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Exposure Draft ED/2015/8

IFRS Practice Statement:

Application of Materiality to Financial Statements

Comments to be received by 26 February 2016

IASB®

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Exposure Draft

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Exposure Draft ED/2015/8 IFRS Practice Statement *Application of Materiality to Financial Statements* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form. Comments need to be received by **26 February 2016** and should be submitted in writing to the address below, by email to commentletters@ifrs.org or electronically using our 'Comment on a proposal' page.

All comments will be on the public record and posted on our website unless the respondent requests confidentiality. Such requests will not normally be granted unless supported by good reason, for example, commercial confidence. Please see our website for details on this and how we use your personal data.

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Introduction

IN1 The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.[1] General purpose financial statements are a type of general purpose financial report.

IN2 The aim of this Exposure Draft of the IFRS Practice Statement *Application of Materiality to Financial Statements* (the '[draft] Practice Statement') is to provide guidance to assist management in applying the concept of materiality to general purpose financial statements prepared in accordance with International Financial Reporting Standards (IFRS). Information is material if omitting or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity.[2]

IN3 When applied within the context of the objective of general purpose financial statements, the concept of materiality helps management to decide what information should be included in, excluded from, or aggregated with other information in, the financial statements. The concept also helps management to decide how information should be presented in the financial statements to ensure the financial statements are clear and understandable.

IN4 The [draft] Practice Statement provides guidance in the following three main areas:

(a) characteristics of materiality;

(b) how to apply the concept of materiality when making decisions about presenting and disclosing information in the financial statements; and

(c) how to assess whether omissions and misstatements of information are material to the financial statements.

IN5 Whether information is material is a matter of judgement that depends on the facts involved and the circumstances of the specific entity. The [draft] Practice Statement aims to illustrate the types of factors that management should think about when considering whether information is material. However, because materiality should be considered within the context of a specific entity, this guidance does not aim to provide a complete list of considerations for making judgements about materiality when preparing the financial statements.

IN6 A Practice Statement is not a Standard and its application is not required in order to state compliance with IFRS. However, a jurisdiction that permits or requires IFRS could choose to formally adopt a Practice Statement into its national financial reporting requirements.

1 Objective taken from paragraph OB2 of the *Conceptual Framework for Financial Reporting*.

2 Definition taken from paragraph QC11 of the *Conceptual Framework for Financial Reporting*. Materiality is also defined in paragraph 7 of IAS 1 and paragraph 5 of IAS 8.

Invitation to comment

The IASB invites comments on any aspect of this Exposure Draft, particularly on the questions set out below.

Comments are most helpful if they:

(a) comment on the questions as stated;

(b) indicate the specific paragraph or group of paragraphs to which they relate;

(c) contain a clear rationale; and

(d) include any alternative that the IASB should consider, if applicable.

Respondents need not comment on all of the questions asked below and are also encouraged to comment on any additional matters relating to the application of materiality in the financial statements. In considering the comments received, the IASB will base its conclusions on the merits of the arguments for and against each alternative, not on the number of responses supporting each alternative.

Comments should be submitted in writing so as to be received no later than **26 February 2016**.

Question 1—Form of the guidance
A Practice Statement is not a Standard. The IASB's reasoning for issuing guidance on applying the concept of materiality in the financial statements in the form of a non-mandatory Practice Statement is set out in paragraphs BC10–BC15. (a) Do you think that the guidance should be issued as non-mandatory guidance? Why or why not? (b) Do you think that a Practice Statement is the appropriate form for non-mandatory guidance on applying the concept of materiality? Why or why not? If not, what alternative(s) do you propose and why?

Question 2—Illustrative examples
Do you find the examples helpful in the [draft] Practice Statement? Do you think any additional practical examples should be included? If so, what scenarios should the examples address? Please be as specific as possible and explain why those example(s) would be helpful to entities.

Question 3—Content of the [draft] Practice Statement

The [draft] Practice Statement proposes guidance in three main areas:

(a) characteristics of materiality;

(b) how to apply the concept of materiality in practice when presenting and disclosing information in the financial statements; and

(c) how to assess whether omissions and misstatements of information are material to the financial statements.

It also contains a short section on applying materiality when applying recognition and measurement requirements.

Please comment on the following and provide any suggestions you have for improving the [draft] Practice Statement:

(a) Do you think that any additional content should be included in the Practice Statement? If so, what additional content should be included and why?

(b) Do you think the guidance will be understandable by, and helpful to, preparers of financial statements who have a reasonable level of business/accounting knowledge and IFRS? If not, which paragraphs/sections are unclear or unhelpful and why?

(c) Are there any paragraphs/sections with which you do not agree? If so, which paragraphs/sections are they and why?

(d) Do you think any paragraphs/sections are unnecessary? If so, which paragraphs/sections are they and why?

(e) Do you think any aspects of the guidance will conflict with any legal requirements related to materiality within your jurisdiction, or a jurisdiction in which you file financial statements?

Question 4—Timing

The IASB plans to issue the Practice Statement before the finalisation of its Principles of Disclosure project.

The IASB has tentatively decided to include a discussion on the definition of materiality, and whether there is a need to change or clarify that definition within IFRS, in the Discussion Paper for its Principles of Disclosure project (expected to be issued early in 2016). Nevertheless, the IASB thinks that to address the need for guidance on the application of materiality, it is useful to develop the Practice Statement now.

The IASB does not envisage that the discussion about the definition of materiality or any other topics in its Principles of Disclosure project will significantly affect the content of the Practice Statement. Nevertheless, the IASB will consider whether any consequential amendments to the Practice Statement are necessary following the completion of the Principles of Disclosure project. Do you agree with this approach?

Question 5—Any other comments
Do you have any other comments on the [draft] Practice Statement? As mentioned in Question 4, a discussion about the definition of materiality will be included in the Discussion Paper in the Principles of Disclosure project, so the IASB is not asking for comments on the definition at this time.

How to comment

Comments should be submitted using one of the following methods.

Electronically (our preferred method)	Visit the 'Comment on a proposal' page, which can be found at: go.ifrs.org/comment
Email	Email comments can be sent to: commentletters@ifrs.org
Postal	IFRS Foundation 30 Cannon Street London EC4M 6XH United Kingdom

All comments will be on the public record and posted on our website unless confidentiality is requested. Such requests will not normally be granted unless supported by good reason, for example, commercial confidence. Please see our website for details on this and how we use your personal data.

The [draft] IFRS Practice Statement *Application of Materiality to Financial Statements* is set out in paragraphs 1–80. The [draft] Practice Statement should be read within the context of its objective, its Basis for Conclusions and within the context of International Financial Reporting Standards (IFRS).

