



December 8, 2015

Ms. Susan M. Cosper, Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

Re: **File Reference Nos. 2015-300 and 2015-310**, Proposed Concepts Statement — *Conceptual Framework for Financial Reporting Chapter 3: Qualitative Characteristics of Useful Financial Information* and Proposed Accounting Standards Update — *Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*

Dear Ms. Cosper:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) is writing to share their views on the Financial Accounting Standards Board's (FASB) exposure drafts of the proposed amendment to *Conceptual Framework for Financial Reporting, Chapter 3: Qualitative Characteristics of Useful Information* and proposed Accounting Standards Update, *Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material* (EDs).

The IMA is a global association representing over 75,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at www.imanet.org (About IMA, Advocacy Activity, Areas of Advocacy, Financial Reporting Committee).

Overall, we support the objective of clarifying the definition of materiality in the amendment to Concepts Statement No. 8 and explicitly confirming its application to the notes to financial statements (disclosures) in Accounting Standards Codification section 235 (ASC 235). We also support eliminating the language in the disclosure sub-sections of the Codification stating that “a reporting entity shall disclose, at a minimum, the following information”

The amendment to the Concepts Statement aligns the definition of materiality in U.S. GAAP to the definition employed by the Securities and Exchange Commission (SEC) in Staff Accounting Bulletins Topic 1, *Financial Statements*, Section M, *Materiality* (SAB Topic 1-M), and the Public Company Accounting Oversight Board (PCAOB) in Auditing Standard No. 11, *Consideration of Materiality in Planning and Performing an Audit* (AS 11). Although the PCAOB definition is not explicitly applicable to preparers of financial statements, the definition



is certainly a relevant consideration for preparers in understanding the expectations of their auditors.¹ In particular, we note that the use of the auxiliary verb “would” in the updated definition not only conforms to the U.S. Supreme Court definition borrowed by the SEC and the PCAOB but also represents a much more definitive threshold than “could,” which is used in the existing definition. Although “could” has been reflected in the FASB’s conceptual framework since 2010 when the FASB and International Accounting Standards Board (IASB) were working on convergence of their conceptual frameworks, we are not aware that there was any noticeable change in practice in light of the guidance in SAB Topic 1-M and AS 11.

We also agree with the Board that application of the materiality concept is critical in enabling preparers of financial statements to exercise discretion in developing footnote disclosures. Removing language such as “shall at a minimum disclose” and similar phrases from the disclosure sections (subsection 50 within each topic) of the Codification will help to convey the message that preparer discretion, subject to materiality, is appropriate throughout the financial reporting process. Furthermore, in light of the practical challenges that many preparer members of our committee have faced in balancing the desire to exercise discretion in preparing disclosures while respecting our auditors’ requirement to report the omission of immaterial disclosures to the audit committee pursuant to PCAOB Auditing Standard No. 16, *Communications with Audit Committees* (AS 16), we also strongly support the Board’s explicit confirmation that the omission of an immaterial disclosure is not an accounting error.

Without diminishing our broad support for the Board’s objectives, we have some observations on the materiality debate and some suggestions to enhance the proposals as drafted.

We are aware of some views that the Board’s decision to refer to materiality as a legal concept will somehow limit the information that preparers would otherwise provide to financial statement users or that every difficult materiality judgment that professional accountants make on a daily basis will require legal advice. We strongly disagree with those points of view. In our experience, legal professionals involved in financial disclosures to the capital markets tend to adopt a ‘disclosure as defense’ posture and err toward the side of disclosing more, not less. Since the inception of the FASB’s conceptual framework as we know it today, materiality has been a pervasive concept in financial reporting—not just for disclosures but as it relates to recognition and measurement as well. It is interesting to note that the FASB has never codified (i.e., included in a FASB statement or today’s ‘authoritative’ master glossary of FASB Codification) a definition of materiality. Somehow, over all those many decades, accountants—both those preparing financial statements and those auditing them—have routinely made frequent materiality judgments without the need to involve lawyers in every one of those decisions.

