STAFF PAPER

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IASB Meeting

Project	**Disclosure Initiative**		
Paper topic	Practice Statement: Application of materiality to financial statements		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Purpose of the paper

1. This paper asks the IASB to discuss the content and initial drafting of the Practice Statement on the application of materiality. The Practice Statement will be issued as an Exposure Draft separate from the Discussion Paper *Principles of Disclosure*.

Structure of the paper

2. The paper is laid out as follows:

   (a) Decisions to date

   (b) Staff approach to drafting the Practice Statement

   (c) Staff proposal and questions for the IASB

   (d) Expected timetable

   (e) Appendix: The draft Practice Statement.

Decisions to date

3. At its November 2014 meeting, the IASB discussed the next steps for its Materiality project and tentatively decided:

The IASB is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRSs. For more information visit www.ifrs.org

(a) to change the current definition of materiality within IFRS only to align the definitions in IAS 1 *Presentation of Financial Statements*, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and the *Conceptual Framework for Financial Reporting* with each other. However the Discussion Paper *Principles of Disclosure* will describe the rationale for retaining the current definition of materiality, and will ask for feedback on this issue;

(b) to insert a paragraph in IAS 1 clarifying the key characteristics of materiality. This will also be included in the Discussion Paper *Principles of Disclosure*;

(c) to provide guidance on the application of materiality, which will take the form of a Practice Statement. However, there will be a question in the Invitation to Comment in the Exposure Draft asking whether respondents think a Practice Statement is the most appropriate form of guidance;

(d) to wait until further work has been performed on the Review of Standards project before considering possible changes to address the use of inconsistent or excessively prescriptive language in Standards; and

(e) not to include a reminder in each Standard that the requirements only apply if their application is material.

4. This paper addresses the content of the Practice Statement (paragraph 3(c)).

5. The staff will ask the IASB to consider the aligned definition and clarifying paragraphs at its April meeting (paragraphs 3(a) and (b)). At the April meeting the staff will also ask the IASB to further consider the use of the word ‘could’ in the definition of materiality. This discussion is not expected to affect the general content of the Practice Statement. Of course, any reference to the definition of materiality in the Practice Statement would be affected, but the staff are confident that the guidance in the Practice Statement will sit comfortably with any definition of materiality.

Staff approach to drafting the Practice Statement

6. The appendix to this paper provides the staff proposal for a draft Practice Statement containing guidance on the application of materiality within the context of the financial statements.

7. Many jurisdictions have developed their own guidance on materiality. The staff have considered much of this guidance during development of the Practice Statement, as well as drawing on the research carried out earlier in the project. Furthermore, the staff have placed additional content in the Practice Statement on three common areas of confusion, as identified through outreach–namely the tendency to focus too much on the quantitative aspect of materiality/use of numerical thresholds, the difference between judgements about materiality on the face of the financial statements versus in the notes, and confusion between application of materiality in preparing financial statements and materiality thresholds used by auditors as a tool in performing an audit.

8. The staff plan to add more practical examples to the Practice Statement and would like the views of the IASB on the types of examples that should be included. The staff have heard from interested parties that examples of applying materiality judgements in the following areas, among others, would be useful:

   (a) disclosures about financial exposure to risks and uncertainties arising from recognised and unrecognised resources and obligations, for example within the context of the disclosures in IFRS 7 *Financial Instruments: Disclosures* about the nature and extent of risks arising from financial instruments;

   (b) the disclosure in IAS 1 about material uncertainties related to events and conditions that may cast doubt on the entity’s ability to continue as a going concern; and

   (c) disclosures about assets and liabilities that do not meet the criteria for recognition in the financial statements, for example within the context of disclosures about a legal dispute, where some disclosures could be prejudicial to a court’s decisions or to the entity’s subsequent business plans.

9. The draft Practice Statement included in the appendix to this paper presents only the main body of the Practice Statement. It does not include the Basis for Conclusions that will be developed to accompany it.

10. The Practice Statement makes a number of references to the *Conceptual Framework for Financial Reporting*. With the exception of the definition of materiality, references are to the existing *Conceptual Framework* pending completion of the *Conceptual Framework* project. However, based on the current wording in the *Conceptual Framework* Exposure Draft, the content of the referenced paragraphs are unlikely to be revised significantly and so are not expected to affect the content of the Practice Statement.

Staff proposal

11. See Appendix.

12. The staff also propose to add more practical examples, for example in the areas listed in paragraphs 8(a)-(c) as well as any other topics that the IASB may suggest.

