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Contents

FASB Continues Discussion on Disclosure Framework

The FASB recently began redeliberations and held a forum on financial disclosure to discuss the status of its Disclosure Framework project.[1] A panel discussion included representatives from financial statement users, preparers, legal firms, auditing firms, and representatives from the FASB, SEC, and IASB.

During redeliberations of the project, the FASB tentatively decided to revise its description of materiality in FASB Concepts Statement 8 to align it with a U.S. Supreme Court decision.[2]

Key Facts

- The FASB's Disclosure Framework project focuses on the separate disclosure decision processes used by the FASB and entities.
- The FASB's disclosure framework would become a chapter in its Conceptual Framework, which is intended to improve the process of how disclosures in accounting standards are developed.
- The FASB is currently reviewing disclosure requirements for fair value measurements, defined benefit plans, inventory, and income taxes using the proposed framework.

Key Impacts

- The project related to the entity's decision process is expected to encourage the use of discretion when making disclosures.
- The SEC plans to issue a concept release in 2015 related to its initiative to improve disclosure effectiveness.
- Users of financial statements that participated in the forum indicated that they would not remove current disclosures; instead, the focus should be on making current disclosures more useful.

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[1] FASB Forum on Financial Disclosure, December 1, 2014, Pace University, New York. Audio playback available at www.fasb.org.

[2] FASB Statement of Financial Accounting Concepts No. 8, Conceptual Framework for Financial Reporting – Chapter 1, The Objective of General Purpose Financial Reporting; and Chapter 3, Qualitative Characteristics of Useful Financial Information, available at www.fasb.org. The Supreme Court decision was made in TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, (1976).

Materiality

While the FASB has tentatively decided to align the materiality description with the U.S. Supreme Court's description, the FASB would retain certain aspects of the existing description to reiterate that materiality would continue to be an entity-specific judgment.[3] The description would include language to describe that materiality is a legal concept that can vary by jurisdiction. The revised materiality description in the Concepts Statement would be used as a reference by the FASB as it discusses its proposed Disclosure Framework project, which would affect only the notes to the financial statements.

Current Description in Concepts Statement No. 8

"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."

U.S. Supreme Court Description

"A fact is material if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by a reasonable investor as having significantly altered the total mix of information made available."

KPMG Observations

Recognizing materiality as a legal concept within the Concepts Statement could introduce additional complexities when differences exist in the legal concepts in different jurisdictions. While Concepts Statements are not authoritative, they provide useful information when the authoritative literature does not address a concept such as materiality. Because legal opinions may vary by jurisdiction, inconsistency and therefore implementation issues could occur.

The IASB description of materiality will differ from the FASB description. The IASB does not currently have plans to amend the guidance on materiality in its conceptual framework. The IASB Conceptual Framework describes materiality as follows:

Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about 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.[4]

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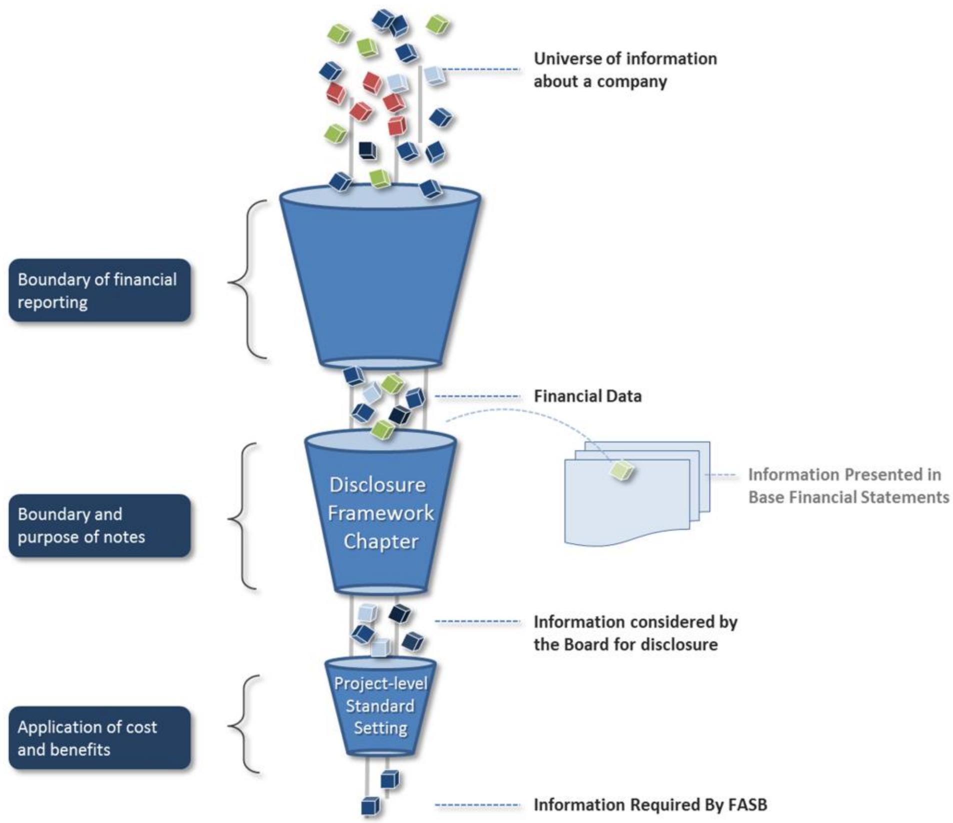
[3] FASB Minutes, November 19, 2014, available at www.fasb.org.

