

December 3, 2015

Financial Accounting Standards Board
401 Merritt Seven
PO Box 5116
Norwalk, CT 06856-5116
Attn: Susan M. Cospers, Technical Director
(File References 2015-300 and 2015-310)

Dear Ms. Cospers-

Thank you for the opportunity to comment on:

- Proposed Amendments to Statement of Financial Accounting Concepts No. 8 *Conceptual Framework for Financial Reporting Chapter 3: Qualitative Characteristics of Useful Financial Information*, issued on September 24, 2015 (hereafter referred to as the "Proposed SFAC Amendments"); and
- Proposed Accounting Standards Update *Notes to Financial Statements (Topic 235) Assessing Whether Disclosures are Material*, also issued on September 24, 2015 (hereafter referred to as the "Proposed ASU")

We are generally supportive of the Proposed ASU. Each reporting entity is unique and should be allowed to exercise discretion in determining which disclosures are most meaningful and relevant for the primary users of its financial statements.

However, we have significant concerns regarding the Proposed SFAC Amendments. Conceptually, we do not agree that materiality for financial reporting purposes should be based on a legal concept, especially as the concept is derived from U.S. Supreme Court decisions that:

- a. Were focused on alleged omissions in proxy solicitations/misleading public statements, and not deficiencies in **financial statement** disclosures, and
- b. May not jurisdictionally apply to all reporting entities that prepare financial statements in accordance with U.S. GAAP.

We instead urge the FASB to define materiality in the context of financial reporting – that is, the preparation of financial statements and footnotes, taken as a whole. Of note, the IASB has recently proposed a Practice Statement on the *Application of*

*Materiality to Financial Statements.*¹ We believe that this draft Practice Statement provides precisely the right guidance “to assist management in applying the concept of materiality to general purpose financial statements”². Rather than relying on a U.S. Supreme Court definition of materiality, the draft Practice Statement indicates that “information is material if omitting or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity”.³

We would be pleased to discuss any aspect of our letter in more detail. If you have any questions, feel free to contact Scott Ehrlich, President and Managing Director of Mind the GAAP, LLC, at +1 (773) 732-0654 or by e-mail at sehrlich@mindthegaap.com.

1. We have significant reservations about using a legal concept of materiality for financial reporting purposes

We acknowledge that the U.S. Supreme Court has defined a concept of materiality for legal purposes.

However, we note that the U.S. Supreme Court’s concept of materiality was based on the two cases cited in Footnote 1 to paragraph QC11 of the Proposed SFAC Amendment. The first case revolved around information alleged to be omitted from proxy materials⁴, and the second case involved issuances of misleading public statements during corporate merger discussions⁵. Neither case considered materiality in the context of errors or omissions from ***general purpose financial statements***.

We therefore find it incongruous that a legal concept of materiality – which was derived from matters unrelated to the financial statements – should be imposed upon financial reporting. Specifically, we are unconvinced that the U.S. Supreme Court concept of materiality is superior to the existing definition contained in the FASB Concept Statement No. 8 that is more tailored to financial reporting purposes.⁶

¹ See http://www.ifrs.org/Current-Projects/IASB-Projects/Disclosure-Initiative/Materiality/Exposure-Draft-October-2015/Documents/ED_IFRSPracticeStatement_OCT2015_WEBSITE.pdf.

² See IN2 of the proposed Practice Statement on the *Application of Materiality to Financial Statements*.

³ Ibid (IN2).

⁴ See <https://www.law.cornell.edu/supremecourt/text/426/438>.

⁵ See <https://www.law.cornell.edu/supremecourt/text/485/224>.

⁶ The existing concept of materiality in paragraph QC11 of Chapter 3 of FASB Concepts Statement No. 8 states: “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

Moreover, our understanding is that the concept of materiality discussed in FASB Concept Statement No. 8 is intended to apply to financial reporting as a whole. Financial reporting involves making judgments pertaining to recognition, measurement, presentation, and classification of amounts in the financial statements, as well as footnote disclosure.

However, the legal concept of materiality only considers materiality in the context of disclosure. Thus, replacing the existing definition of materiality in FASB Concept Statement No. 8 with a legal concept of materiality is inherently limiting. Said another way, the legal concept of materiality considers whether disclosure is material, but does not address other aspects of financial reporting such as recognition, measurement, classification, and presentation.

In our view, it is inappropriate to narrow the existing focus of FASB Concept Statement No. 8 as it relates to the concept of materiality. Instead, the definition of materiality should continue to remain robust enough to apply to all aspects of financial reporting.

2. The Proposed SFAC Amendments would result in different definitions of materiality under U.S. GAAP compared to International Financial Reporting Standards (IFRS)

As noted earlier in this letter, the IASB has recently proposed a Practice Statement on the *Application of Materiality to Financial Statements*. The draft Practice Statement provides guidance in the following three main areas:

- Defining the characteristics of materiality,
- Applying the concept of materiality when making decisions about presenting and disclosing information in the financial statements, and
- Assessing whether omissions and misstatements of information are material to the financial statements.⁷

Paragraphs 5-6 of the draft Practice Statement state: "In many jurisdictions there are requirements that oblige listed entities to keep investors informed about aspects of their business on an ongoing basis. For example, during a takeover bid the parties might be required to keep markets informed about the terms of the takeover offer. There might also be ongoing obligations, beyond the requirement to file financial statements, to

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."

⁷ See IN4 of the proposed Practice Statement on the *Application of Materiality to Financial Statements*.

disclose price-relevant information known to the entity ... The way in which the term 'materiality' is understood in the contexts above is expected to be consistent with the way in which the term is expected to be applied to financial reporting. However, IFRS contains a definition to help management apply the concept in preparing financial statements in accordance with IFRS."

