FASB In Focus

FASB Disclosure Framework Exposure Drafts on Materiality

The Financial Accounting Standards Board (FASB) on September 24, 2015 issued for public comment two Exposure Drafts related to its disclosure framework project.

The objective of the Disclosure Framework project is to improve the effectiveness of disclosures in notes to financial statements by more clearly communicating the information required by Generally Accepted Accounting Principles (GAAP) that is most important to the users of financial statements.

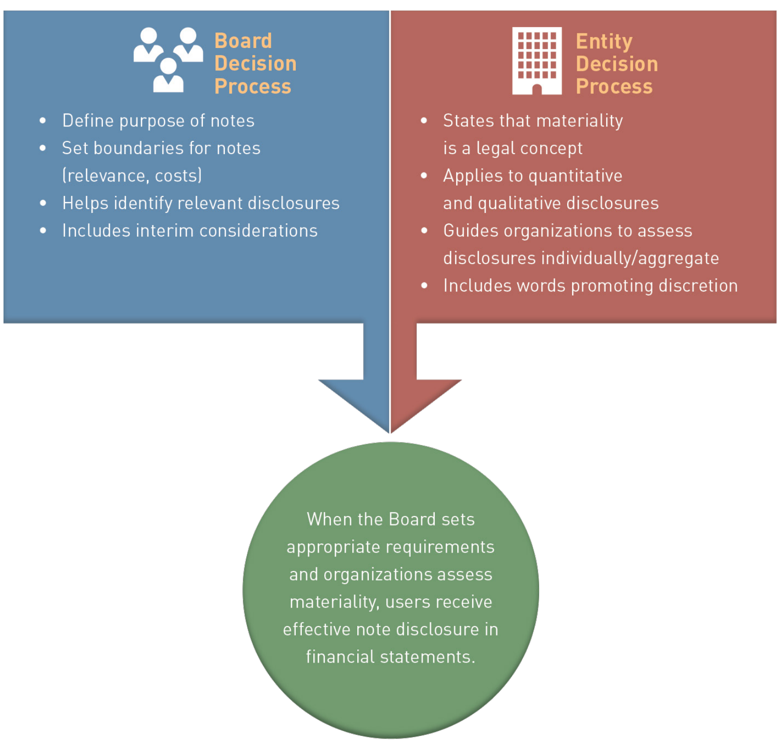
The FASB's disclosure framework project consists of the following components:

- **The Board's decision process,** which is intended to improve the FASB's Concepts Statements to aid the Board when identifying and evaluating disclosure requirements in current and upcoming financial accounting and reporting standards
- **The entity's decision process,** which is intended to guide companies and not-for-profit organizations in using discretion when making decisions about what disclosures should be considered "material" in their particular circumstances.

The Exposure Draft containing amendments to FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, is intended to clarify the concept of "materiality." Specifically, these amendments would be made to Chapter 3, *Qualitative Characteristics of Useful Financial Information*.

The proposed Accounting Standards Update (ASU) *Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*, a component of the "entity decision process," is intended to promote the appropriate use of discretion by organizations when deciding which disclosures should be considered material in their particular circumstances. The amendments to Topic 235 would apply to all types of organizations—public and private companies, not-for-profit organizations, and employee benefit plans.

Improving Disclosure Effectiveness



Why Is Materiality Important?

"Materiality" is a legal concept, defined through court decisions. The FASB does not define what information should be considered "material" when a company or other organization prepares its financial reports.

However, the concept of materiality is an important component of the Disclosure Framework project because it helps organizations use discretion when determining which information to disclose in their particular circumstances.

The FASB revisited the concept of materiality after stakeholders indicated that the current discussion in Chapter 3 of Concepts Statement 8 was inconsistent with the legal concept of materiality as established by the United States Supreme Court.

Materiality helps organizations use discretion when determining which information to disclose in their particular circumstances.

Stakeholders were concerned that this inconsistency created uncertainty about organizations' potential interpretations of materiality, specifically, how organizations should reconcile the current discussion of materiality in the Concepts Statement with the legal concept as expressed by the courts.

How Is the FASB Clarifying Materiality in Its Concepts Statements?

The original discussion in Chapter 3 of Concepts Statement 8 was not intended to conflict with the legal definition of materiality.

Therefore, in the Exposure Draft, the Board decided that the simplest and most effective way to avoid creating uncertainty or confusion for the Board and organizations was to:

a. Make it clear that the FASB does not define materiality, and

b. Delete the existing discussion and replace it with a broad observation of the U.S. Supreme Court's definition of materiality.

