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Proposed Amendments to Statement of Financial Accounting Concepts No. 8
Conceptual Framework for Financial Reporting
Chapter 3: Qualitative Characteristics of Useful Financial Information

Proposed Accounting Standards Update
Notes to Financial Statements (Topic 235)
Assessing Whether Disclosures Are Material

The Accounting Principles and Assurance Services Committee (the “Committee”) of the California Society of Certified Public Accountants (“CalCPA”) respectfully submits its comments on the referenced proposals. The Committee is the senior technical committee of CalCPA. CalCPA has approximately 43,000 members. The Committee consists of 57 members, of whom 43 percent are from local or regional CPA firms, 30 percent are from large multi-office CPA firms, 13 percent are sole practitioners in public practice, 9 percent are in academia and 5 percent are in international CPA firms. Members of the Committee are with CPA firms serving a large number of public and nonpublic business entities, as well as many non-business entities such as not-for-profits, pension plans and governmental organizations.

The Committee is commenting on both proposals in one letter because they are closely related.

The Committee commends the Board's attention to the materiality concept and its effort to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by generally accepted accounting principles (GAAP) that is most important to users of each entity's financial statements by promoting the appropriate use of discretion by reporting entities.

Proposed Amendments to Statement of Financial Accounting Concepts No. 8
Conceptual Framework for Financial Reporting
Chapter 3: Qualitative Characteristics of Useful Financial Information

Question: Do the proposed amendments improve Concepts Statement 8? If so, how? If not, why?

The elimination of the inconsistencies between the framework and the legal concept of materiality may be helpful. However, the Committee does not believe that the mere elimination of the inconsistencies will have any significant bearing on implementation of the concept of materiality in financial statements and disclosures. The auditing literature still

contains a description of materiality which must be observed by auditors, (AICPA AU-C 320) so the change may be meaningless, at least for audits not conducted under PCAOB standards. (The AICPA AU-C320 has a relatively lengthy description while PCAOB AS 11 cites the same Supreme Court cases as cited in the Board's proposal, but further explanatory material is much briefer than that at AU-C320.)

Also, see our comments below on the proposed ASU.

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.

The Committee sees the proposed changes as a clearer articulation of what the assessment of materiality should always have been. As such, the proposed changes should make no difference because they change nothing. But, if the Board believes that the changes will make the assessment easier, then the Committee supports them.

Proposed Accounting Standards Update
Notes to Financial Statements (Topic 235)
Assessing Whether Disclosures Are Material

While the Committee would like to think that the Board's proposal will achieve its objectives, it has serious doubts that it will. The Committee agrees with the obstacles to omission of immaterial disclosures cited by the Board but believes that there is an overarching environmental factor that will make significant progress very difficult. We are in an environment where the legal system encourages litigation over insignificant departures from technical requirements and regulators grasp on seemingly minor deviations from regulations as a basis for supposedly remedial action and fines. Courts, if the matter gets that far, are often not inclined to dismiss these matters. This is a broad factor that affects business generally, and not just preparers and auditors of financial statements. So, what may be considered immaterial by a well reasoned interpretation runs a substantial risk that others with a different agenda will attempt to upset that determination, and, even if ultimately unsuccessful, cause substantial efforts and expenditures in defending the interpretation. Settlements are often reached merely to dispose of a matter that lacks true merit. This may be a rather bleak environment, but it is the world in which we live. It is hard to expect that a deviation from a standard because the disclosure is immaterial will be embraced broadly in this environment.

In the Committee's letter to the Board on June 9, 2014 commenting on the Proposed Statement of Financial Accounting Concepts *Conceptual Framework for Financial Reporting, Chapter 8: Notes to Financial Statements*, the Committee made what it considered a significant recommendation. We stated that the Committee "believes that the notes to financial statements have become much too lengthy and complex, so much so they obscure important information and impose an unreasonable burden on reporting entities." We suggested that the Board consider entirely different ways to meet the needs of providers of resources by providing disclosures on a disaggregated basis. We gave two examples of how this might work: one was three separate "packages": (i) summary financial statements, (ii) supplemental data, and (iii) management's reports, interpretative analyses and all forward looking data. Another was separation of core and non-core data, with the latter furnished in

non-traditional ways, such as via access to an entity's website. Total data furnished might not differ, but it would be segregated based on its relevance to users.

The Committee has a further recommendation that could be part of its 2014 recommendation, or could be acted upon separately.

