



Dec.8, 2015

Technical Director
Financial Accounting Standards Board
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Re: File Reference No. 2015 – 310: Notes to Financial Statements (Topic 235) *Assessing Whether Disclosures Are Material*

The Accounting and Auditing Procedures Committee (the committee) of the Pennsylvania Institute of Certified Public Accountants (PICPA) appreciates the opportunity to comment on the proposed Accounting Standards Update, Notes to Financial Statements (Topic 235) *Assessing Whether Disclosures Are Material*. The PICPA is a professional association of more than 22,000 members working to improve the profession and better serve the public interest. Founded in 1897, the PICPA is the second-oldest CPA organization in the United States. Membership includes practitioners in public accounting, education, government, and industry. The committee is composed of practitioners from both regional and small public accounting firms, members serving in financial reporting positions, and accounting educators.

General Comments

The committee generally agrees that preparers are currently being held accountable to the legal definition of materiality, and supports the integration into the accounting standards of a definition that is closely aligned with the current U.S. Supreme Court definition without a direct reference to a legal concept. While some committee members believe that including a legal concept in the accounting standards would result in no change in practice, others have a number of concerns regarding the ramifications of the standards referring directly to the legal definition, including the potential for litigation of accountants practicing law, misinterpretation due to lack of legal training, jurisdictional variations, and retroactive application. These concerns are further explained below.

- Objective of the proposed revision – The stated goal in the proposed amendments is unclear. Specifically, it is unclear what problem would be fixed by making materiality consistent with the legal concept of materiality. If this project is the result of SEC staff comment letters, which appears to be one of the drivers, wouldn't it be more appropriate to work with the SEC to reduce comment letters on immaterial items? A legal concept of materiality might not have the intended effect of reducing the comment letters. It is unclear why the board would propose removing a consistent, principles-based definition of materiality and replace it with a definition based on legislative, executive, or judicial actions that could vary from period to period, and potentially from one jurisdiction to



another. The committee does not see this as an improvement to the current standard, and questions the degree to which financial statement users will understand the revised approach.

- Potential standards conflict – The proposed definition would result in an inconsistency with the auditing literature. The definition of materiality at AU-C Section 320 does not include the phrase “mix of information.”
- Current definition – The proposal states that the legal definition is the definition currently observed by the board. Shouldn’t the board be using what is actually in the accounting codification?
- Interpreting a legal definition – The committee is concerned that financial statement preparers may not have sufficient legal training in interpreting legal definitions and case law to apply the legal concept to financial statements. The committee believes that the U.S. Supreme Court definition summarized in the basis of conclusions “whether there is a substantial likelihood that the omitted or misstated disclosure would have been viewed by a reasonable resource provider as having significantly altered the total mix of information available in making a decision,” lacks clarity. It is unclear, for example, how to operationalize “mix of information.” Due to the proposed complexity, practitioners may find it easier to include all of the disclosures instead of attempting to apply the new standard. If the FASB moves ahead with this project, the committee recommends more practical guidance and training. The committee believes that legal counsel would need to be involved in the process of informing practitioners and financial statement users as to the application of materiality to the financial statement disclosures.
- Potential inconsistencies in interpretations by other courts, or between the U.S. Supreme Court and the legislative or executive branches – The discussion in the basis for conclusions at BC 14 and BC 15 emphasizes that simply relying on the U.S. Supreme Court definition is insufficient since “a legal concept may be established or changed through legislative, executive, or judicial action.” It is not inconceivable that a court would take a position that is inconsistent with the U.S. Supreme Court. The legislative and executive branches of government also periodically take positions that are inconsistent with the U.S. Supreme Court. What should the practitioner do in the event that there is a period of time in which these bodies disagree? Will accountants need to employ attorneys for each financial reporting period to ensure that the most current legal definition is in use? To ensure the adequacy of the internal controls over financial reporting, will management need to employ an attorney to review the financial



statements? This proposed change would not reduce financial statement preparation costs.

- Applying changes to the legal definition of materiality – In the event that the legal definition of materiality changes based on a case that is several years old, would the revised court definition result in practitioners having to reconsider materiality retroactively? Additional guidance for this would be needed if the proposal is finalized.
- Applying two definitions of materiality – Ultimately, the committee believes that using two separate definitions of materiality, one for financial statement presentation and one for footnote disclosure, introduces unnecessary complexity into the accounting codification.

Answers to Questions in the Exposure Document

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.

As discussed in the committee’s general comments above, the committee does not believe that assessing materiality under the new guidance would be easier to apply since it would entail interpreting legal definitions and case law.

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?

It is unknown whether financial statement preparers would incur additional costs to implement the new perspective, or simply default to the current method of including all relevant disclosures. The committee believes that the standard is unlikely to reduce costs. Any change in practice would necessitate a change in the controls over that new practice. Additional costs may be needed if a financial statement preparer has to consult with legal counsel to apply case law and legal definitions to the engagement specifics.

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?

Due to the potential complexities of implementing this revised definition, the committee believes that financial statement preparers would likely continue to include the same



relevant disclosures as they do today. Therefore, the revised standard may not change the usefulness of the disclosures 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.

The impact of this proposed revision on engagement quality control review, peer review, and ethics investigations is unclear as introducing legal interpretations into the financial reporting process is a new concept.

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

The committee believes that if this standard is adopted, clarification will be needed to determine how to apply different materiality assessments to comparative financial statements.

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 notes that phrases such as “an entity shall at a minimum provide” in practice, in peer review, and in ethics cases tend to be interpreted that these are the items that should be provided. Accordingly, if the intention of the guidance is to provide suggested disclosures that may be applicable depending on their materiality to the entity, then clarification is needed. This could introduce a significant degree of subjectivity, and a judgment framework may be needed to enhance consistency in application.

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 supports the explicit statement that the omission of an immaterial required disclosure is not an accounting error.

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



The committee has no comment on this question.

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

The committee does not support the proposed amendment being effective upon issuance of any final standard as financial statement preparers and users need sufficient time for additional training and practice aids may need to be updated.

We appreciate your consideration of our comments. We are available to discuss any of these comments with you at your convenience.

Sincerely,

A handwritten signature in blue ink that reads "Lisa A. Ritter". The signature is fluid and cursive.

Lisa A. Ritter, CPA
Chair, PICPA Accounting and Auditing Procedures Committee