

January 21, 2016

Mr. Russell Golden  
Chair  
Financial Accounting Standards Board  
401 Merritt 7  
P.O Box 5116  
Norwalk, CT 06856-5116

**Re: *Conceptual Framework for Financial Reporting –  
Chapter 3: Qualitative Characteristics of Useful Financial Information***

Dear Mr. Golden,

CFA Institute,<sup>1</sup> in consultation with its Corporate Disclosure Policy Council (“CDPC”)<sup>2</sup>, appreciates the opportunity to comment on the Financial Accounting Standards Board’s (“FASB” or “Board”) Proposed Accounting Standards Update (“Conceptual Framework Proposed Update”), *Conceptual Framework for Financial Reporting – Chapter 3: Qualitative Characteristics of Useful Financial Information*. Under separate cover we have provided comments on the related Proposed Accounting Standards Update, *Notes to Financial Statements (Topic 235) – Assessing Whether Disclosures Are Material* (“Notes Proposed Update”). Collectively, the Conceptual Framework Proposed Update and the Notes Proposed Update are referred to herein as the Proposed Updates.

CFA Institute is comprised of more than 130,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

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<sup>1</sup> With offices in Charlottesville, New York, Hong Kong, London, Mumbai and Beijing, CFA Institute is a global, not-for-profit professional association of more than 133,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 151 countries, of whom more than 125,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 145 member societies in 70 countries and territories.

<sup>2</sup> The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners’ perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

### ***The Conceptual Framework: Who Applies It?***

Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, states the following with respect to the Conceptual Framework:

*The Board itself is likely to be the most direct beneficiary of the guidance provided by Concepts Statements. They will guide the Board in developing accounting and reporting guidance by providing the Board with a common foundation and basic reasoning on which to consider merits of alternatives.*

However, knowledge of the objectives and concepts the Board will use in developing new guidance also should enable those who are affected by or interested in generally accepted accounting principles (GAAP) to understand better the purposes, content, and characteristics of information provided by financial accounting and reporting. That knowledge is expected to enhance the usefulness of, and confidence in, financial accounting and reporting.

However, knowledge of the objectives and concepts the Board will use in developing new guidance also should enable those who are affected by or interested in generally accepted accounting principles (GAAP) to understand better the purposes, content, and characteristics of information provided by financial accounting and reporting. That knowledge is expected to enhance the usefulness of, and confidence in, financial accounting and reporting. *The objectives and fundamental concepts also may provide some guidance in analyzing new or emerging problems of financial accounting and reporting in the absence of applicable authoritative pronouncements.* (Preface)

The Conceptual Framework is not authoritative. In the absence of guidance on how to account for a transaction or disclosure under the Accounting Standards Codification (“ASC” or “Codification”), other guidance within the Codification must first be considered. Only then is the non-authoritative guidance within the Conceptual Framework to be considered by preparers. Even then, decisions based upon guidance in the Conceptual Framework are not authoritative to preparers.

The non-authoritative nature of the Conceptual Framework and the fact that it serves to inform the Board in standard-setting – rather than preparers in their application of the Codification – are key considerations that stakeholders, including investors, should, in our view, make as they evaluate the potential impact of the proposed changes in the Conceptual Framework Proposed Update.

### ***The Conceptual Framework's Definition of Materiality***

The Conceptual Framework's current definition of materiality was updated in 2010 via the issuance of FASB Concepts Statement No. 8. In the table in **Appendix A**, the existing definition of materiality is compared to the proposed revision set forth in the Conceptual Framework Proposed Update. Also included are observations on the changes or basis for changes. Essentially, the Board is defining materiality as a legal concept.

### ***Our Views on the Proposed Definition of Materiality***

We don't disagree that materiality is a legal concept applied on an entity-specific basis. In 1999 the U.S. Securities and Exchange Commission issued application guidance in the form of [Staff Accounting Bulletin 99 – Materiality](#)<sup>3</sup> to assist preparers (U.S. public registrants) – when applying generally accepted accounting principles in United States (U.S. GAAP) – in their determination of what information should be included in the notes to the financial statements.

The long-standing existence of this guidance raises questions for investors regarding, why there is a perceived need for a change in the definition of materiality at this time.

### ***What is The Purpose of Definition of Materiality within the Conceptual Framework?***

As highlighted above, the Conceptual Framework is principally to be used by the Board in guiding their development of accounting standards rather than by preparers, in ascertaining the disclosures they should make in financial statements.

For many investors the notion of relevance of a particular disclosure in explaining the nature of a transaction or balance would be a more appropriate conceptual foundation for the Board's decision-making process in determining the most appropriate disclosures for financial statements. Many perceive the notion of relevance as a bit more expansive, than a definition of materiality based upon an entity-specific legalistic determination, and would allow the Board to consider a fuller range of possible disclosures in developing standards.

