack of comparable disclosures, if adopted prospectively, it would seem more reasonable to adopt the provision retrospectively. Further, retrospective application would assist users in understanding the nature of disclosures made in previous periods which were deemed material. It would also facilitate illustration of the premise of financial statements including immaterial disclosures. Substantively, adoption acts as the effects analysis sought by investors – albeit after the fact.

Cost vs. Benefit Analysis

The Notes Proposed Update asks the following question with respect to cost/benefit analysis as discussed in Paragraphs BC 5-6:

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?

Without an effects analysis, it is challenging to assess the costs and benefits of the standard for all stakeholders. Paragraphs BC 5 and BC 6 heavily focus on the cost reduction to preparers of not including immaterial disclosures. The Board articulates their belief that the benefit to investors is that their view of important information will not be obscured. However, this presumes that investors share a view that financials are filled with immaterial information.

From an investor perspective, we believe the question regarding whether the proposed standard would remove information they perceive as important should be considered as a part of the cost/benefit equation. Many times the hard costs of preparing information are weighed more heavily than the costs incurred by investors of losing or not receiving important information. We think it is particularly important to balance the benefit to investors of receiving more clear and fulsome disclosure against the reduced costs associated with removing certain disclosures.

Thank you again for the opportunity to comment on the FASB Notes Proposed Update. If you or your staff have questions or seek further elaboration of our views, please contact either Mohini Singh, ACA, by phone at +1.434.951.4882, or by e-mail at mohini.singh@cfainstitute.org or Sandra J. Peters, CPA, CFA by phone at +1.212.754.8350 or by email at sandra.peters@cfainstitute.org.

Sincerely,

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