

STAFF PAPER

December 2016

IASB Meeting

Project	Disclosure Initiative
Paper topic	Proposed clarifications to the definition of materiality and due process summary
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board® (the Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in *IASB® Update*.

Objective of this meeting

1. The objective of this meeting is to ask the International Accounting Standards Board (the Board):
 - (a) whether it agrees with the staff recommendation to expose our proposed clarifications to the definition of materiality separately in an Exposure Draft, rather than discussing them in the forthcoming Principles of Disclosure Discussion Paper; and
 - (b) if it agrees, whether it gives the staff permission to ballot that Exposure Draft.

Structure of this paper

2. This paper includes the following sections:
 - (a) background;
 - (b) proposed clarifications to the definition of materiality;
 - (c) staff analysis;
 - (d) staff recommendation and questions; and

- (e) appendices:
 - (i) A and B: staff initial draft of proposed amendments to IFRS Standards, including consequential amendments;
 - (ii) C: existing definitions of materiality; and
 - (iii) D: actions taken to meet the due process requirements.

Background

3. In April 2015¹ the Board tentatively decided to propose:
 - (a) refinements to the definition of materiality; and
 - (b) clarifying paragraphs about the key characteristics of materiality.

The Board tentatively decided to include these proposed amendments in the Principles of Disclosure Discussion Paper together with the rationale for not making substantive changes to the definition of materiality.
4. We are currently in the process of balloting the Principles of Disclosure Discussion Paper. We expect to publish it in the first half of 2017 with a 180-day comment period.
5. At its October 2016 meeting, during discussions on its project to develop a Materiality Practice Statement (the Materiality project), the Board observed that the concept of materiality is being discussed in several different projects, including the Conceptual Framework project, the Materiality project and the Principles of Disclosure project. The Board also acknowledged that a number of similar, but not identical, versions of the definition of materiality currently exist (illustrated in Appendix C). Some Board members suggested that we should propose refinements to the definition in a separate Exposure Draft to make it clear what changes to the definition the Board is proposing to make and help to avoid confusion.

¹ Covered by Agenda Paper 11B for that meeting

Proposed clarifications to the definition of materiality

Definition of materiality

6. At its April 2015 meeting the Board tentatively decided to propose the following definition of ‘material’ in IFRS Standards:

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions primary users of general purpose financial statements make on the basis of financial information about a specific reporting entity.

7. The proposed definition in paragraph 6 of this paper was developed as follows:

- (a) as a starting point, using the revised wording of the definition that was proposed in the *Conceptual Framework* Exposure Draft,² except to refer to financial statements rather than financial reports. This is because this wording is clearer than the definition in IAS 1 *Presentation of Financial Statements*. The *Conceptual Framework* Exposure Draft proposed to amend the wording in paragraph QC11 of the existing *Conceptual Framework* by replacing the word ‘users’ with ‘the primary users of general purpose financial reports’ (see Appendix C).
- (b) replacing the threshold ‘could influence’ with ‘could reasonably be expected to influence’. This change reflects an existing description of the definition of materiality in paragraph 7 of IAS 1 that states: ‘Therefore, the assessment needs to take into account how users with such attributes *could reasonably be expected to be influenced* in making economic decisions.’ [emphasis added].
- (c) including reference to ‘obscuring information’ in the definition to give it emphasis. Paragraph 30A of IAS 1 already requires: ‘An entity shall not reduce the understandability of its financial statements by *obscuring material information* with immaterial information...’ [emphasis added].

² The same revised wording is expected to be used in the revised *Conceptual Framework* once finalised.

Clarifying paragraphs to support the definition of materiality

8. At its April 2015 meeting the Board tentatively decided to propose paragraphs to clarify and support the definition of materiality. The paragraphs discussed by the Board would:
- (a) retain, but update as appropriate, the requirements in paragraph 7 of IAS 1 that are provided with the definition of ‘material’ and that help to clarify application of that definition;
 - (b) add a description of the characteristics of the primary users of financial statements, based on paragraphs 1.5 and 2.35 of the *Conceptual Framework Exposure Draft*³; and
 - (c) explain the use of the term ‘obscuring’ in the suggested definition of materiality by clarifying that:
 - (i) some users of financial statements may overlook material information if it is hidden within immaterial information; and
 - (ii) material information can also be obscured if it is not communicated clearly.