Questions for the IASB

1. **Do IASB members think any other topics should be addressed in the Practice Statement?**
2. **Do IASB members think there are any other practical examples that should be included in the Practice Statement?**
3. **Do IASB members have any other comments on the content of the draft Practice Statement?**

Expected timetable for reference

Date	Activity
April 2015	Staff request permission to ballot the Exposure Draft of a draft Practice Statement Staff ask the IASB to discuss the use of the word ‘could’ in the definition of materiality, the alignment of the definition across IFRS and the clarifying paragraphs to be inserted in IAS 1 on the key characteristics of materiality (see paragraphs 3(a) and (b)). The definition and paragraphs will be included in the *Principles of Disclosure* Discussion Paper
June 2015	Expected publication of the Exposure Draft of a draft Practice Statement
November 2015	Expected publication of *Principles of Disclosur*e Discussion Paper

Appendix: IFRS Practice Statement—Application of materiality to financial statements

Introduction

Purpose of the Practice Statement

IN1 The IFRS Practice Statement *Application of materiality to financial statements* is primarily intended to provide guidance to help entities apply the concept of materiality to financial statements prepared in accordance with IFRS. However, although other considerations may apply, entities may find some of the guidance in this Practice Statement helpful when making judgements about materiality in other parts of their financial reports, eg management commentary or corporate governance disclosures, and other types of financial information such as other regulatory filings or press releases.

IN2 The Practice Statement is not an IFRS. Consequently, entities applying IFRS are not required to apply the Practice Statement, unless specifically required to do so by their jurisdiction.

Why has the IASB provided guidance on application of materiality to the financial statements?

IN3 The IASB was informed at the Discussion Forum *Financial Reporting Disclosure* in January 2013, in its related survey and by other sources, that there are difficulties applying the concept of materiality in practice when preparing the financial statements. Some interested parties are of the view that these difficulties contribute to a disclosure problem, namely, that there is both too much irrelevant information and not enough relevant information in financial statements. A number of factors have been identified for why materiality is not being applied well in practice. One of these is that there is limited guidance on materiality in IFRS, particularly how it should be applied to disclosures in the notes to the financial statements.

How should the practice statement be read?

IN4 Applying the concept of materiality when deciding what information to include in financial statements requires management to judge who are the primary users of its financial statements, the types of decisions that those users are making, the information that is likely to influence those decisions and the context within which those decisions are made.

IN5 Materiality ultimately depends on a full consideration of all the facts and circumstances and so it is impossible to provide a full list of considerations that apply in any given scenario for a particular entity. The guidance in the Practice

Statement does not aim to provide a comprehensive list of considerations when making judgements about materiality in preparing the financial statements. Instead, it aims to illustrate the sorts of factors that an entity should take into consideration.

IFRS Practice Statement—Application of materiality to financial statements

Objective

1 To assist management in applying the concept of materiality to financial statements prepared in accordance with International Financial Reporting Standards (IFRS) and help users of those financial statements understand the approach that management has taken when making judgements about materiality.

Scope

2 The Practice Statement applies to the preparation of financial statements in accordance with IFRS. However, entities may find the Practice Statement helpful when preparing other types of financial information.

3 Auditors use similar principles to management when making judgements about materiality. However, auditors sometimes make judgements about materiality for a different purpose during an audit than management do during preparation of financial statements. This Practice Statement does not directly cover application of materiality in an audit (which is covered by auditing standards).

What is materiality?

Definition

4 The [proposed] *Conceptual Framework for Financial Reporting* ('*Conceptual Framework'*) defines materiality as follows

> Information is material if omitting it or misstating it could influence decisions that the primary users of general purpose financial reports make on the basis of financial information about a specific reporting entity.[1]

5 The *Conceptual Framework* states that if financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. Relevant financial information is information that is capable of making a difference in the decisions made by users, even if some users choose not to take advantage of it or are already aware of it from other sources.[2]

6 Materiality is an entity-specific aspect of relevance; all information that is material to an understanding of an entity will be relevant to that entity's activities, but not all relevant information will be material. For example, relevant information about a particular transaction might not be material to an entity's financial statements perhaps because the transactions are clearly trivial to the overall performance and position of the entity. Materiality assessments are about determining which information is relevant to an entity and hence must be conveyed in the entity's general purpose financial report.

[1] See paragraph 2.11 of the [proposed] *Conceptual Framework*.

[2] See paragraphs QC4-QC6 of the *Conceptual Framework.*

7 Materiality depends on the nature and magnitude of information, and must be judged in the particular circumstances of the entity. When assessing whether information *could* influence decisions that the primary users make on the basis of the financial statements, management is required to use judgement to assess whether information could reasonably be expected to influence those decisions, rather than automatically including all information about that entity. Information should be included for reasons specific to the reporting entity and not merely because it has previously been reported, or because an entity's peers consider it material to their financial statements. Furthermore, the assessment of whether information is material must be done on both an individual and a collective basis. For example, information that is judged to be immaterial on its own may be material when combined with other information judged to be individually immaterial.

8 If material information is excluded from the financial statements, this may adversely affect decisions made by the users of the financial statements. However, if too much information is included within the financial statements without considering whether it could reasonably be expected to influence decisions made by the primary users, it might obscure material information and inhibit a clear understanding of the entity's business and the issues that it faces.

9 At a practical level, those responsible for preparing the financial statements need to assess the likelihood that a change in the content of the financial statements, or how the information is presented, could influence the decisions made by the primary users of those financial statements.

Primary users

10 The primary users of general purpose financial reports, which include the financial statements, are existing and potential investors, lenders and other creditors who cannot require entities to provide information directly to them and must rely on general purpose financial reports.[3]

11 Other parties, such as regulators and members of the public may also find general purpose financial reports useful. However, those financial reports are not directed primarily to these other groups.

Key characteristics

Pervasive concept

12 The concept of materiality is pervasive to the preparation of the financial statements. It underlies all the requirements in IFRS and applies to all information in a complete set of financial statements.

13 If information is material, it is required to be recognised, measured, presented and disclosed, as appropriate, in accordance with IFRS. The concept of materiality also guides the margin of error that is acceptable in the amount attributed to an item and the degree of precision required in estimating the

[3] See paragraph OB5 of the *Conceptual Framework*.

amount of an item. It also applies when considering whether errors require correction and the appropriate level of aggregation of information.

Judgement

14 IFRS requires management to think beyond the specific requirements in IFRS and provide additional information that is relevant to an understanding of the financial statements.[4] Applying the concept of materiality when preparing financial statements requires management to apply their judgement in considering the particular facts and circumstances of the entity and deciding whether to include or exclude a piece of information. Ultimately, the judgement is not whether an individual piece of information is likely to influence the decisions made by the primary users in isolation, but, instead, whether it could reasonably be expected to influence those decisions in the light of the financial statements as a whole. This involves judgement about how the information contributes to the overall picture of the entity's financial position, financial performance and cash flows.

15 Materiality judgements require full consideration of the information involved and an understanding of how that information will be used by the primary users of the financial statements.

Qualitative assessment

16 Materiality depends on the nature and magnitude of the information that is judged in the particular circumstances of the entity. In other words, applying materiality involves a qualitative assessment. Quantitative information, eg an item's size or amount, including how it relates to other amounts, is only one of the qualities that should be considered. This is especially true for note disclosures, which often include narrative descriptions and explanations, as well as numerical amounts. Consequently, it is not appropriate for IFRS to specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

17 Management could use quantitative thresholds to assist their judgements about materiality in the preparation of the financial statements. For example, the use of a quantitative threshold may provide the basis for a preliminary assumption that an amount less than the specified percentage is unlikely to be material. For example, in the absence of other factors, management may make a preliminary assumption that any income or expenses lower than a particular percentage of profit or a particular percentage of revenue would be unlikely to be material to the financial statements.

18 However, a full analysis of all the facts is also required because the nature of, and the circumstances surrounding, the transaction, event or condition will vary. In particular, for some disclosures, materiality considerations are more sensitive. For example, a relatively small amount might be material if it relates to directors' remuneration, particularly if management stewardship is a known concern.

[4] See paragraph 112(c) of IAS 1.

19 Some other examples of situations in which a small amount might be material include:

(a) if it prevents the identification of trends, eg changes a surplus to a deficit or vice versa, or masks increases in a specific type of cost;

(b) if it affects key ratios, eg interest cover;

(c) if it changes whether the entity meets analysts' expectations or targets set by the entity;

(d) if it changes a loss into a profit or vice versa;

(e) if it triggers non-compliance with, or results in an entity satisfying, a regulatory requirement;

(f) if it triggers non-compliance with, or results in an entity satisfying, loan covenants or other contractual requirements. For example, an entity's banking facility may be dependent on compliance with an interest coverage covenant that is based upon the financial statements. If the interest cover of the entity is close to that limit, even relatively small amounts that increase or decrease interest, or earnings before interest and tax, may be material;

(g) if it relates to part of the entity's business that is currently relatively small or new, but is expected to play a significant role in the entity's future operations. For example, an entity may currently be generating most of its revenue from other products. However, because of advances in technology, it may be expected that a product that has recently been developed is going to take over in the coming years;

(h) if it relates to a non-arm's length transaction between related parties;

(i) if it has the effect of increasing management's compensation—for example, by satisfying requirements for the award of bonuses or other forms of incentive compensation;

(j) if it relates to unlawful transactions, such as illegal dividends, or relates to fines or penalties; or

(k) if it relates to transactions whereby the primary users may be influenced by management's reasoning for undertaking those transactions, for example this may be applicable to some transactions that lack commercial substance or that are usual in nature.

This is not an exhaustive list of circumstances.

20 Furthermore, in some cases, focusing on quantitative amounts may not be helpful when judging materiality. For example:

(a) In deciding whether a particular accounting policy should be disclosed, management considers whether its disclosure is likely to assist users in understanding how transactions, other events and conditions are reflected in reported financial performance and financial position. A description of an accounting policy would be material by its nature if it is likely that the primary users would be unable to understand the financial statements sufficiently for their decision-making purposes if it is not disclosed, or if it is inadequately disclosed.

(b) In considering the materiality of uncertainties and contingencies, the potential monetary amounts involved are not known. Consequently, management needs to consider the nature of the items and make best estimates of the potential quantitative amounts involved, including taking into account the likelihood of crystallisation, when making judgements about materiality.

(c) In considering the materiality of related party transactions for which no price is charged, management should have regard to the underlying quantitative amounts involved, eg a price in an arm's length transaction, as well as the nature of the relationship with the related party.

Types of considerations in applying materiality

21 Some of the considerations involved when applying the concept of materiality to the financial statements are:

(a) What are the characteristics of the primary users of general purpose financial reports (decision-makers)?

(b) What types of decisions are the primary users making and is information likely to influence those decisions ('influence' does not necessarily mean 'change')?

(c) What is the appropriate context for assessing whether information is material?

This is not an exhaustive list. Materiality ultimately requires a qualitative assessment based on a full consideration of all the facts and circumstances. Consequently it is impossible to provide a full list of considerations to apply to any given scenario.

What are the characteristics of primary users?

22 Judgements about materiality ultimately depend on how information could reasonably be expected to influence the decisions of the primary users of general purpose financial reports, ie existing and potential investors, lenders and other creditors.

23 Primary users are assumed to have a reasonable knowledge of business and economic activities and be assumed to 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, for example in understanding complex financial instrument transactions.[5] Judgements about materiality should take into account how users with such attributes are likely to be influenced in making decisions.

24 Individual primary users have different, and possibly conflicting, information needs and expectations. When an entity has many classes of users, it should aim to provide information in such a way as to meet the needs of the maximum number of classes. However, focusing on common information needs does not

[5] See paragraph QC32 of the *Conceptual Framework*.

prevent the reporting entity from including additional information that is most useful to a particular type of primary user.

25 Nevertheless, when there are large numbers of users in a particular class, management should consider representative users. Management should not seek to address a single hypothetical user, especially one on the brink of making a decision to buy or sell, whose decision might be changed by even a small change in a reported number or disclosure.

What types of decisions are the primary users making?

26 Paragraphs OB2-OB6 of the *Conceptual Framework* provide high level guidance on the decisions being 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.

27 Some of the common decisions made by the primary users of financial statements involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit. Furthermore, voting shareholders often have to make decisions in order to vote on company matters such as appointing or removing directors. Other decisions made by primary users will vary depending on the type of entity.

28 In developing IFRS, the IASB seeks to identify the information set that will meet the needs of the maximum number of primary users, for a wide variety of entities. Consequently when deciding what information should be provided in the financial statements, the requirements in IFRS generally provide a good starting point. However, management need not apply a particular requirement in IFRS if the related information is not material and the result of applying the requirement is not likely to influence decisions made by the primary users.

29 IFRS requires additional information to be included in the financial statements if it is relevant to an understanding of those financial statements. Some other ways

in which management can identify what additional information is important to users, and why, include:

(a) discussions with users;

(b) consulting information relating to users' expectations, gathered as a result of a company's corporate governance procedures or that is publicly available;

(c) considering what decisions they themselves would make and what information they would require as users of financial information in similar situations (ie putting themselves in the shoes of the primary users);

(d) observing users' responses to information, eg on particular transactions or disclosures, issued by the company, or by external parties such as the press or analysts;

(e) observing the impact on market prices of information issued by the entity or by external parties, such as the Press or analysts. For example, volatility of the price of an entity's securities in response to certain types of disclosures may provide guidance as to whether investors regard information as material; and

(f) observing the type of information provided by an entity's peers, eg entities operating in the same industry. However, merely because information is being provided by other entities in the same industry. it does not necessarily mean it is material to all entities in that industry.

