



Ernst & Young LLP  
5 Times Square  
New York, NY 10036

Tel: +1 212 773 3000  
ey.com

2015-310  
Comment Letter No. 74

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

23 December 2015

**Re: Proposed Accounting Standards Update, *Assessing Whether Disclosures Are Material* (File Reference No. 2015-310)**

Dear Ms. Cospers:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Assessing Whether Disclosures Are Material* (the Proposal), from the Financial Accounting Standards Board (FASB or Board).

We support the objective of the FASB in its disclosure framework project to improve disclosure effectiveness in the notes to the financial statements. However, we have certain concerns related to the Proposal, particularly on the evaluation of the materiality of omitted disclosures and the definition of materiality. In addition, we have concerns with taking a piecemeal approach to a project on materiality where guidance on materiality is developed to apply to disclosures without addressing the application of materiality to accounting in general.<sup>1</sup>

**Evaluation of materiality of omitted disclosures**

We do not believe that the proposed evaluation of materiality of omitted disclosures is sufficiently clear so as to be applied consistently by preparers, auditors and regulators. Recent efforts by the Securities and Exchange Commission (SEC) staff have encouraged preparers and auditors to have confidence making judgments based on materiality regarding which information to include in the notes to the financial statements. However, as currently drafted, the Proposal will introduce more uncertainty into the process than currently exists. It is unclear how disclosure materiality assessments should be applied and how preparers would make those assessments. For example, the Proposal notes that materiality is applied "...individually and in the aggregate in the context of the financial statements taken as a whole..." It is unclear whether this assessment should be applied at the Accounting Standards Codification (ASC) Topic level or instead an aggregation of omitted disclosures should be assessed.

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<sup>1</sup> This would include defining and providing guidance related to ASC 105-10-05-6 that notes "(t)he provisions of the Codification need not be applied to immaterial items."

In determining whether the notes to the financial statements are misleading in the aggregate, it's not clear whether preparers and auditors would be required to accumulate a list of all immaterial disclosures that were omitted and determine whether the omission of the immaterial disclosures results in a material misstatement in the aggregate. We're also not sure how to evaluate the omitted disclosures that disaggregate components or roll forward activity of financial statement elements presented on the face of the financial statements that are individually material.

The Proposal would benefit from additional guidance to promote the consistent application by preparers, auditors and regulators. One way to accomplish this would be to develop and incorporate comprehensive, realistic examples, including descriptions of what specific disclosures were omitted and how materiality would be assessed. This would be beneficial in that it would clarify not only the steps in the evaluation process but also how they would be applied. We believe that the illustrations in Staff Accounting Bulletin No. 108 promote the consistency of applying materiality assessments and that a similar approach with well-developed application examples would be helpful.

### **Definition of materiality**

We are concerned with defining materiality in an authoritative standard solely as a legal concept when it is intended to be applied (and is applied today) by preparers and auditors on a regular basis. As further discussed in our comment letter on the Proposed Amendments to Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting, Chapter 3: Qualitative Characteristics of Useful Financial Information* (File Reference No. 2015-300), we are concerned that defining materiality solely as a legal concept may result in materiality decisions becoming legal determinations and could result in entities, and auditors, needing to obtain legal advice for purposes of making materiality assessments (e.g., determining what information to include in the notes to the financial statements). We are also concerned that while the intention is to define materiality solely for purposes of evaluating disclosure, by incorporating it into an authoritative ASC Topic, it may be assumed to apply, directly or by analogy, to other ASC Topics where similar concepts and terms are not defined (e.g., ASC 105-10-05-6).

### **Omission of immaterial disclosures is not an error**

In practice, preparers can struggle with omitting immaterial disclosures over concerns that such omissions may be characterized as errors. In an effort to remove these perceived obstacles, the Proposal states "the omission of immaterial disclosures is not an accounting error." While we are supportive of the FASB making this statement, aligning these views with those of other relevant parties (e.g., Public Company Accounting Oversight Board (PCAOB) and the SEC) as part of a comprehensive approach to address this issue is essential to how this statement will affect practice.

\* \* \* \* \*

In fulfilling its mission to establish and improve standards of financial accounting and reporting that provides decision-useful information to investors and other users of financial reports, the FASB is often provided with diverse views on how to best accomplish this objective. The FASB should continue to engage with investors and other users of financial information through a variety of mechanisms to solicit their feedback on proposed changes to its codification. Also as part of the process, the FASB



should provide clear communication on the impact that any change to either the FASB codification or to non-authoritative literature, such as the concept statements, would have on the application of its standards to amounts reported by preparers.