Staff analysis***Exposure Draft versus Discussion Paper***

9. The staff think that the advantages of proposing the clarifications to the definition of materiality (described in paragraphs 6–8 of this paper) in an Exposure Draft are:
- (a) these improvements can be made more quickly than if they are included with other topics in the Principles of Disclosure Discussion Paper.
 - (b) the clarifications being proposed are not expected to be substantive changes. They may therefore fit better within an Exposure Draft, rather

³ This description would be based on the revised Conceptual Framework once issued (subject to usual due process).

than together with more discursive topics in the Principles of Disclosure Discussion Paper.

- (c) stakeholders may expect the definition of materiality to be developed as part of the Board's project to develop a Materiality Practice Statement, rather than in the Principles of Disclosure project. Including the clarifications in a separate document will help to avoid confusion about where they are being addressed and prevent them getting 'lost' in the Principles of Disclosure Discussion Paper. It would also make it clear which definition the Board is working towards in its different projects.
- (d) many stakeholders support the existing definition, and believe that substantive changes are unnecessary and would be unlikely to alter how materiality is applied in practice. Consequently, these stakeholders are likely to favour only having proposed clarifications in an Exposure Draft, rather than opening up a larger debate about the definition in a Discussion Paper.

10. The staff think that the advantages of keeping the discussion about the clarifications to the definition of materiality in the Principles of Disclosure Discussion Paper are:

- (a) providing the proposed clarifications in a separate document from the Principles of Disclosure Discussion Paper would give them more prominence, which might imply that they are more significant than they are; and
- (b) some stakeholders think that more significant changes should be made to the definition of materiality and may prefer the Board to 'reopen the debate' in a Discussion Paper.

Likely effects of the proposed amendments on IFRS Standards

11. The staff do not think any of the proposed clarifications to the definition of materiality would result in substantive changes to the existing requirements because:

- (a) the refinements to the definition explained in paragraphs 6–7 of this paper use wording that currently exists in IAS 1 or that has been proposed in the *Conceptual Framework* Exposure Draft;
- (b) the clarifications to the definition explained in paragraphs 8(a) and (b) of this paper also already exist in IFRS Standards or in the *Conceptual Framework* Exposure Draft; and
- (c) the clarification explained in paragraph 8(c) of this paper gives examples of how information might be obscured and would not be expected to change the way the term ‘obscured’ is currently applied in IAS 1.

Likely effects of the proposed amendments on the Conceptual Framework and Materiality Practice Statement

12. If the Board makes changes to the definition of materiality in IFRS Standards, the staff think that it should update the definition of materiality in the *Conceptual Framework* (subject to usual due process). However if the definition of materiality in the *Conceptual Framework* is to be revised, the reference to ‘financial statements’ in the proposed definition in paragraph 6 would instead be to ‘financial reports’. Although the final *Conceptual Framework* will not have been published, the staff think the Exposure Draft could detail the likely consequential amendments that would be needed to the *Conceptual Framework*. The staff think that only one or two paragraphs of the *Conceptual Framework* would be affected (see paragraph B3 of Appendix B).
13. If the Board favours exposing the clarifications to the definition of materiality in an Exposure Draft it would likely be publishing the proposed amendments at a similar time to the final *Materiality Practice Statement*. Consequently the staff think the Exposure Draft could also detail any proposed consequential amendments to the final *Materiality Practice Statement* as a result of the proposed amendments to the definition of materiality.

Due process requirements

14. The staff observes that the Board has already reviewed and approved all of the necessary activities in the *Due Process Handbook* for publishing the clarifications to the definition of materiality. The due process activities were set out in Agenda Paper 11A for the Board's October 2015 meeting—the agenda paper seeking permission to ballot the Principles of Disclosure Discussion Paper. Nevertheless, the staff have also provided the due process table for publication of an Exposure Draft for a narrow scope amendment in Appendix D.
15. If the Board favours exposing the clarifications to the definition of materiality in an Exposure Draft, then the staff think it could commence balloting the Exposure Draft in early 2017, subject to the balloting schedule for other projects. The staff observe that balloting of the Exposure Draft would likely coincide with balloting of the final Materiality Practice Statement, which is expected to commence in February 2017, and the end of the balloting process for the Principles of Disclosure Discussion Paper.