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<sup>3</sup> Also referred to as [SAB Topic 1.M](#) in the Codification of Staff Accounting Bulletins.

***Why Is the Change in the Conceptual Framework Definition of Materiality Needed?***

Despite the 2010 change in wording regarding the definition of materiality in Concepts Statement No. 8, preparers have been required to apply the legal definition of materiality in ascertaining the appropriate disclosures to be made within the financial statements. As noted above, the definition of materiality has not changed for many years and Staff Accounting Bulletin 99 has provided guidance in assessing materiality since 1999.

Some have suggested that the 2010 change in the definition of materiality in FASB Concepts Statement No. 8 created the inclusion of additional disclosures in financial statements because it incorporated the notion of “could” vs. “would” impact the resource providers’ decision-making process. Still others have observed the 2010 change, and the now existing language, created inconsistencies for preparers.

We would observe, however, that the overlay of the legal concept of materiality has remained constant before, during and after this 2010 change in the Conceptual Framework. Preparers have been required to apply this legal definition of materiality in making financial statement disclosure decisions. The need to apply this legal definition of materiality should have precluded the inclusion of additional disclosure items as the “would” standard in the legal definition was applicable to preparers even when the “could” standard was included in the Conceptual Framework applicable to standard setters. Accordingly, investors question whether this 2010 change in the Conceptual Framework could have had any impact on the volume of disclosures included within the financial statements – and whether the proposed change will have any impact.

Further supporting this question is the notion that the Conceptual Framework exists principally for the use of the Board in its standard-setting process and for use by preparers when there is a lack of guidance on emerging issues. Materiality is not an emerging issue so the FASB’s 2010 change to the definition of materiality within the Conceptual Framework could only have impacted the Board’s thinking in the issuance of disclosure guidance on new standards since that time. Accordingly, investors are left questioning whether this asserted claim of additional disclosures or inconsistencies is a valid basis for proposed changes in the Conceptual Framework Proposed Update. This is important too, in understanding the potential consequence of the changes included in the Conceptual Framework Proposed Update.

***What is the Impact of the Change?***

Because the Conceptual Framework is principally meant to inform the decision-making process of the Board when setting accounting standards, we can see that the language change – from “could” to “would” impact the resource providers’ decision-making process – brings with it the possibility that the Board might consider fewer disclosures when establishing accounting standards. The notion of relevance might result in more expansive disclosures for consideration.

Certainly, we see a definition of materiality focused on relevance as important to providing the Board with the appropriate tools for consideration of all meaningful disclosures to reflect high-quality standard-setting. That said, we don’t see that this proposed change in the Conceptual Framework Proposed Update as the principal concern for investors in the discussion of

materiality. Rather, we see the changes in the Notes Proposed Update, that may add discretion as the area where investors should focus their attention.

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Thank you again for the opportunity to comment on the FASB Conceptual Framework Proposed Update. If you or your staff have questions or seek further elaboration of our views, please contact either Mohini Singh, ACA, by phone at +1.434.951.4882, or by e-mail at [mohini.singh@cfainstitute.org](mailto:mohini.singh@cfainstitute.org) or Sandra J. Peters, CPA, CFA by phone at +1.212.754.8350 or by email at [sandra.peters@cfainstitute.org](mailto:sandra.peters@cfainstitute.org).

Sincerely,

*/s/Sandra J. Peters*  
Sandra J. Peters CPA, CFA  
Head, Global Financial Reporting Policy  
Standards & Advocacy Division  
CFA Institute

*/s/ Ashwinpaul C. Sondhi*  
Ashwinpaul C. Sondhi  
Chair  
Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council  
Kurt Schacht, Managing Director, Standards & Advocacy Division, CFA Institute

The FASB’s existing definition of materiality as compared to the revision – along with some observations on the changes or basis for changes – in the Conceptual Framework Proposed Update is as follows:

EXISTING DEFINITION	PROPOSED DEFINITION
<p><i>Paragraph OC11 –</i></p> <p><b>Information is material if omitting it or misstating it <u>could</u> influence <u>decisions that users make</u> on the basis of the financial information of a specific reporting entity.</b></p> <p>In other words, materiality is an <b>entity-specific aspect of relevance</b> based on the nature or magnitude or both of the items to which the information relates in the context of an individual entity’s financial report.</p> <p>Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.</p>	<p><i>Paragraph OC11 –</i></p> <p>Materiality is a legal concept. In the United States, a legal concept may be established or changed through legislative, executive, or judicial action.</p> <p>The Board observes but does not promulgate definitions of materiality.</p> <p>Currently, the Board observes that the U.S. Supreme Court’s definition of materiality, in the context of the antifraud provisions of the U.S. securities laws, generally states that <b><i>information is material if there is a substantial likelihood that the omitted or misstated item <u>would</u> have been viewed by a reasonable resource provider as having significantly altered the total mix of information.</i></b></p>
<p><b>Observation – Key change is movement from “could” to “would” and from user to resource provider. Emphasis on legal definition of materiality.</b></p>	
<p><i>Paragraph BC3.18 –</i> The Discussion Paper and the Exposure Draft proposed that materiality is a pervasive constraint in financial reporting because it is pertinent to all of the qualitative characteristics.</p> <p>However, some respondents to the Exposure Draft agreed that although materiality is pervasive, it is not a constraint on a reporting entity’s ability to report information.</p> <p>Rather, <b>materiality is an aspect of relevance because immaterial information does not affect a user’s decision.</b></p> <p>Furthermore, a <b>standard setter does not consider materiality when developing standards because it is an entity-specific consideration.</b></p> <p>The Boards agreed with those views and concluded that <b>materiality is an aspect of relevance that applies at the individual entity level.</b></p>	<p><i>Paragraph BC3.18 –</i> The Discussion Paper (July 6, 2006, FASB Preliminary Views, <i>Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information</i>) and the Exposure Draft (May 29, 2008, FASB Exposure Draft, <i>Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Reporting Information</i>) proposed that materiality is a pervasive constraint in financial reporting because it is pertinent to all of the qualitative characteristics.</p> <p>Some respondents to the Exposure Draft agreed <b>that any entity can consider materiality in its reporting decisions; however, it is not a constraint on a reporting entity’s ability to report information because an entity can choose to report immaterial information.</b></p> <p>Furthermore, <b>a standard setter does not consider materiality when developing standards because it is an entity-specific consideration.</b></p> <p>As a result, entity-specific assessments of materiality are not directly relevant to the Board’s assessments on whether the guidance it sets meets the qualitative characteristics of financial reporting information. Instead, the Board evaluates the potential relevance of its guidance (and other qualitative characteristics of the reported information) in the context of a broader financial reporting environment rather than on the materiality of the information to individual entities.</p>
<p><b>Observation – Move away from materiality being an aspect of relevance. Reiterates materiality is entity-specific consideration and pervasive constraint but that it is not a consideration to standard-setters because it is an entity-specific consideration.</b></p>	

EXISTING DEFINITION	PROPOSED DEFINITION
	<p><u>Paragraph BC3.18A</u> – The Board decided to continue to include a discussion of materiality in the Concepts Statements to:</p> <p>(a) demonstrate its understanding of the reporting environment in which the guidance it sets is applied, and</p> <p>(b) highlight the difference between relevance and materiality.</p>
<p><b>Observation</b> – No change, just clarifying basis for above changes including reflecting that Board perceives a change in the reporting environment where materiality assessments are being made.</p>	
	<p><u>Paragraph BC3.18B</u> – The Board became aware that the current definition of materiality in Chapter 3 of Concepts Statement 8 as originally issued was inconsistent with the legal concept of materiality in the United States.</p> <p><b>That inconsistency created uncertainty about potential interpretations and how to reconcile the two when assessing materiality.</b></p> <p>The definition in Chapter 3 was not intended to be different from the legal concept of materiality.</p> <p>The Board decided that the simplest and most effective way to avoid creating uncertainty or confusion is to (a) make it clear that</p>
<p><b>Observation</b> – As noted above, the Codification is non-authoritative and used primarily for the Board in developing standards. Conceptual Framework is only to be referred to by preparers when there is an absence of guidance. However, there is substantial guidance on the definition and application of materiality through Staff Accounting Bulletin 99. As such, the central question for investors is: Does the difference in definitions have any impact?</p>	
	<p><u>Paragraph BC3.18C</u> – The Board is aware that the discussion of materiality as amended in Concepts Statement 8 would no longer be identical to the definition in the IASB’s <i>Conceptual Framework for Financial Reporting</i>, though both were identical when originally issued.</p> <p>IAS 1, <i>Presentation of Financial Statements</i>, and IAS 8, <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>, also include definitions of materiality.</p> <p>It is preferable that both sets of the Conceptual Framework converge. However, that is not possible in this circumstance because the IASB’s definitions of materiality are not consistent with the legal concept of materiality in the United States.</p> <p><b>Some stakeholders also have observed that the IASB’s definitions of materiality generally would require disclosure of more information than would the legal concept of materiality in the United States.</b></p>
<p><b>Observation</b> – Simply a notation that the definitions of materiality will not be aligned with IFRS.</p>	