30 Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.[6] For information to be material, it does not have to change decisions by the primary users, but instead it must have the capacity to influence them. A particular piece of information may be material if it confirms or provides further evidence of trends already evident in the financial statements and thus helps to reinforce decisions made by the primary users.

31 For example, the earnings of an entity may have increased in line with expectations, confirming past predictions made by the primary users of the financial statements about the profitability of the entity and also helping them in forecasting future trends in the earnings of the entity. Such an outcome might simply reinforce a decision to buy, hold or sell shares in the entity.

32 The primary users of financial statements consider the information in a wider context than the financial statements; for example, together with 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 materiality of a given item in the financial statements may also depend on information available from these other publicly available sources. For example, information about oil prices would be useful information to users of the financial statements of an entity operating in the oil and gas industry. Nevertheless, information about oil prices would be publicly available to users in the market and so it might not be necessary to include detailed information about market prices in the financial statements.

[6] See paragraph QC7 of the *Conceptual Framework.*

What is the appropriate context for assessing whether information is material?

33 Applying the concept of materiality when communicating information requires the facts to be viewed within the context of the surrounding circumstances and then using judgement to decide whether to include or exclude information and in considering how it should be presented or displayed.

34 In preparing the financial statements, judgements about the materiality of information need to be made within different contexts, for example:

(a) on the face of the financial statements (sometimes referred to as in the 'primary financial statements');

(b) in the notes; or

(c) on the basis of the financial statements as a whole.

Face of the financial statements

35 If information is material within the context of the financial statements as a whole, an entity will need to decide whether individual recognised items should be presented separately on the face of the financial statements, or alternatively how they should be aggregated with other items on the face of the statements. In other words, the entity decides how to aggregate the individual income, expense, asset, liability and equity balances from its primary records for presentation in the primary financial statements—for example, which assets or classes of assets should be disclosed separately, or whether any unusual expense items should be disclosed separately. (Refer also to *Aggregation of Information*—see paragraphs 58-60.)

36 In making this assessment, management should consider whether information is material relative to individual line items, subtotals and totals on the face of an individual statement, as well as to each individual statement as a whole, while also taking into consideration the linkage between the statements.

37 As discussed in paragraphs 16-20, although applying materiality involves a qualitative assessment, use of quantitative thresholds may provide the basis for a preliminary assumption about materiality. When making judgements about whether an item, or an aggregation of items, is material within the context of the face of the financial statements the relative amount of an item is often a helpful determinant. For example:

(a) In the statement of financial position, it may be appropriate to assess materiality against the relevant asset or liability totals as well as against total net assets, with consideration of both the current and comparative period. For example when assessing whether trade receivables requires separate presentation on the face of the financial statements it may be appropriate to assess materiality against current assets and total net assets. However, when assessing whether a misstatement in the trade receivables balance requires adjustment, it may be appropriate to assess materiality against total trade receivables as well.

(b) In the statement of comprehensive income, it may be appropriate to assess materiality against the relevant total income or expense amount as well as the profit or loss for the period, with consideration of both the current and comparative period.

(c) In the statement of changes in equity, it may be appropriate to assess materiality against the relevant component of equity (eg for a misstatement), or equity in total (eg for separate disclosure of a component of equity). It may also be appropriate to assess materiality against the statements of profit or loss and other comprehensive income or other changes in equity (eg relating to distributions), of both the current and comparative period.

(d) In the statement of cash flows, it may be appropriate to assess materiality against the relevant subtotals for operating, investing and financing cash flows and as well as the total change in cash during the year, and the balance of cash and cash equivalents in the current and comparative period.

However, notwithstanding the guidance above, a small misstatement in a line item may also be considered material, for example if it affects trends or key ratios.

38 Nevertheless, the decision to show something on the face of the statements does not always depend on its relative amount. For example, an item may be disclosed because of its nature, eg cash is often disclosed on the face of the statement of financial position, regardless of its amount, because of its key importance in assessments made by the primary users about an entity’s liquidity and the overall valuation of the entity. Similarly, aggregating assets that have different measurement attributes or expenses that are of a different nature could make the primary financial statements less informative.

39 Information presented on the face of the financial statements will usually get greater attention from the primary users than information in the notes. Consequently, when assessing which line items should be presented on the face, management also considers how best to summarise the financial information to give the most relevant overall representation of the entity. This may lead to the inclusion of line items that are small in relative value but that are important to that summary, because they serve as the best signposts to link the face of the statements with the detail in the notes. They therefore help users to navigate through the financial statements.

Notes

Objectives of the notes

40 The financial statements consist of the individual statements and the notes. The amount and type of detail that can go on the face of the statements is limited. Consequently, one of the key objectives of the notes is to amplify and explain the items on the face of the statements. For that reason, any information that is material to the financial statements about the line items, but that is not available on the face of the statements, must be provided in the notes.

41 For example, an entity may disclose a total revenue amount on the face of the financial statements. However in the notes it must further disclose sufficient

information to enable the primary users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

42 Line items that are presented separately on the face of the financial statements will usually require further disaggregation, as well as explanation, in the notes. This is because in many cases the line items are aggregated totals and management may need to disaggregate that information into material components in the notes to avoid clutter on the face of the statements (see paragraphs 58-60). For example, an entity may decide to provide a total figure for property, plant and equipment on the face of the statement of financial position, but provide a breakdown by classes of property, plant and equipment in the notes.

43 In addition to amplifying and explaining the items on the face of the financial statements, the notes should also provide any material information about any other transactions, events and conditions that could influence decisions of the primary users. For example, a number of items typically found in note disclosures do not relate to line items on the face of the statements, eg events after the balance sheet date, or they relate to items that are not recognised, eg contingent liabilities. The same considerations for determining materiality apply in these circumstances. For example, information on risk exposures should only be provided to the extent that an entity has a material exposure to a particular risk.

44 When deciding what information to disclose in the notes, management should identify which transactions, other events, and conditions are material within the context of the financial statements and then judge what information about these items is material. To make this assessment, management needs to judge what information, by its size and or nature, is necessary to enable the primary users to understand the impact of those transactions, other events and conditions on the entity’s financial position, financial performance and cash flows.

45 Information about some transactions, events, and conditions may be more sensitive and likely to influence decisions made by the primary users than other information (see paragraph 19 for examples). Consequently, judgements about materiality will vary depending on the type of information. For example, it is likely that a relatively small amount would not be material if it relates to the ongoing acquisition of equipment. However, a similar amount may be material, and require more extensive explanation in the notes, if it is relates to more unusual, sensitive or high-risk transactions, eg gain or losses on fair value changes in derivative instruments used for speculative purposes.

Specified disclosures in IFRS

46 In many instances IFRS provides specific disclosure requirements in relation to those transactions, events or conditions and, as noted in paragraph 28, these requirements are generally a good starting point when deciding what disclosures should be provided. However, management does not need to provide a specific disclosure required by an IFRS if the related information is not material, even if the disclosure requirement relates to a material line item presented on the face of the financial statements.[7]

[7] See paragraph 31 of IAS 1.

47 For example, IAS 16 provides specific disclosures for property, plant and equipment. However, even if property, plant and equipment is material to the financial statements, it does not mean that all disclosures specified in IAS 16 will be material. For example, if the amount of contractual commitments for the acquisition of property, plant and equipment is not material, such disclosure need not be provided in the notes. Furthermore, management must 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.

Prior year disclosures

48 If an item was material in the prior year, but it is not material in the current year, management should consider whether any disclosures in the notes are necessary. For example if in the prior year the entity undertook a significant business combination, an entity would need to consider what information is important in understanding the effect on the current period. It would generally not be necessary to include all of the detail provided in the prior year financial statements if this only relates to the prior period. That information will be available in the prior year financial report.

49 Nevertheless, materiality should not be assessed only by reference to conditions at the reporting date. Information about the business combination could be material in the current period, because it enables users to understand the effect on the entity’s performance for the current reporting period. For example, the acquirer would need to disclose information that enables users of its financial statements to evaluate the financial effects of material adjustments recognised in the current reporting period that relate to business combinations in previous reporting periods.

50 Even if an item may not have had a material effect on the current-year financial performance or financial position, if it was material in the prior year it may be appropriate to disclose the reasons for the change.

51 For example, if an impairment loss was recorded for an asset in the prior year, but not in the current year, then detailed impairment disclosures may not be appropriate in the current year. However, normally a fall in sales of a major product to an insignificant amount in the current year could reasonably be expected to influence the decisions of the primary users and would therefore require disclosure.

Financial statements as a whole

52 Ultimately the judgement is not whether an individual piece of information is material by itself, but in the light of the financial statements as a whole. As well as considering whether information is material within the context of the face of the statements and in the context of the notes, an entity must assess whether the information is material within the context of the financial statements as a whole. In particular, management should consider whether the components of the financial statements fit together appropriately to show the big picture, including the trends being experienced by the entity.