Paragraphs 9-10 continue:

"Financial statements are a type of general purpose financial report that summarise for external parties financial information that is recorded internally by an entity. Applying the concept of materiality ensures that financial information that could reasonably be expected to influence decisions that users make on the basis of those financial statements is separately presented in the primary financial statements (sometimes referred to as presenting information 'on the face of a financial statement') or separately disclosed in the accompanying notes.

The concept of materiality is also intended to be applied as a filter to ensure that the financial statements are an effective and understandable summary of the information contained in an entity's internal accounting records..."

In our view, the concept of materiality is described more broadly – and appropriately – in the draft Practice Statement. The draft Practice Statement not only considers materiality from a disclosure perspective, but in evaluating whether financial misstatements or omissions are material as well.

Moreover, the draft Practice Statement acknowledges that various jurisdictions (including the U.S.) may establish materiality thresholds for purposes of providing investors details of transactions companies are considering, or to provide other relevant information to investors on a timely basis. The draft Practice Statement indicates that the definition of materiality under IFRS is entirely compatible with those legal requirements. In other words, the concept of materiality under IFRS is defined in such a way that can be applied in both regulatory and financial reporting contexts.

In sum, we believe it would be preferable for both U.S. GAAP and IFRS continue to have converged definitions of materiality. The U.S. marketplace is not so different from the rest of the world that a different definition of materiality should be necessary for financial reporting purposes. We further believe that the IASB's definition of materiality (which is similar to the existing definition of materiality in FASB Concept Statement No. 8) is more robust than the legal concept set out in the Proposed SFAC Amendments.

3. Basing materiality on the U.S. Supreme Court's legal concept could have unintended consequences for certain U.S. GAAP preparers

U.S. GAAP is widely considered to be one of the preeminent accounting and financial reporting frameworks. As a result, there are a number of entities based outside the United States that voluntarily prepare U.S. GAAP financial statements for statutory or other purposes (as permitted by local regulatory authorities).

It does not seem sensible to require these particular entities to adhere to a materiality definition established by the U.S. legal system, when:

- Local laws and regulations may prescribe a different standard of materiality, and
- The U.S. GAAP financial statements may never be used by any U.S. investor or creditor.

Similarly, many domestic private companies may be exempt from registration and periodic reporting requirements under U.S. securities laws, yet still prepare U.S. GAAP financial statements (perhaps to meet lending or bonding requirements). Again, it seems inappropriate to require those companies to apply a legal concept of materiality that is derived from case law involving perceived disclosure errors and omissions made by public companies.

Finally, foreign private issuers are permitted to file IFRS financial statements with the U.S. Securities and Exchange Commission, or SEC. As discussed in the prior section of this letter, the IASB's definition of materiality will differ from U.S. GAAP presuming the Proposed SFAC Amendments and the IASB's draft Practice Statement are adopted as currently proposed. This would result in both the SEC as well as investors having to apply different concepts of materiality for foreign private issuers versus domestic registrants. This outcome does not seem particularly helpful or appropriate.

4. Other Recommendations and Feedback

Provided the concept of materiality is appropriately defined from a financial reporting perspective, we agree with the Proposed ASU's amendments that disclosures of immaterial information should not be required, and that omitting disclosures due to immateriality should not be considered an accounting error. We also agree with the concept that materiality should be evaluated individually and the aggregate, considering both quantitative and qualitative factors, in the context of the financial statements taken as a whole.

For U.S. GAAP preparers to fully benefit from the flexibility afforded by the Proposed ASU, additional obstacles – all outside of the FASB’s purview – must be overcome⁸.

- As one example, certain U.S. generally accepted auditing standards may be impediments to eliminating immaterial disclosures. Specifically, auditing standards currently require auditors to provide audit committees with schedules of uncorrected misstatements relating to accounts and disclosures, and to articulate the basis for determining that these misstatements were indeed immaterial. If the Proposed ASU is adopted in its current form, one large accounting firm flagged that entities may be forced to increase their documentation to outline why certain disclosures were excluded⁹.
- In addition, the fear of litigation or SEC staff comments may dissuade reporting entities from removing immaterial disclosures.

So while the Proposed ASU would help remove one of the barriers to eliminating immaterial disclosures, other roadblocks will remain, which could diminish the efficacy of the Proposed ASU.

Under the Proposed SFAC Amendments, materiality would be viewed from the perspective of a “reasonable resource provider”. We suggest clarifying the term “reasonable resource provider”. This could be as simple as cross-referencing to the discussion in Paragraphs OB2 – OB11 in Chapter 1 of FASB Concept Statement No. 8. Alternatively, the Proposed SFAC Amendments could clarify that the term “reasonable resource provider” is synonymous with an entity’s primary financial statement users and will vary by reporting entity. For example:

Type of Entity	Possible Reasonable Resources Providers Include
Publicly-listed company	Investors, lenders, creditors, analysts
Privately-held company	Creditors, customers, lessors, suppliers
Special Purpose Entities	Investors, parties that benefit from guarantees, other counterparties

⁸ See BC12(b) of the Proposed ASU.

⁹ KPMG Defining Issues, September 2015, No. 15-42, *FASB Proposes Changes to Materiality for More Effective Disclosures*

Finally, in response to the FASB staff's question of how information should be disclosed in comparative financial statements where materiality assessments differ across years, our view is that where an item is material in any year presented within a set of financial statements, disclosure should be included for all years presented. In practice, we would not expect this situation to arise very often. If it does, though, we do not believe it would not be overly onerous for a reporting entity to provide comparative disclosures in all periods presented.