[Draft] IFRS Practice Statement *Application of Materiality to Financial Statements*

Objective

1 The objective of this [draft] IFRS Practice Statement *Application of Materiality to Financial Statements* (the '[draft] Practice Statement') is to assist management in applying the concept of materiality to general purpose financial statements prepared in accordance with International Financial Reporting Standards (IFRS).

Scope

2 This [draft] Practice Statement is intended to be applied in preparing general purpose financial statements in accordance with IFRS.

3 Sometimes information is incorporated in the financial statements[3] by cross-reference to another statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time.[4] Without the information incorporated by cross-reference, the financial statements are incomplete. This [draft] Practice Statement also applies to information that is incorporated by cross-reference.

General characteristics of materiality

Introduction

4 Materiality is a general concept that is widely used both in financial reporting and for other purposes. For example, it is common for legal agreements to refer to material information, usually within a specific context such as referring to 'material changes to the terms of the offer' which may or may not be financial in nature.

5 In many jurisdictions there are requirements that oblige listed entities to keep investors informed about aspects of their business on an ongoing basis. For example, during a takeover bid the parties might be required to keep markets informed about the terms of the takeover offer. There might also be ongoing obligations, beyond the requirement to file financial statements, to disclose price-relevant information known to the entity. Some jurisdictions use materiality principles, and supplementary guidance, to enforce these obligations. For example, an exchange may have guidelines on when a listed company issues a profit warning. These guidelines have probably been developed by considering the point at which information becomes material and should be publicly disclosed.

6 The way in which the term 'materiality' is understood in the contexts above is expected to be consistent with the way in which the term is expected to be

3 Throughout this [draft] Practice Statement, the term 'financial statements' refers to general purpose financial statements unless specifically indicated otherwise.

4 For example, see paragraph 21B of IFRS 7 *Financial Instruments: Disclosure*.

applied to financial reporting. However, IFRS contains a definition to help management apply the concept in preparing financial statements in accordance with IFRS.

IFRS definition

7 The *Conceptual Framework for Financial Reporting* ('the *Conceptual Framework*') provides the following definition of materiality (there are similar definitions in IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*):

> 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 and magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report.[5]

8 The words 'could influence' in the definition of materiality are clarified in IAS 1. IAS 1 states that the assessment of materiality should take into account how users 'could reasonably be expected to be influenced' in making economic decisions on the basis of financial statements.[6]

9 Financial statements are a type of general purpose financial report that summarise for external parties financial information that is recorded internally by an entity. Applying the concept of materiality ensures that financial information that could reasonably be expected to influence decisions that users make on the basis of those financial statements is separately presented in the primary financial statements (sometimes referred to as presenting information 'on the face of a financial statement')[7] or separately disclosed in the accompanying notes.

10 The concept of materiality is also intended to be applied as a filter to ensure that the financial statements are an effective and understandable summary of the information contained in an entity's internal accounting records. If information in the financial statements is not summarised or aggregated in a clear and helpful manner, for example if an excessive amount of immaterial information is disclosed or material information is obscured or concealed, it makes the financial statements less understandable for users.[8]

Pervasiveness

11 The concept of materiality is pervasive to the preparation of financial statements. Requirements in IFRS must be applied if their effect is material to

5 See paragraph QC11 of the *Conceptual Framework*. However paragraph 2.11 of the Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting*, proposes to modify this definition by including the word 'primary' before the word 'user'.

6 See paragraph 7 of IAS 1.

7 The term 'primary financial statements' is expected to be defined as part of the Principles of Disclosure project. For the purposes of this [draft] Practice Statement, the primary financial statements comprise the financial statements excluding the notes. In other words, the primary statements consist of the statement of financial position, statement of comprehensive income, statement of changes in equity and statement of cash flows.

8 See paragraph 30A of IAS 1.

the complete set of financial statements. Similarly a requirement in IFRS need not be applied if the effect of not applying it is not material.

Judgement

12 When assessing whether information is material to the financial statements, management applies judgement to decide whether information could reasonably be expected to influence decisions that the users make on the basis of those financial statements. When applying such judgement, management should consider both the entity's specific circumstances and how the information will be used by users of the financial statements. An entity's circumstances change over time and so materiality is reassessed in each reporting period in the light of the entity's circumstances during that period. This assessment should include comparing the current year information with comparative information for prior periods to assess changes in the entity's activities or circumstances during the period.

Users of the financial statements and their decisions

13 The definition of materiality refers to decisions made by the *users* of general purpose financial reports. The *Conceptual Framework* identifies the primary users of general purpose financial reports as follows and states that they are the users to whom those reports are directed:

> OB5 Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial reports are directed.
>
> OB10 Other parties, such as regulators and members of the public other than investors, lenders and other creditors, may also find general purpose financial reports useful. However, those reports are not primarily directed to these other groups.

14 Having identified the primary users of the entity's general purpose financial statements and other general purpose financial reports, management should consider the characteristics of those users, including their likely interests and what types of decisions they are making. This will then enable management to identify the information that the primary users could reasonably expect to receive and that could reasonably be expected to influence their decisions.

Characteristics of the primary users of financial statements

15 The *Conceptual Framework* sets out basic attributes of the primary users of the financial statements:

> QC32 Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

16 Although management is entitled to assume that the primary users have a reasonable knowledge of business and economic activities, they cannot assume that the primary users are financial reporting experts. Furthermore, management should focus on typical and rational users, rather than a single, atypical user that is behaving unreasonably or irrationally.

17 An entity may have several different types of primary users. For example, the entity's investors may include individuals holding different classes of shares, institutional investors, bond investors, employees with options to buy shares and/or other types of investors. Across the range of possible primary users there may be a broad range of information needs and some may have dissimilar information needs and expectations. For example, some information might be useful to some primary users, but not others. If an entity has many classes of primary users, the financial statements should present and disclose information so as to meet the common information needs of a broad range of those classes.

18 Management cannot reasonably be expected to meet all of the information needs of all of the entity's primary users. For example, a single investor might be particularly interested in detailed information about an entity's expenditure in a specific location because that investor may also have a business operating in that location, but such detailed information may be inconsequential for the other primary users.

19 Nevertheless, information would usually be expected to be material if it is relevant to either a range of primary users across different classes or to a significant class of primary user (for example a class with a large number of users).

Decisions made by the primary users of financial statements

20 The *Conceptual Framework* provides a description of the decisions made by the primary users and their information needs:

> OB2 The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.
>
> OB3 Decisions by existing and potential investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases. Similarly, decisions by existing and potential lenders and other creditors about providing or settling loans and other forms of credit depend on the principal and interest payments or other returns that they expect. Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity. Consequently,

existing and potential investors, lenders and other creditors need information to help them assess the prospects for future net cash inflows to an entity.

