

STAFF PAPER

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World Standard Setters meeting

Project	Disclosure Initiative		
Paper topic	Materiality		
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Background

1. Part of the disclosure problem, identified at the Financial Reporting Disclosure Discussion Forum (the 'Forum') and in the related survey, is that too much irrelevant information is being disclosed in financial statements, ie 'disclosure overload'. Disclosure overload can mean that useful information is obscured and that the connections between disclosures are not obvious.
2. Some are of the view that a main cause of disclosure overload is that the concept of materiality is not being applied as well as it could be in determining what information should be disclosed in the financial statements. We have heard a number of reasons why this may be the case, including:
 - (a) the behaviour of those in the financial reporting process, for example:
 - (i) preparers adopt a 'better safe than sorry' approach because of litigation and reputational pressures;
 - (ii) preparers and auditors use a tick-box approach to disclosure; and
 - (iii) regulators challenge the removal of information, even when immaterial;
 - (b) the way in which some Standards are drafted suggests that the concept of materiality in IAS 1 *Presentation of Financial Statements* (IAS 1)

does not apply to the specific disclosure requirements in that Standard;
and

- (c) the guidance on materiality in IAS 1 is not as clear as it could be.
3. The Forum and the related survey also highlighted that another aspect of the disclosure problem is that often the “right” information is not being disclosed. Some with this view thought that a better application of materiality should not only result in a reduction in ‘disclosure overload’, but should also result in better (more relevant) information being disclosed, whether required by IFRS or not.
 4. Paragraph 7.45 of the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*, published in July 2013 (the ‘Conceptual Framework 2013 DP’), describes the IASB’s preliminary view that no changes should be made to the concept of materiality. This is because the IASB believes that the concept is clearly described in the existing *Conceptual Framework*. However the IASB also understands that some in the financial reporting chain say that they have difficulty applying the concept of materiality in practice.
 5. The materiality requirements currently in IAS 1 are reproduced in Appendix A to this paper

How we plan to address this problem

6. The IASB has two projects that form part of the Disclosure Initiative which plan to address materiality:
 - (a) amendments to IAS 1; and
 - (b) assessment of existing materiality guidance in IFRS to determine whether additional guidance is warranted.
7. Some of the problems associated with materiality could also be addressed by the review of existing Standards, a medium-term project under the Disclosure Initiative. For example, Agenda Paper 8B of the September 2013 IASB meeting that discussed IAS 1 amendments (see Agenda Paper DIS4 of this meeting) acknowledged that the terminology ‘at least’/‘at a minimum’ in disclosure requirements may be causing problems in practice. However, that paper proposed

to defer research/assessment of that issue to a medium-term review of the Standards.

Amendments to IAS 1

8. This project proposes narrow focus amendments that seek to clarify some existing language and guidance in IAS 1 including some of the guidance relating to the concept of materiality. The proposed amendments on materiality do not intend to change or interpret the materiality requirements, but rather clarify or highlight aspects that we think would improve application of the concept.
9. The proposed narrow focus amendments for materiality aim to:
 - (a) clarify that materiality applies to both the primary financial statements and the accompanying notes;
 - (b) clarify that disclosures specifically required by Standards and Interpretations are still subject to the materiality requirements in IAS 1; and
 - (c) remind preparers and others that providing too much immaterial information can obscure useful information.
10. The proposed amendments are set out in paragraphs 10–35 of Agenda Paper DIS4 for this meeting.

Question 1

Do you think the proposed amendments to IAS 1 will help entities apply the concept of materiality and in doing so help address some of the problems associated with materiality eg disclosure overload?

Assessment of existing guidance on materiality

11. For this part of the Disclosure Initiative, IASB staff plan to work with preparers, auditors and securities regulators to consider whether additional guidance is needed for materiality. The project will consider work already done in this area. If it is determined that additional guidance is needed it could be in the form of application guidance or education material.

12. The materiality part of the project is in its initial stages. Possible issues to be considered include:
- (a) How does the concept of materiality apply to the notes to the financial statements? For example:
 - (i) Determining whether an amount within a note disclosure is material;
 - (ii) Determining whether a qualitative disclosure is material.
 - (b) How does the application of materiality differ in making the following decisions (if at all):
 - (i) To correct an error or omission;
 - (ii) To make a new disclosure or presentation;
 - (iii) To remove an existing disclosure or presentation?
 - (c) How does the concept of materiality apply to comparative information?
 - (d) Should the concept of materiality incorporate the notion of a collective assessment across disclosures, periods etc? If so, what is meant by a “collective assessment”?
13. The above list of issues is in no way exhaustive and we expect it to develop/change as our research into materiality gets underway.

Question 2

What problems in the application of materiality have you seen in your jurisdiction (if any)? Are these covered by the list of issues in paragraph 12 above? If not, should it be added to the topics to be considered as part of this project?

Question 3

In your jurisdiction, do you think that additional application guidance/education material would be helpful for entities applying the concept of materiality to their IFRS financial statements?

Appendix A—materiality requirements in IAS 1

14. The following paragraphs are extracts from IAS 1 which relate to the materiality requirements.

7 ...

Material Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

...

15 Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the *Framework*. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.

17 In virtually all circumstances, an entity achieves a fair presentation by compliance with applicable IFRSs. A fair presentation also requires an entity:

- (a) to select and apply accounting policies in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. IAS 8 sets out a hierarchy of authoritative guidance that management considers in the absence of an IFRS that specifically applies to an item.
- (b) to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
- (c) to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

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.

- 31 An entity need not provide a specific disclosure required by an IFRS if the information is not material.