53 For example, there may be a disproportionate focus on explaining specific transactions in the notes, with insufficient consideration being given to the wider

perspective of how they fit in with the bigger picture. Consequently, after judging what information is material to the face of the financial statements, and then to the notes of the financial statements, management should make an overall assessment of the materiality of information on the basis of the financial statements as a whole, ie a collective assessment of all information in the financial statements. This overall assessment may lead to management removing some information from the financial statements, or adding further information to the financial statements.

Immaterial information

54 If transactions, events or conditions are material they must be presented or disclosed in the financial statements (and recognised and measured in accordance with IFRS if appropriate). When a transaction, event or condition is not material, it does not mean that it should not be recorded in the financial system, but it means instead that it would not be necessary to separately provide information about it in the financial statements.

55 Moreover, providing too much immaterial information can obscure useful information and consequently mean that the financial statements are less understandable. An example could be an entity that discloses, as its accounting policies, descriptions of the requirements for all of the Standards relevant to the entity. Such an approach could make it difficult for a user to understand which accounting policies were important or required judgement to be exercised by the entity.

56 IFRS does not prohibit entities from disclosing immaterial information, because such a requirement is not likely to be enforceable. Nevertheless, such disclosure should not result in material information being obscured.

57 In some cases management may think it is important to draw attention to an area where information has been left out, for example to give comfort to the primary users that the entity is not exposed to a risk. Consequently, management has considered that the statement itself is material. An example may be where an entity only has limited operations in a particular sector/geographical area that the entity would be expected to operate in, and that sector/area is undergoing difficulties. For example, an international bank may note that it does not hold any debt in a particular jurisdiction that is suffering severe financial difficulties.

Aggregation of information

58 Paragraph 29 of IAS 1 states:

> 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

59 If a line item on the face of the statements is not individually material, it can be aggregated with other items. However, an item that is not sufficiently material to warrant separate presentation on the face of those statements may warrant separate presentation in the notes. For example, an entity may decide to combine all of its financial assets measured at fair value together in one line item on the face of the statement of financial position, if separate presentation is not considered material. The entity will also need to 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, it may be necessary to disclose information about equity investments categorised within Level 1, Level 2 or Level 3 separately in order to help users of its financial statements to assess the different valuation techniques and inputs used to develop those measurements.

60 When making judgements about whether to aggregate information either on the face of the statements or in the notes, management should assess whether aggregating information means that information that could reasonably be expected to influence the decisions of the primary users is thereby lost (ie if material information is hidden within a total). For example, if an entity has 500 similar leases of similar assets, combining them is unlikely to lead to a loss of material information for the primary users. However if one of those 500 leases is significantly larger and has significantly different characteristics to the others, it may be appropriate to provide information about that lease separately.

Omissions and misstatements

61 If an entity presents a complete set of financial statements knowing that it has omitted or misstated any information (collectively referred to as misstatements in this document), it shall be required to amend the financial statements, if the misstatement is considered material. For example:

(a) After closing the accounting records 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 financial statements have been formatted and prepared for printing, some relevant information could come to light. Examples could include the company lawyer forgetting to pass on details of a letter received by the entity indicating that another party was claiming damages against the entity, or the accountant failing to notice the recent issuance of a new IFRS that is relevant to the entity.

62 Management would not be expected to incur excessive cost or effort to correct immaterial misstatements that are identified when preparing the financial statements. Conversely, where there is little cost or delay involved in correcting them, failing to do so intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows would be an intentional misstatement. The assessment of the costs and effort of correcting misstatements is likely to be affected by how close the entity is to its reporting deadline.

63 Omissions (ie not including data/information), errors (ie stating data/information inaccurately) and other misstatements of information (eg describing information ambiguously) are material if they could reasonably be expected to, individually or collectively, influence the decisions of the primary users made on the basis of the financial statements. Some of the key considerations involved when assessing whether misstatements of information are material to the financial statements are:

(a) How did the misstatement arise?

(b) What is the effect of other misstatements during the period and in the prior period?

This is not an exhaustive list.

How did the misstatement arise?

64 Misstatements can arise in a number of ways including:

(a) human error;

(b) incorrect judgement of the needs of the primary users;

(c) different measurement or accounting methods; and

(d) intentional misstatements.