OB4 To assess an entity's prospects for future net cash inflows, existing and potential investors, lenders and other creditors need information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's 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 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.

OB6 However, general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks.

21 In developing Standards, the IASB seeks to identify the information that is expected to meet the needs of a broad range of primary users, for a wide variety of entities. Consequently, when management considers what information should be provided in the financial statements, the requirements in IFRS should provide the basis for that assessment. The requirements within IFRS have been developed by the IASB taking into consideration the balance between the benefits of providing information to users of the financial statements and the costs of complying with those requirements. Consequently, the cost of applying the requirements in IFRS is not a factor for management to consider when assessing whether information is material. However, it is not sufficient to apply the presentation and disclosure requirements in a Standard mechanically, without considering the entity's specific circumstances, whether the entity's primary users have any special needs and whether the information provided meets or exceeds the needs of an entity's primary users.

22 Some examples of ways in which management can identify whether information is or is not useful to the primary users include:

(a) considering information about users' expectations, including how they think the entity should be managed (ie stewardship) gathered through discussions with users or from information that is publicly available;

(b) considering what decisions management themselves would seek to make and what information they would want as users of financial information in similar situations (ie as if they were external users themselves and did not possess the internal knowledge held by management for example about key risks or key value drivers);

(c) observing users' or market responses to information or requests for information, for example on particular transactions or disclosures issued by the entity, or responses by external parties such as analysts; and

(d) observing the types of information provided by entities operating in the same industry. However, while there are similarities between entities in the same industry, it does not mean that the same kind of information will necessarily be material.

23 Financial information is capable of making a difference to decisions if it has predictive value, confirmatory value or both.[9] The focus of the materiality assessment is whether the information 'could reasonably be expected to influence' decisions made by users rather than whether that piece of information alone is capable of changing their decisions. Information is material if it confirms trends that could reasonably be expected to reinforce decisions made by the primary users. For example, an entity's earnings may have increased in line with expectations and this information may reinforce a decision to buy, hold or sell shares in the entity.

Qualitative and quantitative assessment

24 The assessment of whether information is material depends on its size and nature, judged in the particular circumstances of the entity.[10] Consequently, applying materiality involves assessing qualitative and quantitative factors.

25 Quantitative information, such as an item's value or carrying amount, is not the only factor that is considered when assessing whether an item is material. The assessment of whether an item is material also depends on qualitative considerations, including entity-specific factors. Consequently, it would not be appropriate for an entity applying IFRS to rely on purely numerical guidelines. Similarly, it is not appropriate for IFRS to specify a uniform quantitative threshold for materiality or to predetermine what is material in a particular situation.

26 However, while quantitative thresholds are not in themselves determinative, they can be a helpful tool in applying the concept of materiality. A quantitative threshold may provide the basis for a preliminary assessment that an amount is likely to be material or immaterial; for example if it is below a specified percentage of profit or net assets. However, a materiality assessment also requires consideration of the nature of the item and the entity's circumstances.

27 Examples in which considering quantitative aspects may not be helpful when making assessments about materiality include:

(a) in deciding whether a particular accounting policy should be disclosed, management considers whether its disclosure is necessary to understand the financial statements. A description of an accounting policy would be material by its nature if the primary users would be unable to understand the financial statements sufficiently for their decision-making purposes if it were not disclosed or if it were

9 See paragraph QC7 of the *Conceptual Framework*.

10 See paragraph 7 of IAS 1.

inadequately disclosed. An example of an inadequate and potentially immaterial disclosure would be when an entity simply quotes the requirements within IFRS without tailoring the description of its accounting policy to explain how it has been applied by the entity.

(b) in considering the materiality of uncertainties and contingencies, the monetary amounts involved are not always known or may have a potentially wide range of outcomes. Consequently, when making judgements on whether information about these uncertainties and contingencies is material, management considers factors such as the nature of the items, their potential financial effect and timing of cash outflows.[11]

28 For some matters, materiality considerations will be more sensitive because they relate to key statistics used by the primary users, or to targets communicated by management, or otherwise relate to areas of particular importance to the primary users. Examples of items for which this may be the case include:

(a) those that could trigger non-compliance with regulatory requirements or loan covenants;

(b) those that could reasonably be expected to be key to the entity's future operations, even if they do not have a material effect on the primary financial statements in the current period. An example would be part of the entity's business that is currently relatively small but for which management are planning an expansion; or

(c) rare or unusual transactions, for which management's reasoning for undertaking the transactions could reasonably be expected to influence decisions made by the primary users. For example, a transaction may be unusual because it was on special terms with a related party of the entity.

Individual and collective assessment

29 The assessment of whether information is material or immaterial should be undertaken on both an individual and a collective basis.[12] Even if information is judged not to be material in isolation (ie it is considered immaterial), it might be material when considered together with other information (for example see paragraph 39(c)).

Presentation and disclosure in the financial statements

The context of the materiality assessment

30 The primary objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Judgements on whether information is material should be made within the context of this

11 Key factors to consider can often be determined by looking at the IFRS disclosures for those items—for example, see paragraph 85(b) of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

12 See paragraph 7 of IAS 1.

objective and by considering the complete set of financial statements (ie the primary financial statements together with the notes). Financial statements also show the results of the management's stewardship of the resources entrusted to it.[13]

31 Applying the concept of materiality when preparing the financial statements requires judgement to be applied in the light of the objective of the financial statements. Management should use judgement not only to decide whether to include or exclude information in the financial statements, but also in considering how information should be presented or disclosed in those financial statements.

32 Management should also assess whether information is material within the context of the different parts of the financial statements; for example:

(a) whether and how information should be presented separately in the primary financial statements;

(b) whether and how information should be included in the notes; and

(c) whether the assessment in paragraph 32(a) or (b) changes after reviewing the complete set of financial statements.

33 The last step in paragraph 32(c) would include an assessment of the overall mix of information in the financial statements. This overall assessment could lead to a reassessment of how information is presented or disclosed in order to make it more understandable or give it increased prominence. The overall assessment may also identify that some information should be supplemented (for example to highlight key trends) or be removed (for example if it is sufficiently covered by other information).

Immaterial information

34 Providing immaterial information in the financial statements may obscure material information and consequently mean that the financial statements are less understandable. For example, if an entity discloses detailed information about transactions that do not have a material effect on the entity's reported financial position or financial performance this may make the material information harder to find. Disclosing immaterial information increases the length of financial statements, makes them less understandable and requires the primary users to spend more resources in searching for material information.

