FASB Conceptual Framework

Amendments to Statement of
Financial Accounting Concepts No. 8

August 2018

Conceptual Framework for Financial Reporting

Chapter 3, *Qualitative Characteristics of Useful Financial Information*

Financial Accounting Standards Board

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Introduction to the Conceptual Framework

FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, establishes the concepts, along with other FASB Concepts Statements, 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 Amendments?

The FASB is issuing these 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 definition of materiality used by the U.S. Securities and Exchange Commission (SEC), the auditing standards of the Public Company Accounting Oversight Board (PCAOB) and the American Institute of Certified Public Accountants (AICPA), and the United States judicial system. Respondents to the 2012 FASB Invitation to Comment, *Disclosure Framework*, and the 2014 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 definition used by other standard setters, regulators, and other participants in the financial reporting system in the United States.

Authoritative Status of the Framework

Paragraph 105-10-05-03 of the *FASB Accounting Standards Codification*® states that FASB Concepts Statements are nonauthoritative. Furthermore, paragraph 105-10-05-02 states that 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. If none exists, then the entity should consider nonauthoritative guidance from other sources (including Concepts Statements).

What Are the Main Amendments?

The main amendment to Chapter 3 of Concepts Statement 8 reinstates the definition of materiality that was in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information,* which was superseded in 2010 by Concepts Statement 8. Another amendment to Chapter 3 of Concepts Statement 8 adds language similar to that in Concepts Statement 2, which discusses:

a. How materiality differs from relevance
b. That materiality assessments can be properly made only by those with an understanding of the reporting entity's pertinent facts and circumstances.

Amendments to the *Conceptual Framework for Financial Reporting*

Introduction

1. Concepts Statement 8 is amended as described in paragraphs 2 and 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 a Concepts Statement is integral to the Concepts Statement to which it relates. Therefore, changes to the basis for conclusions (BC) paragraphs are marked similar to the qualitative characteristics (QC) paragraphs. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Chapter 3 of Concepts Statement 8

2. Amend paragraph QC11 and add paragraphs QC11A and QC11B 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. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.~~ <u>Relevance and materiality are defined by what influences or makes a difference to an investor or other decision maker; however, the two concepts can be distinguished from each other. Relevance is a general notion about what type of information is useful to investors. Materiality is entity specific. The omission or misstatement of an item in a financial report is material if, in light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.</u>

<u>QC11A. A decision not to disclose certain information or recognize an economic phenomenon may be made, for example, because the amounts involved are too small to make a difference to an investor or other decision maker (they are immaterial). However, magnitude by itself, without regard to the nature of the item</u>

and the circumstances in which the judgment has to be made, generally is not a sufficient basis for a materiality judgment.

QC11B. No general standards of materiality could be formulated to take into account all the considerations that enter into judgments made by an experienced, reasonable provider of financial information. That is because materiality judgments can properly be made only by those that understand the reporting entity's pertinent facts and circumstances. Whenever an authoritative body imposes materiality rules or standards, it is substituting generalized collective judgments for specific individual judgments, and there is no reason to suppose that the collective judgments always are superior.

3. Amend paragraph BC3.18 and add paragraphs BC3.18A–BC3.18D 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 the 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 that the Board sets meets the qualitative characteristics of financial reporting. 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 observed that the definition of materiality in this chapter as originally issued is inconsistent with the definitions and discussions by the U.S. Securities and Exchange Commission (SEC), auditing standards of the Public Company Accounting Oversight Board (PCAOB) and the American Institute of Certified Public Accountants (AICPA), and the judicial system in the United States. That inconsistency does not help the Board to understand the environment in which reporting entities operate. In September 2015, the Board issued proposed Accounting Standards Update, *Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*, which stated that materiality is a legal concept and that the Board observed that the U.S. Supreme Court definition of materiality is the appropriate definition. Preparers and practitioners objected to stating that materiality is a legal concept because it may imply that only legal professionals can make materiality judgments and that materiality should be considered an accounting concept. Others objected to the citing of the U.S. Supreme Court definition of materiality because of its origins in antifraud litigation. Still others stated that the meaning of the term is debatable and there is a concern that the definition may change. Some stakeholders suggested that the definition in Concepts Statement 2[5a] would be a better definition. After considering the feedback, the Board decided to replace the current definition of materiality in this chapter with the superseded definition in Concepts Statement 2. The definition of materiality that is in Concepts Statement 2 is quoted in SEC Staff Accounting Bulletin No. 99, *Materiality*. SAB 99 notes that the definition that is in Concepts Statement 2 is in substance identical to the definition of the U.S. Supreme Court, which in turn results in the definition in this chapter being in substance identical to the definition in the auditing standards of the AICPA and the PCAOB.

BC3.18C The Board decided not to incorporate all the content of the definition of materiality from Concepts Statement 2 into this chapter. The language that was not carried forward included, in large part, examples of how one might think about a materiality assessment. In the Board's view, the examples in Concepts Statement 2 were not necessary to capture the substance of the definition.

BC3.18D The Board is aware that the discussion of materiality as amended in this Concepts Statement is no longer identical to the definition in the International Accounting Standards Board's (IASB) *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 the FASB's and the IASB's Conceptual Frameworks converge. However, that is not possible because (a) the IASB's definitions of materiality are not consistent with the definition used in the United States and (b) the IASB is working to further amend its definitions of materiality.

[5a]Superseded.

The amendments in this Concepts Statement were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Marsha L. Hunt
Harold L. Monk, Jr.
R. Harold Schroeder
Marc A. Siegel