How Is the FASB Promoting Discretion When Organizations Assess Whether Disclosures Are Material?

Stakeholders often have stated that certain disclosures may be relevant to other organizations, but that they do not provide relevant information in their circumstances. They also requested that GAAP specifically address assessments of materiality.

The amendments in the proposed ASU, *Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*, are intended to promote the appropriate use of discretion by reporting organizations when assessing if their note disclosures are material or not.

The amendments in this proposed ASU would clarify the way materiality should be considered when organizations assess requirements for providing information in notes to financial statements. This would improve the effectiveness of notes to financial statements by helping organizations omit immaterial information and focus communication with users on the material, relevant items. The amendments would not change any specific disclosure requirements.

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The amendments in this proposed ASU:

- State 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. Therefore, some, all, or none of the requirements in a disclosure may be material.
- Refer to materiality as a legal concept.
- State specifically that an omission of immaterial information is not an accounting error.

What Kind of Feedback Is the Board Seeking from Stakeholders?

The Board invites individuals and organizations to review and comment on all matters in these Exposure Drafts—particularly on questions for respondents, including suggesting alternatives that might increase the expected benefits, minimize complexities, and reduce costs. Instructions on how to submit comments are contained in the Exposure Drafts. All written comments are requested by December 8, 2015.

What Is the Status of Other Components of the Disclosure Framework Project?

The proposed ASU and the Exposure Draft are part of the several workstreams in the Disclosure Framework project.

For example, in March 2014 the FASB issued a proposed Concepts Statement, *Conceptual Framework for Financial Reporting: Chapter 8: Notes to Financial Statements,* as part of the Board's decision process component. If approved, the Concepts Statement would become the relevant framework for the Board when evaluating existing disclosure requirements and creating disclosure requirements in the future. The Board is currently re-deliberating the proposed Concepts Statement based on stakeholder input.

Another phase of the Disclosure Framework project joins the Board's decision process with the entity's decision process. This phase is the evaluation and modification of disclosure sections in five topic areas:

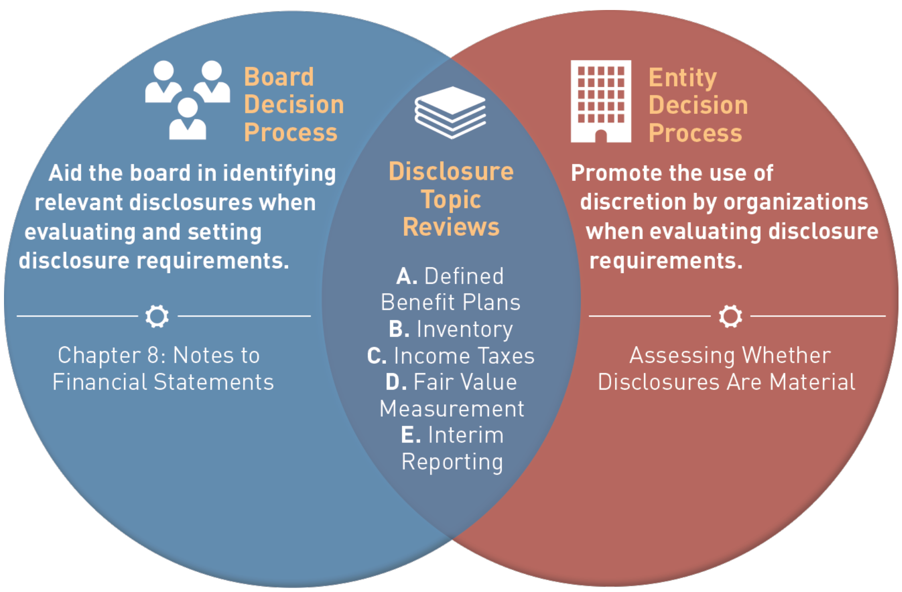
- Fair Value Measurement
- Defined Benefit Plans
- Income Taxes
- Inventory
- Interim Reporting.

Each topic review will include:

- An evaluation of existing disclosure requirements within the topic after applying the concepts in the Board's Decision Process, and
- The promotion of the appropriate use of discretion by organizations specifically within the topic as a part of the entity's decision process.

The Board expects to issue an exposure draft addressing the concepts on defined benefit plans in Q4 2015. ■

Disclosure Framework Projects



For more information about the project, please visit the FASB's website at www.fasb.org.

The views expressed in this document do not necessarily reflect the views of the FASB. Official positions of the FASB are arrived at only after extensive due process and deliberation.

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