FASB Exposure Draft

Proposed Amendments to Statement of Financial Accounting Concepts

Issued: September 24, 2015
Comments Due: December 8, 2015

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Conceptual Framework for Financial Reporting

Chapter 3: Qualitative Characteristics of Useful Financial Information

The Board issued this Exposure Draft to solicit public comment on proposed amendments to Statement of Financial Accounting Concepts. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing written comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2015-300, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

Notice to Recipients of This Exposure Draft of Amendments to the Statements of Financial Accounting Concepts

The Board invites comments on all matters in this Exposure Draft and is requesting comments by December 8, 2015. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing a written letter to director@fasb.org, File Reference No. 2015-300
- Sending written comments to "Technical Director, File Reference No. 2015-300, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Do not send responses by fax.

All comments received are part of the FASB's public file. The FASB will make all comments publicly available by posting them to the online public reference room portion of its website.

An electronic copy of this Exposure Draft is available on the FASB's website.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Proposed Amendments to Statement of Financial Accounting Concepts No. 8

Conceptual Framework for Financial Reporting

Chapter 3: Qualitative Characteristics of Useful Financial Information

September 24, 2015

Comment Deadline: December 8, 2015

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Introduction to the Conceptual Framework

Along with other FASB Concepts Statements, FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, establishes the concepts that underlie financial reporting standards. When completed, the framework is expected to be a coherent system of concepts that flow from the objective of financial reporting. The concepts provide the FASB with a framework for selecting the transactions, events, and circumstances to be represented; how those items should be recognized and measured; and how they should be summarized and presented or disclosed in financial reports.

Why Is the FASB Issuing These Proposed Amendments?

The FASB is issuing the proposed amendments to Chapter 3, *Qualitative Characteristics of Useful Financial Information*, of Concepts Statement 8 to ensure that the materiality concepts discussed are consistent with the legal concept of materiality. Respondents to the FASB Invitation to Comment, *Disclosure Framework*, and the proposed FASB Concepts Statement, *Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements,* along with other stakeholders, have requested these amendments to eliminate inconsistencies between the framework and the legal concept of materiality.

Authoritative Status of the Framework

Paragraph 105-10-05-03 of the *FASB Accounting Standards Codification*® states that FASB Concepts Statements are nonauthoritative. If guidance for a transaction or event is not specified within a source of authoritative generally accepted accounting principles (GAAP) for that entity, the entity first must consider accounting principles for similar transactions or events within authoritative GAAP and then consider nonauthoritative guidance (including Concepts Statements).

In preparing responses to this Exposure Draft, respondents should consider the difference in status of the FASB Concepts Statements and the Accounting Standards Codification.

What Is the Main Amendment?

The main amendment to Chapter 3 of Concepts Statement 8 is a modification of the current definition of materiality that adds a statement that materiality is a legal concept. Another amendment to Concepts Statement 8 includes a brief summary of the U.S. Supreme Court's definition of materiality because that is the definition that is currently observed by the Board.

Question for Respondents

The Board invites individuals and organizations to comment on all matters in this Exposure Draft, particularly on the question below. Comments are requested from those who agree with the proposed amendments as well as from those who do not agree. Those who disagree with the proposed amendments are asked to describe their suggested alternatives, supported by specific reasoning.

Question: Do the proposed amendments improve Concepts Statement 8? If so, how? If not, why?

Amendments to the *Conceptual Framework for Financial Reporting*

Introduction

1. Concepts Statement 8 is amended as described in paragraphs 2–3. The amendments include changes to both Chapter 3 on the qualitative characteristics of useful financial information and the chapter's basis for conclusions. Unlike the basis for conclusions related to amendments to the Accounting Standards Codification, the basis for conclusions in Concepts Statements is integral to the Concepts Statements to which it relates. Therefore, changes to the basis for conclusions will be marked similar to the qualitative characteristics (QC) paragraphs in Chapter 3. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Chapter 3 of Concepts Statement 8

2. Amend paragraph QC11 as follows:

Materiality

QC11. ~~Information is material if omitting it or misstating it could influence decisions that users make on the basis of the financial information of a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance 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.~~ Materiality is a legal concept. In the United States, a legal concept may be established or changed through legislative, executive, or judicial action. The Board observes but does not promulgate definitions of materiality. 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 information 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.[1] Consequently, the Board cannot specify or advise specifying a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

[1]This general statement is a summary of observations of the following cases:

a. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976).
b. *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

3. Amend paragraph BC3.18 and add paragraphs BC3.18A–BC3.18C as follows:

Materiality

BC3.18 The Discussion Paper (July 6, 2006, FASB Preliminary Views, *Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information*) and the Exposure Draft (May 29, 2008, FASB Exposure Draft, *Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Reporting Information*) proposed that materiality is a pervasive constraint in financial reporting because it is pertinent to all of the qualitative characteristics. ~~However, some~~Some respondents to the Exposure Draft agreed that ~~although materiality is pervasive,~~ 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. ~~Rather, materiality is an aspect of relevance because immaterial information does not affect a user's decision.~~ Furthermore, a standard setter does not consider materiality when developing standards because it is an entity-specific consideration. 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. ~~The Boards agreed with those views and concluded that materiality is an aspect of relevance that applies at the individual entity level.~~

BC3.18A The Board decided to continue to include a discussion of materiality in the Concepts Statements to (a) demonstrate its understanding of the reporting environment in which the guidance it sets is applied and (b) highlight the difference between relevance and materiality.

BC3.18B 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. That inconsistency created uncertainty about potential interpretations and how to reconcile the two when assessing materiality. The definition in Chapter 3 was not intended to be different from the legal concept of materiality. The Board decided that the simplest and most effective way to avoid creating uncertainty or confusion is to (a) make it clear that the Board should not define materiality and (b) remove the existing definition of materiality and replace it with a broad observation of the U.S. Supreme Court's definition in the context of the antifraud provisions of the U.S. securities laws.

BC3.18C 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 *Conceptual Framework for Financial Reporting,* though both were identical when originally issued. IAS 1, *Presentation of Financial Statements*, and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, also include definitions of materiality. 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. 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.

The proposed amendments were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Daryl E. Buck
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith