



Kurt S. Schulzke, JD, CPA, CFE  
Associate Professor of Accounting & Business Law  
Director - Law, Ethics & Regulation  
Corporate Governance Center  
+ 1770-423-6379 (O)  
+ 1404-861-5729 (C)

December 8, 2015

Technical Director  
Financial Accounting Standards Board  
P.O. Box 5116  
Norwalk, CT 06856-5116

Re: File Reference No. 2015-300, 2015-310

Dear Director:

Thank you for the opportunity to comment on the above-referenced proposals relating to materiality and ASC Topic 235.

I applaud the FASB proposal for officially recognizing the relationship between materiality and financial statement disclosures. However, for reasons explained in some detail in my May 2015 article in the *Tennessee Journal of Business Law*,<sup>1</sup> I believe this oddly truncated proposal—stating that “materiality is a legal concept” and presenting a stripped-down summary of the majority opinions in two aging, controversial U.S. Supreme Court cases—delivers neither the interpretive guidance nor the professional leadership needed by financial statement preparers, readers, and regulators—including courts—on this pivotal topic.

*Materiality* is a technical financial term that the justices of the Supreme Court are not professionally competent to define. Yet, the proposal’s Basis for Conclusions declares without elaboration, “materiality has been defined by the U.S. Supreme Court.” More accurately, left to its own devices, the Supreme Court has ineffectively tried to define materiality, leaving nearly everyone wondering what it means when it really matters. One result has been frequent courtroom carnage in which highly-trained and richly paid accounting experts have been summarily disregarded as irrelevant or otherwise made to look like fools by judges and opposing counsel in major securities cases like *U.S. v. Simon*, *U.S. v. Skilling*, *U.S. v. Ebbers*, *U.S. v. Rigas*.

Non-attorneys may mistakenly assume that the legal community universally agrees with the *Basic, Inc. v. Levinson* definition of materiality. Not so. *Basic* continues to receive lip service because no serious alternative has been offered by anyone with requisite industry expertise. The FASB could and should. The SEC could make it happen

---

<sup>1</sup> Kurt S. Schulzke, *Wink, Wink, Nudge Judge: Persuading U.S. Courts to Take Accountants Seriously in Federal Securities Cases with Help from the U.K. Companies Act*, 16 Tenn. J. Bus. L. (2015), <http://trace.tennessee.edu/transactions/vol16/iss2/4>.

by ratifying a FASB pronouncement or by writing its own regulation. Congress, of course, can legislatively overturn judicial precedent on statutory questions.

Sitting mostly unused on the FASB's shelf is a great starting point for a comprehensive, professionally responsible definition of materiality: Concepts Statement No. 8. Remarkably, Concepts No. 8 stands to be amended by this very FASB proposal! Concepts No. 8 articulates three key usefulness criteria for financial statements—helpfulness in predicting cash flows, relevance, and representational faithfulness—all of which should be seen through the eyes of reasonably trained and reasonably diligent equity investors and creditors. These reasonable readers are largely defined by AICPA AU-C § 320. Importantly, the training and diligence prerequisites to “reasonable investor” status prescribed by AU-C § 320 have not been articulated by the U.S. Supreme Court in its rendition of materiality.

Could the FASB go beyond accepting *Basic, Inc.* and *TSC Industries* as the final, comprehensive word on materiality? I think so. They could craft a complete materiality package from Concepts No. 8 and AU-C § 320 and salt to taste. At this point, lay readers may be wondering why auditors and preparers can't use the language in Concepts No. 8 and AU-C § 320 without further action by the FASB. Answer: Because the FASB has warned practitioners *not* to use Concepts No. 8 in practice. Why? In theory, concepts statements are mere concepts to be used only by the FASB in drafting new accounting standards. Meanwhile, AU-C § 320 is available only to auditors of private companies, not public ones. However, if FASB were to incorporate AU-C § 320-like language in the Accounting Standards Codification, it would (mostly) automatically receive SEC blessing and, therefore, be accessible to preparers and auditors of public company financial statements, as well as private ones. Preparers, auditors, regulators, investors and courts would all stand to benefit from improved clarity of purpose and definition of materiality.

Sincerely,



Kurt S. Schulzke