Comment period

16. The Board normally allows a minimum period of 120 days for comment on an Exposure Draft. The Exposure Draft would be narrow in scope and not be proposing substantive changes. Consequently if the Board favours exposing the clarifications to the definition of materiality in an Exposure Draft, then the staff think a 120-day comment period is sufficient. The staff note that the comment period on the Principles of Disclosure Discussion Paper is 180 days. Therefore, we would have both documents out for comment at the same time enabling constituents to consider both documents together, even if the Exposure Draft is issued a few months after the Principles of Disclosure Discussion Paper.

Staff recommendation and questions for the Board

17. The staff recommend that the Board should propose the clarifications to the definition of materiality separately in an Exposure Draft with a 120-day comment period, rather than including them in the forthcoming Principles of Disclosure Discussion Paper.
18. In Appendix A the staff have provided an initial draft of the proposed amendments to IAS 1 for the clarifications to the definition of materiality. In Appendix B the staff have identified consequential amendments to other IFRS Standards. The staff do not ask the Board to approve these proposed amendments at this meeting, but welcome any initial comments from Board members to improve the drafting.

Questions

1) Publication of Exposure Draft: Does the Board agree with the staff recommendation to propose the clarifications to the definition of materiality separately in an Exposure Draft, rather than include them in the Principles of Disclosure Discussion Paper?

Follow-up questions (if Board decides to proceed with an Exposure Draft):

- 2) Permission to ballot:** Is the Board satisfied that the due process requirements have been met and that the staff can begin the balloting process for the proposed amendments?
- 3) Dissents:** Do any Board members plan to dissent from the publication of the proposed amendments?
- 4) Comment period:** Do Board members agree with a comment period of 120 days?

Appendix A: Staff initial draft of proposed amendments to IAS 1

A1. In this appendix the staff have provided an initial draft of the proposed amendments to IAS 1 for the clarifications to the definition of materiality. This is similar to the draft included in Agenda Paper 11B that was discussed at the Board's April 2015 meeting, updated using wording in the *Conceptual Framework* Exposure Draft.

Proposed Amendments to IAS 1 Presentation of Financial Statements⁴

Paragraph 7 is amended. New text is underlined and deleted text is struck through.

Definitions

7 ...

~~Material Information is Omissions or misstatements of items are material if omitting, misstating or obscuring it they could reasonably be expected to, individually or collectively, influence the economic decisions that primary users of general purpose financial statements make on the basis of financial information about a specific reporting entity the financial statements.~~

Materiality depends on the size ~~or and~~ nature of information, or both, and an entity assesses whether information is material both individually and collectively with other information in the context of an individual entity's financial statements 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. Material information might be obscured if placed within immaterial information or communicated unclearly.

Assessing whether ~~information an omission or misstatement~~ could reasonably be expected to influence ~~economic~~ decisions of primary users of general purpose financial statements, ~~and so be material,~~ requires consideration of the characteristics of those users. The *Conceptual Framework Framework for the Preparation and Presentation of Financial Statements* states in paragraphs 1.5 and 2.35 ~~25²~~ that:

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.

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.

~~'users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.' Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.~~

⁴ The quotes from the *Conceptual Framework* used in this text have been taken from the *Conceptual Framework* Exposure Draft.

² In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*. Paragraph 25 was superseded by Chapter 3 of the *Conceptual Framework*.