35 IFRS does not prohibit entities from disclosing immaterial information. Nevertheless, it requires them to consider whether disclosure of immaterial information results in material information being obscured.[14]

13 See paragraphs 9 of IAS 1 and paragraph OB2 of the *Conceptual Framework*. Note: paragraph 3.4 of the Exposure Draft *Conceptual Framework for Financial Reporting* is proposing to modify the description of the objective of financial statements (and includes an explicit discussion of stewardship considerations) as follows: 'The objective of financial statements is to provide information about an entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources'.

14 See paragraphs 30A and BC30F of IAS 1.

36 In some cases it might be helpful to disclose the fact that a particular issue is immaterial to the entity. For example, management may wish to inform the primary users that the entity is not exposed to a particular risk normally associated with an item that is of particular interest to market participants. This can often be done by making a simple statement rather than including detailed information or analysis about the amount or nature of the item. For example, an international bank may explain that it does not hold a material amount of debt in a particular jurisdiction or industry that is suffering severe financial difficulties, without providing further information. In this case, the statement that the entity is holding an immaterial amount of debt may provide material information about how effective management has been in protecting the entity's resources from unfavourable effects of economic conditions.

Aggregating and disaggregating information

37 IAS 1 states:

> 29 An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial.
>
> 30 Financial statements result from processing large numbers of transactions or other events that are aggregated into classes according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data, which form line items in the financial statements. If a line item is not individually material, it is aggregated with other items either in those statements or in the notes. An item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes.
>
> 30A When applying this and other IFRSs an entity shall decide, taking into consideration all relevant facts and circumstances, how it aggregates information in the financial statements, which include the notes. An entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions.

38 If a line item in the primary financial statements is not individually material, it does not need to be disaggregated further, and it can be aggregated with other related or similar items even if IFRS prescribes separate presentation. However, an item that is not material in the primary financial statements may warrant separate presentation in the notes. For example, management may decide to combine all of its financial assets that are measured at fair value through profit or loss together in one line item on the face of the statement of financial position, if separate presentation is not considered material within the context of the primary financial statements. However, management should also consider whether separate presentation of different classes of financial assets is material within the context of the notes because of the different characteristics of those financial assets. For example, there may be different types of financial assets (such as equity or debt instruments) or assets may have different risk characteristics. Nevertheless, line items in the primary financial statements are

disaggregated in the notes only if information about their components is material. If, for example, the components of the line item are similar and there is no single significant component, disaggregation in the notes may not provide useful information.

39 Aggregating information means that information about the components becomes less detailed. Hence, when making judgements about whether to aggregate information, either in the primary financial statements or in the notes, management is assessing whether the information that would be 'lost' through aggregation is material. For example:

(a) if an entity has 500 similar leases of similar assets, then combining them together for disclosure purposes may not lead to a loss of material information. However, if a subset of those 500 leases has significantly different characteristics from the others (such as residual value guarantees or extension options), separate information about that subset may be material.

(b) an entity may have a small net foreign exchange difference as a result of transactions in foreign currencies. That net difference might have arisen from a large number of small exchange gains on a broad base of recurring transactions and a substantial loss that resulted from one speculative forward foreign exchange transaction. IAS 21 *The Effects of Changes in Foreign Exchange Rates* specifies only that the amount of exchange differences is disclosed. When making judgements about materiality, the entity should assess whether the loss should be reported separately from the other exchange differences. The fact that a large loss was incurred relative to the other transactions, and that the loss was from speculative activity, suggests that aggregating these exchange differences would result in a loss of material information. In this scenario, information that could influence users' opinions of management's stewardship would be lost through aggregation.

(c) an entity might acquire many small businesses during the reporting period. Each acquisition might be individually immaterial, but in aggregate the acquisitions could change the structure and prospects of the business in a material way. Because it is the aggregated effect of the business combinations that is material, it may be appropriate to include information about the acquisitions in aggregate.

Primary financial statements versus the notes

Primary financial statements

40 The primary financial statements provide a structured summary of the entity's:

(a) recognised assets, liabilities, equity, income and expenses;

(b) cash flows; and

(c) contributions from, or distributions to, holders of equity claims.

41 The role of the primary financial statements in meeting the objective of financial statements is to provide information that gives an overview of the financial position and performance of an entity. Such an overview may be useful for the primary users as follows:

(a) obtaining essential information about the entity's assets, liabilities, equity, income, expenses, cash flows and contributions and distributions from/to holders of equity claims;

(b) understanding the past financial position and performance of the entity in order to forecast net cash inflows and to understand trends;

(c) making high-level comparisons between entities and reporting periods; and/or

(d) identifying areas of particular interest for which the user could expect to find additional information in the notes.[15]

42 When assessing which line items should be presented on the face of a primary financial statement, management considers how to provide a representative summary of the financial information of the entity—for example, it considers which items or classes of items should be presented separately because of their relative size or their nature. Management should also consider the degree of similarity or difference between individual line items when determining whether those items should be combined or presented separately.

43 Management considers whether an item is material by considering it relative to individual line items, subtotals and totals on the face of an individual statement, as well as to each overall individual statement. Management should also consider the relationships between each of the primary financial statements. When presenting line items, management should assess which items serve as useful signposts to link the face of the statements with the detail in the notes to help the primary users navigate through the financial statements.

44 If recognised items are not presented separately in the primary financial statements, then management considers how they should be aggregated with other items (see paragraphs 37–39).

Notes

45 Because of their structure, the amount and type of detail that can be included in the primary financial statements is limited. The notes:

(a) explain the information presented in the primary financial statements in greater detail; and

(b) supplement the primary financial statements with additional information that is necessary to meet the objective of financial statements (see paragraph 30).[16]

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15 The guidance in paragraphs 41, 45 and 47 is drafted in line with the IASB's initial thinking during its Principles of Disclosure project—see paragraph BC21 of the Basis for Conclusions on this [draft] Practice Statement.

16 The guidance in paragraphs 41, 45 and 47 is drafted in line with the IASB's initial thinking during its Principles of Disclosure project—see paragraph BC21 of this [draft] Practice Statement.

46 Although the concept of materiality does not change when applied to the notes, the context in which that concept is applied is different. This is because the notes have a different role from the primary financial statements in meeting the objective of financial statements (see paragraphs 40–44). Consequently, this may result in different conclusions regarding whether information is material in the different contexts and whether further disaggregation in the notes is necessary compared to the face of a primary financial statement.

47 One of the main objectives of the notes, as an integral part of the financial statements, is to amplify and explain the items in the primary financial statements. Information that is material to the financial statements, but for which separate presentation in the primary financial statements is not material, is provided in the notes. Nevertheless, if information is material in the context of the primary financial statements then disclosure in the notes is not sufficient. For example, management may decide to present only a single amount for total revenue on the face of the statement of comprehensive income. In the notes management should disaggregate the amount and disclose further information, as appropriate, to enable the primary users to understand the nature, amount, timing and uncertainty of the revenue and related cash flows.[17]

48 In addition to amplifying and explaining the items in the primary financial statements, the notes also provide any other financial information that is necessary to meet the objective of financial statements (see paragraph 30) and could reasonably be expected to influence decisions of the primary users. Some information typically found in note disclosures does not relate to line items in the primary financial statements; such as material non-adjusting events after the balance sheet date. Furthermore, some information relates to items that are not recognised, such as contingent liabilities.

Disclosures specified in IFRS

49 IAS 1 states:

> 31 Some IFRSs specify information that is required to be included in the financial statements, which include the notes. An entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material. This is the case even if the IFRS contains a list of specific requirements or describes them as minimum requirements. An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

50 The disclosure requirements in IFRS are the basis for management to decide what information should or should not be disclosed in the notes. When a Standard contains a disclosure requirement and the related information to satisfy that requirement is material, then management should disclose that

17 The guidance in paragraphs 41, 45 and 47 is drafted in line with the IASB's initial thinking during its Principles of Disclosure project—see paragraph BC21 of this [draft] Practice Statement.

information in line with the IFRS requirement. However, this does not mean that IFRS disclosure requirements should be treated as a checklist, without regard to the entity's circumstances and the needs of its primary users. Management is not required to provide disclosures in the level of detail specified by a Standard, or even provide them at all, if the related information is not material, because immaterial information does not need to be disclosed.

51 When Standards contain disclosure objectives, management should make an overall assessment of whether it has satisfied those objectives for material information. This includes considering:

(a) whether financial statements provide all the specified disclosure requirements related to an objective; and

(b) whether information in addition to that specified in the Standards should be disclosed to meet those objectives and help users understand the information provided.

52 An entity must also provide information in addition to the information specified in IFRS if that information is relevant to an understanding of the financial statements and could reasonably be expected to influence decisions that the primary users make on the basis of the financial statements.

53 For example:

(a) IAS 16 *Property, Plant and Equipment* prescribes specific disclosure requirements for property, plant and equipment. However, even if property, plant and equipment is presented as a separate line item in the statement of financial position, not all disclosures specified in IAS 16 will automatically be material for an entity. For example, if the amount of contractual commitments for the acquisition of property, plant and equipment is not material, such disclosure is not required. Furthermore, management should provide other information about property plant and equipment, even if not specifically required by IFRS, if that information could reasonably be expected to influence decisions that the primary users make on the basis of the financial statements.

(b) IAS 19 *Employee Benefits* prescribes detailed disclosure requirements about the amount, timing and uncertainty of future cash flows for defined benefit plans (paragraphs 145–147 of IAS 19), including a sensitivity analysis. However, if an entity has several large plans and some smaller plans, then for the smaller plans, it may be sufficient to disclose only the key risks and sensitivities.

(c) IFRS 2 *Share-based Payments* prescribes detailed disclosure requirements for an entity that has share-based payment transactions. If share-based payments are material to the financial statements, the entity considers which information required by paragraphs 44–52 of IFRS 2 is useful to the primary users and also whether any additional information should be disclosed. In some cases, instead of disclosing all the information in paragraphs 44–52 of IFRS 2, it might be appropriate to summarise some information, such as providing a range of vesting periods, if that does not lead to the loss of material information.

(d) IFRS 8 *Operating Segments* requires disclosure of information that might be recognised and measured on a different basis than IFRS (even though IFRS 8 requires the segment information to be reconciled to corresponding IFRS figures in the entity's financial statements). Nevertheless the concept of materiality should still be applied by management in deciding what information to include in the financial statements about an entity's operating segments. IFRS 8 also provides additional criteria that management should consider as part of its materiality judgements, including segment aggregation criteria, and quantitative thresholds for segments.

Reviewing note disclosures at each reporting date

54 If a disclosure was material to the prior period's financial statements, but the same level of detail or type of information is not material to the current-year financial statements, the disclosure often does not need to be repeated in the same level of detail. The information could be summarised or in some cases omitted altogether provided that material information, for example information needed to identify key financial trends, is not lost. For example:

(a) if in the prior period the entity undertook a significant business combination, management would consider what information is important to an understanding of the current period financial statements. This might lead management to conclude that it should not reproduce all of the detail about the business combination provided in the prior period's financial statements. However, management should still provide sufficient information for comparisons to be made between years and to the extent that the information is relevant to understanding the current period financial statements, including the comparative information.

(b) a detailed reconciliation of property, plant and equipment may have been included in the prior year financial statements because of changes that took place in that period. However, it might not be necessary to include such a detailed reconciliation in the current period if there have been limited changes in the current year. For example, it may be appropriate to aggregate some of the information that was presented separately in the prior year reconciliation when preparing comparative information for the current period financial statements.

(c) if an impairment loss was recorded for an item of plant or machinery in the prior year, but not in the current year, then detailed impairment disclosures may not be material in the current year.

55 Nevertheless, materiality is not assessed only by reference to the current reporting date. For example:

(a) information about a prior year business combination might be material in the current period if it enables the primary users to understand the effect of the prior year business combination on the entity's performance for the current reporting period. For example, an acquirer discloses information that enables the primary users of its financial statements to evaluate any material effects of adjustments recognised in the current reporting period that relate to business combinations in previous reporting periods.

(b) a fall in sales of a major product from a material amount in the prior year to an immaterial amount in the current year may be a material change that should be separately disclosed or identified in the current year.

Complete set of financial statements

56 IAS 1 requires an assessment of whether information is material individually and collectively (see paragraph 29). Consequently, the assessment of whether an individual piece of information is material in the financial statements is not made in isolation. This assessment should also consider whether the information is material in combination with other information in the complete set of financial statements. This wider perspective enables management to consider the overall picture of the entity's financial position, financial performance and cash flows, including information about financial trends. It also enables an overall assessment of whether information in the financial statements is communicated in an effective and understandable way. For example management should consider whether matters of particular importance have been given sufficient prominence and whether related information is presented in such a way that the linkage is clear.

57 The primary users of financial statements consider information in a wider context than the financial statements. For example, they also consider other sections of the financial report, information about the industry that the entity operates in and its competitors, and about the economy in general. Consequently, the assessment of whether and how information should be disclosed in the financial statements may depend on the availability of other information from publicly accessible sources. Nevertheless, public availability of information does not relieve the entity of the obligation to disclose information that is specifically required by IFRS in the financial statements if that information is material.

58 The financial statements are intended to be a comprehensive document that provides information about the financial position, financial performance and cash flows of an entity that is useful to the primary users in making decisions. Consequently it would not be appropriate to omit information that is specifically required by IFRS about the entity from the financial statements solely because it had previously been included in a press release or other publicly available document.

Interim reporting

59 Materiality is a pervasive concept in IFRS. The same general principles on the application of materiality to the annual financial statements also apply to interim financial statements. However, the context and objectives in which the concept is applied are different. This is because the objective of interim financial statements is different from the objective of annual financial statements. In particular, interim financial statements are intended to provide

an update on the latest complete set of annual statements. Accordingly, interim financial statements focus on new activities, events, and circumstances and do not duplicate information previously reported.[18]

60 Furthermore, even though IAS 34 *Interim Financial Reporting* regards interim financial statements as an update of the latest annual financial statements, IAS 34 specifies that materiality for interim financial statements is assessed in relation to the interim period financial data, not forecast annual data.[19] IAS 34 provides the following guidance on the assessment of materiality for interim financial statements:

> 23 In deciding how to recognise, measure, classify, or disclose an item for interim financial reporting purposes, materiality shall be assessed in relation to the interim period financial data. In making assessments of materiality, it shall be recognised that interim measurement may rely on estimates to a greater extent than measurements of annual financial data.
>
> 25 While judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual items, changes in accounting policies or estimates, and errors are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The over-riding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period.

Recognition and measurement

61 Much of the content of this [draft] Practice Statement focusses on providing guidance on the application of materiality when presenting and disclosing information in the financial statements. However, similar considerations also apply to the recognition and measurement of the information that is provided in the financial statements.

62 IFRS recognition and measurement requirements are applied if their effect is material to the financial statements. In particular, IAS 8 states that financial statements do not comply with IFRS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows.[20]

Practical expedients

63 IFRS does not specify requirements for an entity's internal record keeping procedures. Consequently, management might decide not to apply a requirement in a Standard when it records a particular item, provided it later

18 See paragraph 6 of IAS 34.

19 See paragraph IN9 of IAS 34.

20 See paragraph 41 of IAS 8.

makes an adjustment to ensure the information is in accordance with IFRS for financial reporting purposes. For example, an entity might maintain a periodic inventory system and then later adjust amounts for the purchases and inventory for financial reporting purposes based on physical stock counts.

64 An entity might have an internal policy of capitalising capital expenditures only in excess of a specified threshold and recognising smaller amounts as an expense, because any smaller amounts are considered to be clearly immaterial. Management has assessed that this departure from IFRS is unlikely to have a material effect both on the current financial statements and in future financial statements, because it is clear such expenditure could not reasonably be expected to influence decisions made by the primary users. Such a policy should nevertheless be reassessed periodically to ensure that these assumptions remain appropriate. Provided that such a practice does not have a material effect on the financial statements, it would not prevent the entity's financial statements from complying with IFRS (see also paragraphs 77–79).

65 It is also conventional for entities to select a monetary unit, for example CU1,000[21], and to round to the nearest unit when preparing the financial statements. The chosen unit is set sufficiently low to ensure that the resulting loss of precision and detail is immaterial.

66 Provided information is fairly presented in accordance with IFRS in the financial statements, it is beyond the scope of IFRS to specify how that information is recorded internally. Nevertheless, there may be legal requirements in an entity's jurisdiction that prescribe requirements for an entity's internal record-keeping procedures.

Omissions and misstatements ('misstatements')

Identified misstatements

67 Omissions (ie excluding relevant data/information), errors and other misstatements of information (eg describing information ambiguously or obscuring material information) (collectively referred to as 'misstatements' in this document) are material if, individually or collectively, they could reasonably be expected to influence decisions that the primary users make on the basis of the financial statements. Management should assess whether misstatements of information are material to the financial statements. This assessment includes considering any misstatements in the comparative information included in respect of prior periods.

68 Errors are a type of misstatement in the entity's financial statements arising from a failure to use, or misuse of, reliable information that:

(a) was available when financial statements for those periods were authorised for issue; and/or

21 In this [draft] Practice Statement, currency amounts are denominated in 'currency units' (CU).

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.[22]

Such errors include the effects of arithmetical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

69 In assessing whether misstatements are material, management should take into account how precisely transactions can be measured. For example most cash disbursements or cash sales are capable of precise measurement and so misstatement of these transactions would not be expected to occur frequently if an entity has effective internal controls. For other transactions, precise measurement will not be possible and management is required to make estimates; for example provisions for expected environmental clean-up costs[23] or Level 3 fair value measurements.[24] Because of the uncertainty inherent in estimates, it may be more difficult to assess misstatements in these situations. Consequently, the disclosures in the financial statements should ensure that the primary users are made aware of the subjectivity involved in recognising and measuring such items. When considering whether an adjustment should be treated as a change in estimate or the correction of an error management should be guided by the requirements in IAS 8.

Current period misstatements

70 Two common examples of situations in which management may identify that it has misstated information in the entity's financial statements are:

(a) in preparing the financial statements, management might identify bookkeeping errors. Examples could include a mathematical error in an adjusting journal entry, or a double counting or omission of a physical inventory count.

(b) after the preliminary announcement of financial information and/or after the financial statements have been prepared but not yet authorised for issue, additional relevant information could be identified.

71 Management should amend the financial statements for all material misstatements identified before the entity's financial statements are authorised for final issue regardless of the cost of doing so.[25] Furthermore, it would be considered good practice that management corrects all misstatements, even those that are not material. However, in some circumstances correcting an immaterial misstatement may be unduly costly or delay publication of an entity's financial statements. In such a case, management should evaluate all identified misstatements to consider whether, in relation to individual line items, subtotals, or totals in the financial statements, failure to address those misstatements could result in a material misstatement and hence result in

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22 Derived from the definition of a prior period error in paragraph 5 of IAS 8.

23 See measurement guidance in IAS 37.

24 See measurement guidance in IFRS 13 *Fair Value Measurement*.

25 See IAS 10 *Events after the Reporting Period* for the requirements about the date when the financial instruments are authorised for issue.

non-compliance with IFRS. This requires consideration of the pervasiveness of the misstatements in the financial statements (eg whether they affect numerous line items). For example, an error recorded on a purchase of inventories will affect other balances such as trade payables, cost of sales and closing inventory.

72 IAS 1 requires an assessment of whether information is material individually and collectively. Consequently, management first considers whether each misstatement is material, irrespective of its effect when combined with other misstatements. If the misstatement causes the financial statements to be materially misstated, that effect cannot be offset by other misstatements. For example, if an entity's investment income is material within the context of the financial statements and it is materially overstated, the financial statements will be materially misstated even if the effect on profit is completely offset by an equivalent overstatement of expenses.

73 Management then considers whether any misstatements are material on a collective basis. Even if a misstatement is judged not to be material on its own, it might be material when considered with other information.

Prior period errors

74 Prior period errors are errors in the entity's financial statements for one or more prior periods. Paragraph 42 of IAS 8 states

> "... an entity shall correct material prior period errors retrospectively in the first set of financial statements authorised for issue ..."

75 Errors in a prior period are sometimes not discovered until the current period. Any material prior period errors are corrected retrospectively by amending the comparative information presented in the financial statements unless it is impracticable to determine either the period specific effects or the cumulative effect of the error.[26]

76 Management will also need to consider the effects in the current period of immaterial prior period errors if it is possible that those errors could cause the current period financial statements to be materially misstated. Because the error relates to information in the prior year, it may be less likely to influence materiality decisions than a similar misstatement in the current year, because the passage of time may make such information less relevant.

Misstatements made intentionally to mislead

77 Paragraph 41 of IAS 8 states:

> ...Financial statements do not comply with IFRSs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows...

78 Sometimes a deliberate decision is made by management not to apply a requirement in a Standard because management has concluded that the effect of not applying that requirement will not lead to a material difference in the financial statements (for an example, see paragraph 64). Unless management

26 See paragraph 43 of IAS 1.

has intentionally misstated items to achieve a particular presentation or result, such practical expedients would not prevent the financial statements from complying with IFRS. However, if management intentionally misstates items to achieve a particular presentation or result it has done so presumably because it thinks that particular presentation or result could reasonably be expected to influence the decisions of the primary users of the financial statements and such misstatements are material.

79 For example there is a difference between:

(a) management deciding not to discount a liability to reflect the time value of money because there is no material difference between the discounted and non-discounted value, and

(b) management deliberately choosing to use an inappropriate discount rate to in order to reduce the amount of the liability.

A deliberate choice by management to use an inappropriate discount rate would be material because management is presumably doing so in order to 'achieve a particular presentation of an entity's financial position, financial performance or cash flows'.

Approval by the Board of the Exposure Draft IFRS Practice Statement *Application of Materiality to Financial Statements* was published in October 2015

The Exposure Draft IFRS Practice Statement *Application of Materiality to Financial Statements* was approved for publication by all fourteen members of the International Accounting Standards Board.

Hans Hoogervorst	Chairman
Ian Mackintosh	Vice-Chairman
Stephen Cooper	
Philippe Danjou	
Martin Edelmann	
Patrick Finnegan	
Amaro Gomes	
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Mary Tokar	
Wei-Guo Zhang	

Basis for Conclusions on the Exposure Draft IFRS Practice Statement *Application of Materiality to Financial Statements*

This Basis for Conclusions accompanies, but is not part of, the [draft] Practice Statement.

Introduction

BC1 This Basis for Conclusions summarises the considerations of the International Accounting Standards Board (IASB) when developing the Exposure Draft IFRS Practice Statement *Application of Materiality to Financial Statements*. Individual IASB members gave greater weight to some factors than to others.

Background

Reasons for undertaking a project on materiality

BC2 The IASB was informed at the Discussion Forum on Financial Reporting Disclosure in January 2013, in its related survey, in feedback received from respondents to the 2014 Exposure Draft of proposed amendments to IAS 1 *Presentation of Financial Statements* and by other sources, that there are difficulties applying the concept of materiality in practice when preparing financial statements. Some stakeholders think that these difficulties contribute to a disclosure problem. They are concerned that, when reporting entities make inappropriate materiality assessments, those assessments can lead to irrelevant (ie immaterial) information being disclosed in some cases and material information being omitted in other cases. The type of difficulties reported to the IASB were:

(a) management may be unsure how to apply the concept of materiality. The result is that some follow the disclosure requirements in IFRS as a checklist, rather than using judgement when deciding what information to disclose or present in the financial statements. A checklist approach appears to be perceived by some as saving time, avoiding challenges and scrutiny from auditors and regulators, and as protection against possible litigation. However this approach can result in excessive disclosure of immaterial information in the financial statements which can lead to material information being obscured and result in the financial statements being less understandable.

(b) following a checklist approach also means that management does not use judgement to decide when to disclose information that, although relevant to an understanding of the financial statements, is not specifically required by IFRS. The result is that in some cases not enough relevant information is disclosed.

BC3 One of the factors suggested by interested parties as contributing to the problem was the lack of guidance on materiality in IFRS, particularly on how it should be applied to disclosures in the notes to the financial statements. In the light of this feedback, the IASB decided to undertake a project on materiality with the aim of providing further guidance.

Outreach

BC4 The IASB staff performed outreach in order to assess whether guidance on materiality should be developed and what should be included in that guidance. During 2014 the staff held consultations about the problems surrounding materiality and their causes with the IFRS Advisory Council; the Accounting Standards Advisory Forum (ASAF); the World Standard-Setters (WSS); the Global Preparers Forum (GPF); representatives of the International Accounting and Assurance Standards Board (IAASB) and the International Organization of Securities Commissions (IOSCO); and a number of other accounting professionals, academics and representatives of other regulatory bodies. In addition, the staff carried out their own review of academic literature and research. This included performing outreach with National Standard-Setters to help the staff to understand the application of materiality in their jurisdictions.

Form of the guidance

Why we are considering issuing guidance

BC5 During outreach we heard widespread support for developing guidance to address the lack of understanding of how to apply the concept of materiality in the financial statements. Two areas of particular difficulty highlighted during that outreach were:

(a) the tendency for management and auditors to focus too much on the quantitative aspect of materiality, including overreliance on numerical thresholds in making materiality judgements; and

(b) the lack of clarity about the difference between judgements about materiality when presenting items separately in the primary financial statements versus judgements about materiality when presenting information in the notes.

BC6 The IASB observed that several jurisdictions have developed their own guidance on materiality and noted that issuing its own guidance will reduce the need for regional guidance and promote comparability across jurisdictions. In producing its own guidance, the IASB has considered available guidance that has been produced at a jurisdiction level and has in some cases incorporated similar guidance into the [draft] Practice Statement.

BC7 Some interested parties have said that that the concept of materiality is well understood and that guidance on the application of materiality is unnecessary. These parties think that the main issues regarding application of materiality are behavioural, for example time pressures on management and management's aversion to risk. Some parties noted that it is often easier for management to include immaterial information in the financial statements rather than monitor on an ongoing basis whether that information is material and/or justify the removal of disclosures to auditors or regulators. The IASB acknowledged that these behavioural issues do exist but observed that guidance may help to counteract this type of behaviour. The IASB noted that if management is given guidance to refer to, they may feel more confident in exercising judgement when applying the concept of materiality. Consequently, the issuance of guidance may promote a change in behaviour.

