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February 24, 2016

Technical Director
Financial Accounting Standards Board (the "Board")
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

VIA EMAIL SUBMISSION; director@fasb.org

Re: Proposed Amendments to Statement of Financial Accounting Concepts—*Conceptual Framework for Financial Reporting Chapter 3: Qualitative Characteristics of Useful Financial Information*—Exposure Draft (File Reference No. 2015-300)

Proposed Accounting Standards Update—*Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*—Exposure Draft (File Reference No. 2015-310) (together, the "Exposure Drafts")

Dear Members of the Board:

We support the Board's efforts to ensure that the definition of materiality under U.S. Generally Accepted Accounting Principles ("U.S. GAAP"), specifically with respect to disclosure in the notes to financial statements, is consistent with the legal definition of materiality established by the U.S. Supreme Court.

The concept of materiality has always been the principal threshold for determining what should be disclosed to investors in securities offering documents and reports filed under the Securities Exchange Act of 1934, as amended. Until 2010, the definition of materiality endorsed by the Board for financial reporting mirrored the legal definition of materiality articulated by the U.S. Supreme Court in *TSC Industries vs. Northway*[1]—information that a reasonable person *would* have considered important in the decision making process.[2]

In 2010, the Board adopted a different materiality threshold—information that *could* influence investor decision making.[3] The Board adopted the new "could" formulation to mirror the standard in the International Financial Reporting Standards ("IFRS") in connection with its effort, together with the International Accounting Standards Board (the "IASB"), to harmonize U.S. GAAP and IFRS. Although the Board notes in the Exposure Drafts that it did not intend to broaden the definition of materiality in 2010, the change from the former "would" formulation to a "could" formulation has caused market participants to question whether the Board's standard is more broad than the legal standard and thus requires disclosure of more information than required by the legal standard.

We support the Board's proposal to expressly tie the U.S. GAAP definition of materiality to the U.S. legal standard in effect from time to time (at the time of this letter, the standard articulated in *TSC Industries vs. Northway*) principally for two related reasons: first, a "could" standard for materiality can be expected to result in over-disclosure of immaterial information, which does not benefit investors, and, second, IFRS and U.S. GAAP standards should not in all cases be the same, and particularly in this case.

With respect to U.S. GAAP/IFRS convergence on the issue of materiality, we believe a narrower definition is appropriate in the United States because of the higher risk of disclosure-related litigation in the United States as compared to most IASB jurisdictions.[4] The ability to bring a class action suit under the securities laws (along with the contingency fees for plaintiffs' lawyers that such actions invariably involve) is almost exclusively a U.S. phenomenon. The facility that a "could" definition of materiality provides litigants in challenging disclosure *ex post* can be detrimental to investors because it results in companies flooding disclosure with immaterial information to avoid future challenges based on subsequent, but (*ex ante*) objectively improbable, events.

The Supreme Court in *TSC Industries vs. Northway* recognized the risk that fear of litigation can result in over-disclosure:

> "If the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial

[1] 426 U.S. 438, 449 (1976).
[2] Statement of Financial Accounting Concepts No. 2—*Qualitative Characteristics of Accounting Information.*
[3] Statement of Financial Accounting Concepts No. 8—*Conceptual Framework for Financial Reporting Chapter 3: Qualitative Characteristics of Useful Financial Information.*
[4] In fact, instead of harmonizing the U.S. GAAP standard with IFRS as intended, we believe materiality in Concepts Statement No. 8 is actually broader than under IFRS. IAS 1 includes guidance that the words "could influence" in the definition of materiality should take into account how users "could reasonably be expected to be influenced" in making decisions. See IASB Exposure Draft ED/2015/8. That guidance does not appear in Concepts Statement No. 8. While not the same as the current U.S. legal standard, a "could reasonably" definition is certainly narrower than the unvarnished "could" definition.

liability may cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking."[5]

A more narrow definition based on the "would" standard requires management to consider materiality *ex ante* (ideally, more thoughtfully than under the "could" standard), but it also requires a litigant to show a greater degree of certainty *ex post* that information would have been important to a decision maker at the time management made its assessment. When materiality is based on a "would" standard, this balance results in disclosure that is more calibrated by relative probability and thus more useful for investors.[6]

The ultimate purposes of financial reporting and other qualitative disclosure, and the antifraud (and stricter) protections of the U.S. securities laws applicable to them, are the same—to provide information about an entity that is useful to investors, lenders and other creditors in making decisions about providing resources to the entity. As noted above, the Supreme Court has said that a more narrow definition of materiality produces better information for investors and other decision makers. While a court should not find a disclosure violation under a broader materiality threshold than that established by the Supreme Court, notes disclosure under a "could" standard is more time consuming to prepare and more expensive to audit, and ultimately more likely to bury investors in superfluous information. The financial reporting rules should not require a second, separate assessment for financial statement notes than that applicable to disclosure overall. And by linking the materiality definition to the legal definition, the Board will ensure that if the legal definition changes in the future, the definition of materiality in financial reporting will change with it.

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We thank you for the opportunity to submit this comment letter. Please do not hesitate to contact Leslie N. Silverman or Andrea M. Basham (212-225-2000) if you would like to discuss these matters further.

Respectfully submitted,

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[5] 426 U.S. at 448.

[6] Where materiality is to be assessed with respect to a possible future event, the Supreme Court said in *Basic Inc. v. Levinson*, 485 U.S. 224, 250 (1988), that materiality is a function of probability and magnitude ("Materiality in the merger context depends on the probability that the transaction will be consummated, and its significance to the issuer of the securities."). More generally, the Supreme Court quoted the following test for materiality formulated by the U.S. Court of Appeals for the Second Circuit: "materiality 'will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.'" Basic, 485 U.S. at 238 (quoting SEC v. Texas Gulf Sulphur Co., 401 F. 2d 833, 849 (2d Cir. 1986)).