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Appendix B: Proposed consequential amendments to other IFRS Standards

- B1. To identify where consequential amendments may need to be made to other Standards the staff have performed a basic search through the IFRS Bound Volume 2016 (Red Book):
- (a) for instances of ‘material’, ‘materiality’, ‘materially’ and ‘immaterial’; and
 - (b) for the wording being replaced in the definition of materiality, for example ‘could influence’ and ‘omissions and misstatements’.
- B2. Based on this search the staff have identified the following list of proposed consequential amendments:

Reference	Explanation of proposed consequential amendment
IFRS 2.IG17 and IFRS 4.IG15-16	Update definition of materiality that is quoted in this paragraph.
IAS 1.24	Change ‘...would be likely to influence economic decisions made by users of financial statements...’ to ‘...could reasonably be expected to influence decisions made by the primary users of general purpose financial statements...’
IAS 8.IN3 & IN7	Change ‘material omissions or misstatements’ to ‘material information’.
IAS 8.5	Same changes to the definition of ‘material’ as proposed to IAS 1 (see Appendix A). Delete second sentence or move it into IAS 8.6.
IAS 8.6	Either delete paragraph or make the same changes as proposed to identical text in IAS 1 (see Appendix A).
IAS 10.21	In the explanation of material non-adjusting events, change ‘could influence the economic decisions that users make on the basis of the financial statements’ to ‘could reasonably be expected to influence decisions primary users of general purpose financial statements make on the basis of financial information about a specific reporting entity’
IAS 34.24	Update definition of materiality that is quoted in this paragraph.
IAS 37.75	In the requirements for disclosure of restructuring plans, change wording ‘could influence the economic decisions that users make on the basis of the financial statements’ to ‘could reasonably be expected to influence decisions primary users of general purpose financial statements make on the basis of financial information about a specific reporting entity’
Glossary:	Update definition of materiality.

definition of material	
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- B3. The table does not include the following:
- (a) there are many references to ‘economic decisions’ and ‘users of financial statements’ in IFRS Standards that do not directly relate to requirements about materiality. The staff do not think it is necessary to change all instances of ‘economic decisions’ to ‘decisions’ and ‘users’ to ‘primary users of general purpose financial statements’; and
 - (b) proposed consequential amendments to the *Conceptual Framework* (see paragraph 12 of this paper). Based on the *Conceptual Framework Exposure Draft*, the staff think the only consequential amendments would be the definition of materiality in paragraph 2.11 and in the Glossary.

Appendix C: Existing definitions of materiality

C1. The *Conceptual Framework* and IFRS Standards define ‘material’ as follows:

<i>Conceptual Framework</i>	IFRS Standards
<p>Information is material if omitting it or misstating it could influence decisions that <u>the primary users of general purpose financial reports</u> make on the basis of financial information about a specific reporting entity.</p> <p>(Paragraph QC11 of the <i>Conceptual Framework for Financial Reporting</i>, with proposed amendments to QC11 proposed in paragraph 2.11 of the <i>Conceptual Framework Exposure Draft</i> shown in underline)</p>	<p>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.</p> <p>(Paragraph 7 of IAS 1 [paragraph 5 of IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> has identical wording])</p>

Appendix D: Actions taken to meet the due process requirements

D1. The following table sets out the actions taken by the Board to meet the due process requirements.

Exposure Drafts for narrow-scope amendments

<i>Step</i>	<i>Required/optional</i>	<i>Metrics or evidence</i>	<i>Actions</i>
The Board and the Interpretations Committee's meetings are held in public, with papers being available for observers. All decisions are made in public session.	Required	Meetings held. Project website contains a full description with up-to-date information. Meeting papers posted in a timely fashion.	The Board discussed and tentatively decided to make clarifying amendments to the definition of materiality at its November 2014 and April 2015 meetings. The Board will discuss whether to propose these amendments in an Exposure Draft at this meeting. The project webpages have up to date information. Papers for the Board meetings were posted before each meeting.
Consultation with the Trustees and the Advisory Council	Required	Discussions with the Advisory Council.	Not considered necessary for these specific amendments because they are narrow in scope and are not expected to be substantive changes. The Advisory Council has received updates on the progress of the Disclosure Initiative, including work on materiality.
Consultative groups used, if formed.	Optional	Extent of consultative group meetings, and evidence of substantive involvement in issues. Consultative group review of the draft ED.	There are no consultative groups for the Disclosure Initiative. The Board decided that rather than form a consultative group, it might be more effective to focus on wider stakeholder engagement as well as continuing to seek the advice of a number of existing consultative groups, in particular the ASAF, CMAC and GPF.
Fieldwork is undertaken to analyse proposals.	Optional	The Board has described publicly the approach taken on fieldwork. The Board has explained to the DPOC why it does not believe fieldwork is warranted, if that is the preferred path. Extent of field tests taken.	Not considered necessary because the amendments are narrow in scope and are not expected to be substantive changes.
Outreach meetings with a broad range of stakeholders, with special effort to consult investors.	Optional	Extent of meetings held. Evidence of specific targeted efforts to consult investors.	Not considered necessary because the amendments are narrow in scope and are not expected to be substantive changes.
Webcasts and podcasts to	Optional	Extent of, and participation in, webcasts.	Not considered necessary because the amendments are narrow in scope and are not expected to be