BC8 Other interested parties have said that guidance on materiality would not be sufficient on its own to address the difficulties highlighted without first reconsidering the existing disclosure requirements and objectives in Standards. The IASB acknowledges that addressing both aspects are important, but noted that this need not occur simultaneously. The IASB will consider reviewing the disclosure requirements and objectives in existing Standards as part of its wider Disclosure Initiative project. The IASB also observed that guidance on the application of materiality could be issued more quickly than the changes resulting from that review and would help to clarify the role of materiality when applying disclosure requirements in Standards.

BC9 On balance the IASB proposes to provide guidance on the application of materiality separately to respond to these concerns.

Why we are considering issuing guidance in the form of a Practice Statement

BC10 This [draft] Practice Statement sets out non-mandatory guidance with the aim of assisting management to use judgement in applying the concept of materiality when preparing financial statements. Entities applying IFRS are not required to comply with the Practice Statement, but the relevant authorities in their jurisdiction may require that they do so. Nevertheless the IASB thinks that this [draft] Practice Statement will help to promote a greater understanding of the role of materiality in IFRS and how it should be applied in preparing financial statements. This will help to improve the usefulness and understandability of financial statements across entities and jurisdictions.

BC11 The IASB proposes to provide guidance on the application of materiality in the form of a non-mandatory Practice Statement, rather than as mandatory guidance in a Standard. The IASB noted that if it issued mandatory guidance in a Standard, concerns about creating conflicts with national legal frameworks could add complexity when developing the guidance. Nevertheless the IASB noted that even though some jurisdictions have legal or regulatory requirements about materiality, this should not necessarily result in a conflict with the guidance in this [draft] Practice Statement (provided that those local requirements do not prevent an entity from applying requirements in IFRS if the effect of doing so would be material). For example, many companies file with the US SEC as foreign registrants using financial statements that are prepared in accordance with IFRS. The IASB is not aware of any difficulties to these registrants caused by differences between the definition of materiality in IFRS and the definition developed by the U.S. Supreme Court.

BC12 The IASB also noted that IFRS would not prohibit an entity from providing additional information in order to meet local requirements in a jurisdiction. Furthermore, local requirements may help establish the type of information that is likely to be material to the primary users within that jurisdiction.

BC13 The IASB also noted that issuing mandatory guidance in a Standard could risk appearing prescriptive, which could undermine the emphasis on management applying their judgement in the application of materiality. Nevertheless, the IASB noted that jurisdictions could choose to adopt the Practice Statement into their national framework.

BC14 The IASB also observed that issuing guidance as a separate non-mandatory document, rather than as non-mandatory implementation guidance supporting a specific Standard, such as IAS 1, would help to emphasise that the concept of materiality is pervasive throughout IFRS.

BC15 The IASB also decided that a Practice Statement was preferable to education material for the following reasons:

(a) it will be subject to full due process, including public consultation. This consultation step enables the IASB to obtain input from a wide range of stakeholders on the proposed content of the Practice Statement; and

(b) it will be more accessible and formal than education material, because it would become part of the IFRS Bound Volume. Furthermore, the Practice Statement would constitute a formal document that a jurisdiction could choose to mandate.

Scope

BC16 The objective of this [draft] Practice Statement is to assist management in applying the concept of materiality when preparing general purpose financial statements prepared in accordance with IFRS. The IASB observed that management may find some of the guidance in this [draft] Practice Statement helpful when making judgements about materiality for other financial reporting purposes and also when internally documenting its conclusions about the judgements it uses when applying the concept of materiality. For example, some of the guidance might be helpful when preparing other parts of an entity's financial report, such as management commentary or corporate governance disclosures, or when preparing regulatory filings or press releases. However the IASB noted that this [draft] Practice Statement is not designed to cover these other purposes because different considerations may apply because of the different objectives for preparing the information. Regulators may also have different descriptions of what is considered material in filings other than financial statements.

BC17 The IASB also noted that although the [draft] Practice Statement is aimed at assisting management, it is also likely to help other stakeholders, for example users of financial statements, understand the approach that management follows when making judgements about materiality when preparing financial statements.

Materiality thresholds used by an auditor

BC18 The objective of an auditor is to express an opinion as to whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. Auditors may use similar principles as management does when making judgements in applying the concept of materiality.

BC19 However, auditors also apply the concept of materiality for different purposes during an audit than management does during preparation of financial statements. For example, auditors usually apply the concept of materiality when making judgements about the amount of work to be done to obtain reasonable assurance on whether the financial statements are free from material misstatement and to enable them to communicate as required by auditing standards. These communications requirements may include—for example reporting to the entity's audit committee any weaknesses in internal controls and uncorrected misstatements identified during the audit.

BC20 This [draft] Practice Statement does not directly cover materiality considerations made by auditors for these other purposes. The IASB also observed that it would not be appropriate for management to rely on materiality thresholds used by the auditors for audit purposes when management makes decisions about the application of materiality to the financial statements.

Definition of materiality

BC21 The IASB has tentatively decided to include a discussion on the definition of materiality, and whether there is a need to change or clarify that definition, in its forthcoming Discussion Paper for its Principles of Disclosure project. Nevertheless, the IASB thinks that it is useful to develop guidance on the application of materiality now, rather than wait until the Principles of Disclosure project has been finished, to address requests for guidance. Furthermore, the IASB does not envisage that the discussion about the definition will substantively affect the general content of the Practice Statement.

BC22 The IASB also observed that the guidance about the role of the primary financial statements and the role of the notes described in paragraphs 41, 45 and 47 in the [draft] Practice Statement are based on the IASB's current thinking during its Principles of Disclosure project. The IASB noted that it intends to update the content of the Practice Statement, as necessary, following completion of its Principles of Disclosure and Conceptual Framework projects.

Analysis of the likely effects of this [draft] Practice Statement

BC23 The IASB is committed to assessing and sharing knowledge about the likely costs of implementing proposed new requirements and guidance—the costs and benefits are collectively referred to as 'effects'. The guidance in the [draft] Practice Statement aims to clarify the concept of materiality and to provide guidance on its application to the financial statements. It does not change the existing requirements in IFRS. Consequently, the expected effect of the proposed guidance is a better understanding and application of materiality without any significant costs for management.

BC24 The guidance in this [draft] Practice Statement is also expected to help to influence positive changes in behavioural issues such as rigid adherence to checklists when preparing the financial statements. This is because it is expected to encourage management to exercise judgement to a greater extent when determining what information to include or not to include in financial statements. It is hoped that such exercise of judgement will contribute to a reduction in the amount of boilerplate disclosures and redundant information and an increase in the quality and accessibility of information in the financial statements.

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