Paragraphs 65-67 provide further explanation of the considerations in cases (c)-(d)

Different measurement or accounting methods

65 Some transactions and balances are capable of precise measurement, eg cash and trade payables. Consequently, misstatement of these transactions would not be expected to occur frequently. For some transactions and balances, precise measurement will not be possible and estimates are required, eg provisions for expected costs and Level 3 fair value measurements. Because of the uncertainty inherent in estimates, it may be more difficult to assess whether errors or omissions have occurred, such as failing to factor a particular risk into a Level 3 measurement. This is also true when divergence in practice exists over the appropriate accounting treatment for an item, or the appropriate accounting treatment is not perceived to be clear. In these situations, additional disclosures are likely to be required to ensure that users are aware of the subjectivity involved in providing the information and to explain management's reasoning for choosing a particular accounting treatment.

Intentional misstatements

66 Financial statements do not comply with IFRS if they contain misstatements made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows.[8]

67 If management has intentionally misstated items in the financial statements to achieve a particular presentation, it has presumably done so believing that the resulting amounts and trends could be significant to the primary users of the financial statements. Furthermore, the fact that management has intentionally misstated items to achieve a particular presentation could reasonably be expected to influence decisions that the primary users make about management stewardship. Consequently all intentional misstatements to achieve a particular presentation of an entity's financial position, financial performance or cash flows would be considered material.

[8] See paragraph 41 of IAS 8.

What is the effect of other misstatements?

Current period misstatements

68 Management should evaluate all identified errors and omissions to consider whether, in relation to individual line items, subtotals, or totals in the financial statements, failure to address them would materially affect the financial statements as a whole. This also requires consideration of the pervasiveness of the misstatements (ie whether they affect the presentation of numerous financial statement items). For example, an error recorded on a purchase of inventories could also affect trade payables, cost of sales and closing inventory.

69 Management should first consider whether each error or omission is material, irrespective of its effect when combined with other errors or omissions. If misstating an individual amount causes the financial statements as a whole 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 taken as a whole will be materially misstated even if the effect on profit is completely offset by an equivalent overstatement of expenses.

70 Even though the misstatement of an individual amount may not, on its own, cause the financial statements taken as a whole to be materially misstated, it may, when aggregated with other misstatements, mean that the financial statements taken as a whole are materially misstated. For example, identified errors related to several individually immaterial sales should be considered in aggregate.

Prior period misstatements

71 Management should consider the effect of misstatements made in prior periods on the current financial statements. An entity is required to correct material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery.[9] However, management also needs to consider the effects of any unadjusted immaterial prior period errors on the face of the financial statements and in the notes. This is because those unadjusted errors could potentially cause the current period financial statements to be materially misstated, even if the adjustments are not material in the current period. This may arise in a situation in which immaterial misstatements reoccur for several years and the cumulative effect becomes material in the current period.

72 For example, an expense accrual may have been overstated by CU200 each year for a period of five years, leading to an overstatement of CU1,000 at the end of the current year.[10] Management may have previously evaluated the misstatement as being immaterial to each of the prior year financial statements (ie, Years 1-4). However, even if management considers the overstatement of CU200 in expenses not to be material in the fifth year, management would also need to assess whether the overstatement in the accrual of CU1,000 is material in the current year.

[9] See paragraph 42 of IAS 8.

[10] In this guidance monetary amounts are denominated in 'currency units (CU)'.

73 When determining whether a prior period error is material and requires restatement, management should consider whether restatement could reasonably be expected to influence decisions made by users of the financial statements. Because the error relates to information in the prior year, it may be less likely to influence decisions made by the primary users than a similar misstatement in the current year. The judgement on materiality should reflect this; for example, it may not require further explanation in the notes unless it relates to sensitive information, eg related party transactions.

Materiality thresholds used by an auditor

74 The objective of the 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.

75 Auditors may use similar principles to management when making judgements about materiality. In particular, they may try to understand the judgements made by the preparer about whether information could influence decisions made by the primary users. However, auditors may also make materiality decisions for a different purpose during an audit than management do during preparation of financial statements.

76 For example, auditors usually make judgements about materiality in order to determine the amount of work to be done to obtain reasonable assurances on whether the financial statements as a whole are free from material misstatement. They also make judgements about materiality to enable them to communicate as required by auditing standards—for example reporting to the entity's audit committee any weaknesses in internal controls and uncorrected misstatements identified during the audit.

77 An auditor will often intentionally set low materiality thresholds to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole and also for particular class of transactions, account balances or disclosures. Furthermore, an auditor's materiality thresholds are also affected by its understanding of the entity and the nature and extent of misstatements identified in previous audits.

78 The materiality thresholds used by an auditor, for example for the purposes of identifying issues of interest of an audit committee, are likely to be lower than the threshold used as the basis for the preparation of general purpose financial reports.

Application date

79 An entity may apply this Practice Statement to financial statements presented prospectively from **X 201X**.