	Conceptual Framework:
Project	**Objective and qualitative characteristics**
Topic	**Sweep issues from the ballot draft**

Purpose of this meeting

1. Some board members were very concerned with some aspects of the ballot draft on the objective of financial reporting and qualitative characteristics chapters. This paper discusses their concerns:

   (a) The objective of financial reporting as drafted implied that there were two objectives rather than a single objective of financial reporting; and

   (b) Some board members think that *materiality* is not a constraint of financial reporting like *cost* and is related to *relevance*.

Objective of financial reporting

2. Some board members think that the objective of financial reporting as drafted implied that there were two objectives rather than a single objective of financial reporting. The ballot draft stated:

   > The objective of general purpose financial reporting[1] is to provide financial information about the reporting entity that is useful in making decisions about providing resources to the entity and in assessing whether the management and the governing board of that

[1] Throughout this Conceptual Framework, the terms *financial reports* and *financial reporting* refer to *general purpose financial reports* and *general purpose financial reporting* unless specifically indicated otherwise.

> entity[2] have made efficient or effective use of the resources provided.

3. We agree with them and suggest the proposed words below. We also moved some aspects from the ballot draft that discussed users' needs to this main section. We think the proposed single objective will also address those who were concerned about management's stewardship as an objective of financial reporting.

> OB2. The objective of general purpose financial reporting[3] is to provide financial information about the reporting entity that is useful in making decisions about providing resources to the entity through equity investments and loans or other forms of credit.
>
> OB3. Decisions of existing and potential investors, lenders, and other creditors are based on assessments of amounts, timing, and uncertainty of prospective cash outflows from the entity itself (in the form of dividends, interest, redemptions, maturities, or similar payments) and from the sale of their interests in that entity. An entity's ability to provide cash outflows depends on the amounts, timing, and uncertainty of the entity's prospective net cash inflows, and the prices of interests in that entity are affected by market perceptions about those prospective inflows.
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> OB4. Prospective cash inflows to an entity and market perceptions about those inflows are affected by the resources of the entity and on how well the management and the governing board of that entity[4] have discharged their responsibilities to make efficient or effective use of those resources. Examples of such responsibilities include protecting the entity's resources from unfavourable effects of economic factors such as price and technological changes and ensuring that the entity is complies with applicable laws, regulations and contractual provisions. Information about management's discharge of its responsibilities is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions.

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[3] Throughout this Conceptual Framework, the terms *financial reports* and *financial reporting* refer to *general purpose financial reports* and *general purpose financial reporting* unless specifically indicated otherwise.

[4] Throughout this Conceptual Framework, the term *management* refers to the *management and the governing board of an entity* unless specifically indicated otherwise.

Question 1
Do the Boards agree with the staff's proposed wording? If not, please tell us your suggested objective of financial reporting.

Materiality

4. Some board members think that *materiality* is not a constraint of financial reporting like *costs* because is it not a matter to be considered by standard-setters and is related to *relevance*. Furthermore, the definition of *relevance* and *materiality* are the same. Extracts from the ballot draft are as follows:

> QC6. This is because relevant financial information is capable of making a difference in the decisions made by users.
>
> QC34 Materiality is defined as Information is material if omitting it or misstating it could influence decisions that users make on the basis of a reporting entity's financial information. To determine whether information is material, both the nature and/or magnitude of the item(s) to which the information relates must be considered in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold or predetermine what could be material in a particular situation.

Background

5. The existing IASB *Framework* states that materiality is part of relevance.

> The relevance of information is affected by its nature and materiality. … Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful. [paragraphs 29 and 30]

6. The FASB's Concepts Statement No.2, *Qualitative Characteristics of Accounting Information*, similarly characterised materiality as a threshold rather than a constraint.

7. In developing the discussion paper, exposure draft and the final Chapters, the boards viewed that materiality is a constraint of financial reporting because it

affects both faithful representation and relevance, and it is a consideration for individual entities and their auditors but not standard-setters.

> Information is material if its omission or misstatement could influence the resource allocation decisions that users make on the basis of an entity's financial report. Because materiality depends on the nature and amount of the item judged in the particular circumstances of its omission or misstatement, it is not possible to specify a uniform quantitative threshold at which a particular type of information becomes material. When considering whether financial information is a faithful representation of what it purports to represent, it is important to take into account materiality because material omissions or misstatements will result in incomplete, biased or not free from error. [exposure draft paragraph QC28]
>
> … materiality is a consideration for individual entities and their auditors, not standard-setters, because whether something is material can be assessed only in relation to a particular reporting entity's situation. [exposure draft paragraph BC2.59]

8. Some respondents to the exposure draft think that materiality should be part of relevance:

> We agree also that materiality is a *pervasive* notion. It does not strike us as being a *constraint* though, because it is not clear to us how materiality constrains a reporting entity's ability to present information that meets the other qualitative characteristics. [CL137]
>
> Immaterial information should not be reported and material information should not be omitted. However, the notion of *materiality* is synonymous with relevance (or, equivalently, usefulness) because information is immaterial when its communication would not affect the decisions of users. Consequently, materiality is a redundant notion and should be dropped from the set of pervasive constraints. [CL99]

9. When redeliberating this issue for the final Chapter, the staff said:

> We think that materiality is related to relevance (because immaterial information is by definition incapable of making a difference in users' decisions) and cost (because any cost of reporting information that is not useful is too high). However, we think that as materiality has always been considered a separate constraint by most people, including standard-setters, and that we do not think that board members will change the way standards are considered, the staff

> proposes that materiality should continue to be a separate constraint of financial reporting.[5]

Staff analysis and recommendation

10. We recommend that materiality be discussed in the framework as an aspect of relevance instead of as a constraint. Unlike cost, materiality is not a constraint on a reporting entity's ability to report information. Nor does materiality affect standard-setters' decisions because it is an entity-specific consideration. It makes no difference whether or not immaterial information is reported because, by definition, it cannot affect a user's decisions (which is also the definition of relevance).

11. We propose moving the discussion of materiality to be part of the relevance section as stated below:

Relevance

> QC6. Relevant financial information is capable of making a difference in the decisions made by users. Information may be capable of making a difference in a decision even if some users choose not to take advantage of it or are already aware of it from other sources.
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> QC7. Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.
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> QC8 to QC10. … [Discussion on predictive and confirmatory value]
>
> ***Materiality***
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> QC11~~34~~. Materiality is an entity-specific aspect of relevance. Information is material if omitting it or misstating it could influence decisions that users make on the basis of a reporting entity's financial information. The individual entity determines whether information is material because~~,~~ both the nature and/or magnitude of the item(s) to which the information relates must be considered in the context of ~~an individual entity's~~ its financial report. Consequently, the Board cannot specify a uniform quantitative threshold or predetermine what could be material in a particular situation.

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[5] January 2009 IASB Agenda Paper 5/FASB Memorandum 80

Question 2
Do the Boards object to moving the discussion of materiality to the relevance section as recommended by the staff? If so, why do Board members consider it a constraint?