

What's Material? Don't Ask FASB

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ateriality is a concept that is essential to the application of the fundamental qualitative characteristics of accounting information included in the conceptual framework for financial reporting. Proper application of the materiality concept establishes the threshold for relevance of an item in financial disclosure decisions.

The Financial Accounting Standards Board (FASB) has received feedback in recent years that the definition of materiality included in the conceptual framework is inconsistent with the legal concept the U.S. Supreme Court has established. In response, FASB has issued two exposure drafts dealing with materiality. One is a proposed amendment to Chapter 3, Qualitative Characteristics of Useful Financial Information, of Concepts Statement 8, *Conceptual Framework for Financial Reporting*. The other is a proposed update, *Notes to the Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*.

Amendment to the Conceptual Framework

Proposed amendment to Chapter 3, Qualitative Characteristics of Useful Financial Information, of Concepts Statement 8, *Conceptual Framework for Financial Reporting* has an objective to ensure that the materiality concepts, as defined by FASB, are consistent with the legal concept of materiality. The amendment modifies the current definition of materiality and adds that it is a legal concept.

The current definition of materiality is as follows: "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."

FASB has omitted the above definition of materiality and inserted the following definition. "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."

In other words, FASB is no longer taking responsibility for what is determined to be material. "The board cannot specify or

advise specifying a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation." Entities must follow the Proposed Accounting Standards Update, *Notes to the Financial Statements (Topic 235): Assessing Whether Disclosures Are Material* when using discretion on what to include in the notes to the financial statements.

ASC Topic 235

Proposed Accounting Standards Update, *Notes to the Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*, has an objective to improve the effectiveness of disclosures in the notes to the financial statements. FASB wants to clarify the information required by generally accepted accounting principles (GAAP) that is most important to users of the financial statements. To achieve this objective of improving the effectiveness of notes to the financial statements, FASB has developed a framework that promotes consistent decisions about disclosure requirements. Reporting entities must apply this framework appropriately and use proper discretion.

The main provisions in this update draw attention to the role materiality plays in making decisions about disclosures. The proposed update explains that materiality would be applied to quantitative and qualitative disclosures individually and in the aggregate in the context of the financial statements as a whole. Therefore, some, all or none of the requirements in a disclosure section may be material. The update also states that materiality would be identified as a legal concept and the omission of a disclosure of immaterial information would not be an accounting error.

The Next Steps

Comments on both of the above mentioned proposed updates, *Notes to the Financial Statements (Topic 235): Assessing Whether Disclosures Are Material* and proposed amendment to Chapter 3, Qualitative Characteristics of Useful Financial Information, of Concepts Statement 8, *Conceptual Framework for Financial Reporting* were due on Dec. 8, 2015. FASB is re-deliberating its proposed changes based on feedback received through the comment letter process. For more information on this topic, visit fasb.org.

Auditors Still on the Hook

It should be noted that these proposed changes do not impact the auditing literature. Therefore, the definition of the term and its applications under U.S. and international auditing standards is expected to remain as it has been in the past. ■

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