Clearly, materiality is a pervasive consideration in financial reporting. From the FASB’s earliest thinking on the conceptual framework for financial reporting, materiality was described as a threshold consideration for what should be recognized, measured, and/or disclosed. However, the Board never explicitly defined materiality, rather, describing it in the context of the plain

¹ Both SAB Topic 1-M and PCAOB AS 11 refer to the definition of materiality in two Supreme Court rulings, which conclude that “An item is material if there is a substantial likelihood that the omitted or misstated item would have been viewed by a reasonable resource provider as having significantly altered the total mix of information.”



meaning of the word—of substantial import; of much consequence; important; likely to influence a decision. The Board acknowledged that it is entity-specific—i.e., that which is material to one entity may be immaterial to another based on their relative size, or the nature of the item relative to the nature of the entity’s activities. For the most part, the so-called “materiality box,” which was included as a legend on every FASB standard prior to codifying the language in ASC 105-10-05-6, and which read, “The provisions of this statement need not be applied to immaterial items,” seemed to be well enough understood to serve the financial reporting community for at least a few decades. Alas, with the increased regulatory scrutiny of financial reporting (and the auditing of it) over the last decade or so, materiality decisions have been called into question with greater frequency and new requirements have been imposed on auditors to formally communicate omitted immaterial (but more than trivial) disclosures to audit committees. This has introduced additional cost and strained the preparer-auditor dialogue around disclosures without an equivalent or even apparent, benefit to financial statement users. This is an unfortunate but very real outcome, and the FASB’s proposal is a helpful step in the right direction.

The EDs are likely not, however, the definitive solution to the problem. Importantly, the present proposal only explicitly addresses the disposition of immaterial omissions of disclosures. Beyond the ‘materiality box’ language in ASC 105, the consideration of materiality for questions of recognition and measurement, while pervasive in accounting and financial reporting, is addressed only in the body of practice that has developed over the years as influenced by regulators. Beyond the conspicuous exclusion of matters of recognition and measurement from this proposal, of great consequence to the members of this committee is the ability to rely on immateriality as a basis for the appropriate application of practical expedients—simply not accounting for things that don’t matter—like immediately charging to expense small value purchases of long-lived assets.

We believe the materiality debate is really not the FASB’s to arbitrate. This is a profession-wide issue that we believe can only be addressed at a profession-wide level with a constructive dialogue among preparers, auditors, users (investors and creditors), regulators (both of capital markets disclosure and the audit profession) and standard setters. Nevertheless, we applaud the FASB for leading in this debate in taking an important first step. Given the Board’s well-developed standard-setting forum and due process protocols, we encourage the Board to continue to lead in bringing the relevant constituencies together to further debate this topic and develop a comprehensive solution—a common understanding of materiality—for the wider financial reporting community.

As to some specific suggestions to enhance the Board’s proposal, we recommend that the FASB explicitly incorporate the ‘working definition’ of materiality as it is understood and applied in practice today. While it is fair for the Board to observe that other relevant authorities (i.e., the U.S. Supreme Court) have already weighed in the concept, we believe that it would be more helpful for the Board to explicitly incorporate that definition of materiality into the codification to avoid any confusion or to potentially raise the specter of an exhaustive legal research process each time a materiality call needs to be made to ensure the definition has not changed or might be different in some other jurisdiction where U.S. GAAP is being applied.



We are also aware that the IASB is currently considering the question of materiality and has recently published a draft IFRS Practice Statement, *Application of Materiality to Financial Statements*. We find some of the discussion in this document helpful, in particular, paragraphs 77-79, which clearly articulate the basis for not applying GAAP to immaterial items even if it is a 'known error,' while at the same time clarifying that doing so only to achieve a desired accounting result would be inappropriate. We would encourage the Board to include that language (or similar language) in the Codification.

We would be pleased to discuss our comments with the Board or the FASB staff at your convenience.

Sincerely,

A handwritten signature in blue ink that reads "N. Schroeder".

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