There may be a way to tier disclosures differently without necessarily labeling them as material or non-material. One tier would be "core" disclosures which would always be required if a transaction or event is present unless the transaction or event was not material. A second tier would be "non core" disclosures which would be described as not necessary unless they were material to an understanding of a material transaction or event. This would switch the presumption on the non-core disclosures from them being material unless determined to be immaterial, to the presumption that they are immaterial unless determined to be material. This distinction may make it much easier to not include disclosures that many would agree are unnecessary.

For example, there are many mechanical accounting disclosures that are of little consequence other than to show that the accounting rules were followed. Business combination disclosures have these. And stock compensation disclosures, especially lengthy disclosures of the mechanics of Black-Scholes calculations, are another. Does anyone really make meaningful use of disclosures of this type? Or, could they simply be removed as immaterial unless there was something unusual that made them material?

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.

The Committee sees the proposed changes as a clearer articulation of what the assessment of materiality should always have been. As such, the proposed changes should make no difference because they change nothing. But, if the Board believes that the changes will make the assessment easier, then the Committee supports them.

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?

The Committee does not believe that the amendments will reduce costs of preparing notes to the financial statements to any significant degree. It will still be necessary to consider disclosures set forth in the accounting standards, and likely necessary to quantify ones that are not obviously immaterial to determine if they are immaterial. Some small savings will come from not having to quantify and disclose items that will now not be disclosed because they are not material, and there may be small savings in not communicating omissions of immaterial disclosures as errors to audit committees (if the communication can be avoided - see response to Question 7).

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?

The determination to omit information that had previously been disclosed will require an assessment of the risk of its omission, even if immaterial, and that assessment may require consultation with counsel. But, since the information would be immaterial, its omission should not change the usefulness of the notes, and, in fact, may increase their usefulness by not obscuring more important information that is material.

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.

Yes. The potential regulatory and legal consequences are environmental factors which cannot be ignored, and these will affect auditors' consideration of materiality as well.

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

Assessment of materiality in comparative financial statements is an area where there are different views. Some say that each year presented should be able to stand on its own, notwithstanding the provision in ASC paragraph 205-10-45-4. Others say that the most recent period should stand on its own, but that disclosures for prior periods can be abbreviated or omitted if they are no longer important, consistent with ASC paragraph 205-10-42-4. The Committee favors the latter view. The Board should consider resolving this difference by strengthening ASC paragraph 205-10-45-4. The Committee suggests that the Board could do this by stating that "the context of the financial statements as a whole" include comparative financial statements of subsequent periods that may obviate the need for disclosures in the financial statements of the earlier periods.

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.

The Committee agrees that the Board should 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 wherever they appear.

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 Committee recommends that the Board further consider whether the proposed amendment will achieve its objective of excluding immaterial disclosures from financial statements. There may still be concerns that, absent a concomitant change in the auditing standards, these "non-accounting errors" will still be considered immaterial misstatements under the auditing literature which are required to be communicated to those charged with governance unless they are trivial.

Notwithstanding this reservation, the Committee does agree with the objective of the proposed amendment.

We note that the FASB standards do not deal with "errors" except in the accounting for corrections of errors in previously issued financial statements.

AICPA and PCAOB audit standards deal with misstatements, which by definition (AICPA AU-C 450 definition and PCAOB AS 14) can arise from fraud or errors. The standards are at AU-C260 and AS 16, respectively. Those standards require that misstatements be brought to the attention of those charged with governance, including immaterial misstatements. Immaterial misstatements would include those arising from immaterial errors. (The only exclusion is trivial misstatements; trivial is a far smaller magnitude than immaterial.)

We question whether the Board can remove immaterial disclosure errors from the scope of immaterial errors set by the auditing standards without a concomitant change in the auditing literature.

In this same vein, if the Board can remove immaterial disclosure errors from the scope of what must be disclosed to those charged with governance by pronouncing that they are not accounting errors, we suggest that the Board consider steps to remove all other immaterial errors (i.e., failure to correct an amount, classification and presentation) from the scope of that disclosure by the same type of pronouncement. We believe all such immaterial errors should be handled in the same manner.

Question 8: Are there considerations other than those discussed in this proposed Update that would apply to not-for-profit entities?

The Committee is not aware of any.

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

Yes. The Committee sees no need to defer their effectiveness

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We thank you for the opportunity to comment on this matter. We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Sincerely,



A.J. Major III
Chair
Accounting Principles and Assurance Services Committee
California Society of Certified Public Accountants