

MEMO# 31389

September 18, 2018

FASB Modifies Fair Value Measurement Disclosure Requirements and Finalizes Definition of Materiality

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September 18, 2018 TO: ICI Members SUBJECTS: Fund Accounting & Financial Reporting Valuation RE: FASB Modifies Fair Value Measurement Disclosure Requirements and Finalizes Definition of Materiality

The Financial Accounting Standards Board recently released an accounting standards update that modifies fair value measurement disclosures required by Topic 820.[\[1\]](#) As described below, the ASU eliminates, modifies, and adds disclosure requirements for fair value measurements. The ASU is a part of the Board's disclosure framework project, which is intended to improve the effectiveness of disclosures in the financial statement notes.

At the same time, FASB adopted a new chapter in its conceptual framework that explains what information the Board should consider including in its financial statement note disclosure requirements by describing the purpose of notes, the nature of appropriate content, and general limitations.[\[2\]](#) Finally, the Board adopted an update to an existing chapter of the conceptual framework for its definition of materiality.[\[3\]](#) The amendment aligns the FASB's definition of materiality with other definitions in the financial reporting system.

Changes to Fair Value Measurement Disclosures

The following disclosure requirements were removed from Topic 820:

1. The amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy;
2. The policy for timing of transfers between levels;
3. The valuation process for Level 3 fair value measurements;[\[4\]](#) and
4. For nonpublic entities, the changes in unrealized gains and losses for the period included in earnings (or changes in net assets) for recurring Level 3 fair value measurements held at the end of the reporting period.

The following disclosure requirements were modified in Topic 820:

1. For investments measured at net asset value in reliance on the practical expedient,[\[5\]](#) disclosure of the timing of liquidation of an investee's assets and the date when

restrictions from redemption might lapse are required only if the investee has communicated the timing or announced the timing publicly;

2. The measurement uncertainty disclosure required for investments categorized in Level 3 of the fair value hierarchy is intended to communicate information about the uncertainty as of the reporting date. The Board clarified that the disclosure relates to significant unobservable inputs at the measurement date, and does not relate to their possible future changes; and
3. In lieu of a rollforward for Level 3 fair value measurements, a nonpublic entity is required to disclose transfers into and out of Level 3, and purchases and issues of Level 3 assets and liabilities.

The ASU adds the following new disclosure requirements for Level 3 fair value measurements. These disclosures, however, are not required for non-public entities.

1. The range and weighted average of significant unobservable inputs used. The reporting entity should disclose how it calculated the weighted average (e.g., weighted by relative fair value). For certain unobservable inputs, a reporting entity may disclose other quantitative information, such as the median or arithmetic average, in lieu of the weighted average, if such information would be a more reasonable method to reflect the distribution of unobservable inputs; and
2. Changes in unrealized gains and losses for the period included in other comprehensive income.

The amendments in the ASU are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. An entity is permitted to early adopt any removed or modified disclosures immediately and delay adoption of the additional disclosures until their effective date.

Materiality

In 2015 the Board issued two exposure drafts addressing materiality. The first exposure draft proposed to amend the definition of materiality in the conceptual framework for financial reporting. The second exposure draft proposed to amend the accounting standards codification to explain the application of materiality to the preparation of financial statement note disclosures.[\[6\]](#)

The proposed amendments to the discussion of materiality included in the conceptual framework indicted that materiality is a legal concept established through legislative, executive, or judicial action, and stated that the FASB observes but does not promulgate definitions of materiality. The proposed amendments went on to state that the Board observes that the US Supreme Court's definition of materiality 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.

Stakeholders responding to the 2015 proposal expressed concern with the reference to materiality as a legal concept because of the perceived implication that legal professionals may need to be involved in evaluating materiality for financial reporting. Other commenters on the proposal, including the SEC's Investor Advisory Committee, expressed concern that the proposed amendments do not reflect the interests of investors and instead appear motivated to accommodate preparers of financial statements.

The recently adopted amendments to Chapter 3 of Concepts Statement No. 8 indicate that the omission or misstatement of an item in a financial report is material if, in the 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. According to the Board the recently adopted definition is consistent with that used by the SEC, PCAOB, and AICPA.

The Board decided to not move forward with the second exposure draft that proposed amendments to the codification explaining the application of materiality to financial statement note disclosures.

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endnotes

[1] The accounting standards update, [Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement, No. 2018-13](#) (August 28, 2018) is available on the FASB website.

[2] [FASB Statement of Financial Accounting Concepts No. 8, Conceptual Framework for Financial Reporting, Chapter 8, Notes to Financial Statements](#) (August 28, 2018) is available on the FASB website.

[3] [FASB Statement of Financial Accounting Concepts No. 8, Conceptual Framework for Financial Reporting, Chapter 3, Qualitative Characteristics of Useful Financial Information](#) (August 28, 2018) is available on the FASB website.

[4] The Board also removed the related implementation guidance at 820-10-55-105 which suggested disclosure of a) the group within the reporting entity that decides the valuation policies and procedures; b) the frequency and methods for calibration, back testing, and other testing procedures of pricing models; c) the process for analyzing changes in fair value measurements from period to period; d) how the reporting entity determines that third party information, such as broker quotes or pricing services, was developed in accordance with Topic 820; and e) the methods used to develop and substantiate unobservable inputs.

[5] ASC 820-10-35-59 permits an entity to measure the fair value of investments in funds that do not have a readily determinable fair value at net asset value per share.

[6] See ICI [Memorandum No. 29406](#), dated October 5, 2015.