[4] IASB Conceptual Framework, available at www.ifrs.org.

Observations from the Forum on Financial Disclosure

FASB

FASB representatives described the Disclosure Framework projects and discussed the standard-setting process and entities' decision process. The FASB noted that the Board's standard-setting process is intended to be a filter on what belongs in the financial statements (see the diagram below). Once the framework is determined, the Board can evaluate what items would require disclosure. The FASB indicated that when using the disclosure framework to determine the disclosures required for fair value measurement, defined benefit plans, inventory, and income taxes, it found both missing disclosures as well as those that may not add value to the user. The FASB also said that both its process and entities' decision process would be evaluated together as it determines what changes to make for the four topics currently under review.



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SEC

SEC representatives suggested that the FASB should determine what disclosure requirements it believes are required and that the financial statements and notes should "stand on their own." The SEC will then determine if additional disclosure is needed outside the financial statements.

SEC representatives also indicated that the Jumpstart Our Business Startups (JOBS) Act required the SEC to review existing disclosure requirements and issue a report.[5] That report described "how we got to where we are today." The SEC plans to issue a concept release on its disclosure initiative in 2015.

IASB

The IASB is evaluating the current conceptual framework with a goal of giving preparers more flexibility to "tell the story" to investors in the financial statements and notes rather than solely focusing on reducing disclosure.

Panel Discussion

The FASB held the forum to engage in a dialogue and understand the views of its stakeholders as they relate to financial statement disclosure. The FASB has held similar outreach initiatives for other projects to gather as much information as possible when developing standards. The FASB will utilize the information obtained through the forum as it continues to deliberate the Disclosure Framework project.

More than 20 individuals participated in the panel discussion, which focused on two topics.

- What is the current state of disclosure practices and how should the standard setters and regulators focus their efforts to improve disclosure?
- How would a change in the language around materiality impact disclosure practices?

The following paragraphs highlight some of the views that were expressed by the panelists throughout the discussion.

No Need to Reduce Disclosures. Financial statement users expressed their view that there is no need to reduce disclosures. Technology allows users to identify and filter the information that is important to them. The users on the panel were interested in consistent and more effective disclosure that can be analyzed.

Create a Disclosure Structure That Promotes Effectiveness. Panelists agreed that providing preparers with more structure could lead to more effective disclosure, and help them move from a compliance mindset of completing a checklist to focusing on effectiveness. Panelists also said that it is important for the FASB to first reconsider the boundaries of the financial statements before determining what information belongs in the financial statements.

[5] SEC Report on Review of Disclosure Requirements in Regulation S-K, December, 2013, available at www.sec.gov.

Determining Appropriate Disclosures. Preparers and their auditors continue to struggle with what information and how much of it should be disclosed. Panelists said that it is more difficult to audit qualitative information than quantitative, and that consideration should be given to whether qualitative information belongs outside of the financial statements and notes. Preparers noted that when they have focused on making more effective disclosure, they have been successful; however, it has required significant time and resources.

FASB Should Describe Materiality. Panelists cautioned against leaving the description of materiality entirely up to a legal interpretation because it may be interpreted differently. They said that the FASB should be responsible for setting the policy for financial reporting purposes, even though it could be subject to legal interpretation. Panelists also noted that changing the language to be consistent with the Supreme Court ruling could mean that additional guidance would be required.

KPMG Observations

The FASB and its stakeholders attending the forum continue to believe that there is room for improvement in financial disclosure. Redundancy in disclosure and materiality appear to be the areas that command the most attention. While the FASB and the SEC focus on financial disclosure, it is not clear whether these steps will result in less redundancy. The potential changes for materiality could impact both users and preparers, however, it is too early to tell what that impact would be.

While the timing is unknown, we expect the Board to consider potential revisions to the existing disclosure requirements for the four topics that are currently being reviewed in 2015 (fair value measurement, defined benefit plans, inventory, and income taxes).

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