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

Very truly yours,

*Ernst + Young LLP*

**Appendix A – Response to specific question raised in the Proposed Accounting Standards Update, *Assessing Whether Disclosures Are Material***

**Question 1:** Would assessing materiality subject to the proposed changes to paragraph 235-10-50-7 through 50-8 be any easier under current GAAP? If yes, please explain why.

As discussed in detail in our cover letter, we do not believe that the proposed changes will result in making materiality assessments easier than current GAAP, and in fact it may become more complicated. We do not believe the Proposal provides adequate guidance for making materiality assessments. It is not clear how reporting entities would apply materiality to disclosures in the aggregate. For example, when applying materiality to an individual disclosure, does in the aggregate mean whether it is material to that ASC Topic, or whether it is material to the financial statements taken as a whole? In addition, we are concerned that defining materiality solely as a legal concept may result in materiality decisions becoming legal determinations and could result in entities, and auditors, needing to obtain legal advice for purposes of making materiality assessments (e.g., determining what information to include in the notes to the financial statements). See also the response to question 2.

**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?

We believe the Proposal may result in additional unintended consequences to preparers, auditors and regulators. The Proposal states that “materiality is applied to quantitative and qualitative disclosures individually and in the aggregate in the context of the financial statements taken as a whole....” In determining whether the notes to the financial statements are misleading in the aggregate, preparers could be required to accumulate a list of all disclosures that were omitted and perform an evaluation to determine whether the omission of the disclosures, in the aggregate, results in a material misstatement (see also the response to question 1). The implementation of processes and internal controls to perform this evaluation, along with the additional audit work, could be costly to preparers. This analysis will be further complicated by any processes and controls associated with assessing materiality as a legal concept.

Costs may also increase due to preparers being required to document the rationale for omitting disclosures that are not material individually but are more than inconsequential. If the cost of documenting the immateriality of the disclosure (including all costs associated with supporting the exclusion to management, auditors, etc.) is more than the cost of preparing the disclosure, preparers may be more inclined to include the disclosure. This does not align with the project’s objective of improving disclosure effectiveness.

**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?

This question is better addressed by preparers.

**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.

Preparers are better able to respond to how they believe regulatory, legal or audit consequences would affect them. However, in addition to considering our responses noted above, we would suggest the Board solicit feedback from the PCAOB as to how they believe the Proposal would affect the procedures an auditor would perform as well as any required audit committee communications. The documentation of such feedback would serve as an important component of the basis of conclusion in a final standard.

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

When a disclosure is made because of materiality in any one of the years presented in the financial statements, we do not believe that disclosure is required in any of the other year(s) if it is not material. That said, this may raise questions about the item in the year(s) not disclosed (e.g., user perception that when a comparative disclosure is not made, an item is not present versus present but immaterial).

**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.

We support the Board’s initiative of eliminating restrictive language, such as “an entity shall at a minimum provide,” from the codification. Eliminating this type of language will remove a perceived obstacle in applying materiality.

Below is a list of additional paragraphs we identified within the ASC that contain restrictive language but are not included in Appendix B of the Proposal:

- ▶ 270-10-50-1
- ▶ 942-505-50-1
- ▶ 958-30-50-1
- ▶ 958-205-50-1A
- ▶ 958-805-50-11
- ▶ 958-810-50-5

**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?

We support the proposed amendment to explicitly state that the omission of an immaterial required disclosure is not an accounting error. However, we do not believe that this alone will remove the perceived obstacles of omitting immaterial disclosures as discussed in the Basis for Conclusions. We believe the Board, prior to moving forward with this project, should work closely with other regulators (e.g., PCAOB and the SEC) to comprehensively address this matter.

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

We believe that applying materiality for not-for-profit (NFP) entities will be performed consistently with other business enterprises and therefore believe no additional considerations are needed for NFP entities.

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

We believe that some of the proposed amendments could be effective upon issuance, such as the elimination of restrictive language in the disclosure sections. However, we believe that other proposed amendments should not be effective upon issuance so that companies have time to undertake a comprehensive reevaluation of their disclosures, processes and controls before adopting the new guidance. Instead, we support allowing the option for reporting entities to early adopt these proposed amendments following their issuance.