provide interested parties with high-level updates or other useful information about specific projects.			substantive changes.
Public discussions with representative groups.	Optional	Extent of discussions held.	The ASAF discussed the definition of materiality when also discussing the development of guidance on materiality at its September 2014 meeting.
Online survey to generate evidence in support of or against a particular approach.	Optional	Extent and results of surveys	Not considered necessary because the amendments are narrow in scope and are not expected to be substantive changes.
The Board hosts regional discussion forums, where possible, with national standard-setters.	Optional	Schedule of meetings held in these forums.	The definition of materiality was discussed together with the development of guidance on materiality at the World Standard-setters meeting in September 2014. Disclosure Initiative activities, including materiality, have also been a topic at IFRS conferences.
Round-table meetings between external participants and members of the Board.	Optional	Extent of meetings held.	Not considered necessary because the amendments are narrow in scope and are not expected to be substantive changes.
Analysis of the likely effects of the forthcoming Standard or major amendment, for example, initial costs or ongoing associated costs.	Required	Publication of the Effect Analysis as part of the Basis for Conclusions.	The amendments are narrow in scope and are not expected to be substantive changes (see paragraph 11 of this paper for this analysis).
Finalisation			
Due process steps are reviewed by the Board.	Required	Summary of all the due process steps have been discussed by the Board before an Exposure Draft is published.	This step will be met by this agenda paper.
The Exposure Draft has an appropriate comment period.	Required	The period has been set by the Board. If outside the normal comment period, an explanation from the	In accordance with the <i>Due Process Handbook</i> , the staff are recommending a comment period of 120 days (see paragraph 16 of this paper).

		Board to the Due Process Oversight Committee (DPOC) has been provided, and the decision has been approved.	
Drafting			
Drafting quality assurance steps are adequate.	Required	The Translations team has been included in the review process.	The Translations team will review the pre-ballot draft.
Drafting quality assurance steps are adequate.	Required	The XBRL team has been included in the review process.	The Taxonomy team will review the pre-ballot draft.
Drafting quality assurance steps are adequate.	Optional	The Editorial team has been included in the review process. In addition, external reviewers have reviewed drafts for editorial review and the comments have been collected and considered by the Board.	The Editorial team have seen appendix A of this paper and will review drafts during the balloting process. The staff will ask external parties to perform an editorial review of the pre-ballot draft.
Drafting quality assurance steps are adequate.	Optional	Drafts for editorial review have been made available to members of the International Forum of Accounting Standard-Setters (IFASS) and the comments have been collected and considered by the Board.	The pre-ballot draft will be made available to members of the International Forum of Accounting Standard-Setters (IFASS). The staff will summarise the comments for the Board and ask the Board to discuss publicly any significant matters that arise.
Drafting quality assurance steps are adequate.	Optional	Review draft has been posted on the project website.	Not considered necessary because the amendments are narrow in scope and are not expected to be substantive changes.
Publication			
Exposure Draft.	Required	Exposure Draft posted on the Board website.	The Exposure Draft will be made available on our website when published.
Press release to announce the publication of the Exposure Draft.	Required	Press release published. Media coverage of the release.	A press release will be published with the Exposure Draft.
Snapshot document to explain the rationale and basic concepts of the Exposure Draft.	Optional	Snapshot has been posted on the Board website.	Not considered necessary because the amendments are narrow in scope and are not expected to be substantive changes. However, the proposed amendments to the definition would likely be mentioned in the snapshot prepared for the final Materiality Practice Statement.