STAFF PAPER

April 2018

IASB Meeting

Project	**Disclosure Initiative: Definition of Material**
Paper topic	Comment letter feedback—Exposure Draft: Definition of Material

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Objective

1. This paper provides an analysis of the feedback received from comment letters on the *Definition of Material—Proposed amendments to IAS 1 and IAS 8* Exposure Draft (Exposure Draft). We received 71 comment letters. Appendix A provides a summary by type of respondent and geographical region. Most responses were consistent across types of respondents and geographical regions, however, where a trend has been identified this has been highlighted.

2. Agenda Paper 11A uses the following terms to describe the extent to which particular feedback was provided by respondents:

Term	*Extent of response among respondents*
Almost all	all except a very small minority
Most	a large majority, with more than a few exceptions
Many	a small majority or large minority
Some	a small minority, but more than a few
A few	a very small minority

3. We will not ask the Board to make any decisions at this meeting. However, to help us develop our papers for the May 2018 Board meeting, we will ask the Board for its initial thoughts on the feedback received, particularly in relation to the concept of 'obscuring information' (see paragraphs 15-18).

4. Throughout this paper, references to the *Conceptual Framework* refer to the May 2015 *Conceptual Framework* Exposure Draft and not to the revised *Conceptual Framework* published on 29 March 2018. This is because feedback from respondents was based on the *Conceptual Framework* Exposure Draft.

Overview

5. This paper is structured as follows:

   (a) Background (paragraphs 6-7);

   (b) Key messages (paragraphs 8-9);

   (c) Support for the proposals (paragraphs 10-11);

   (d) The alignment of the definition of material between IFRS Standards and the *Conceptual Framework* (paragraph 12);

   (e) Replacing the threshold 'could influence' with 'could reasonably be expected to influence' (paragraphs 13-14);

   (f) Incorporating 'obscuring information' into the definition of material (paragraphs 15-18);

   (g) Location of the definition of material and explanatory paragraphs (paragraph 19);

   (h) Amendments to the Materiality Practice Statement and the revised *Conceptual Framework* (paragraphs 20-21);

   (i) Other comments on the proposed amendments (paragraphs 22-25);

   (j) Other feedback on the Materiality Practice Statement (paragraphs 26-29);

   (k) Question for the Board;

   (l) Appendix A—Demographic information;

(m) Appendix B—Proposed amendments to IAS 1 *Presentation of Financial Statements*;

(n) Appendix C—Extract from ISA 320 *Materiality in Planning and Performing an Audit*;

(o) Appendix D—Extracts from the Materiality Practice Statement: paragraphs 11, 21, 22 and 23.

Background

6. The Exposure Draft proposed minor amendments to IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The Exposure Draft proposed to clarify the definition of material by:

   (a) aligning the wording of the definition of material in IAS 1 and IAS 8 with the definition proposed in the *Conceptual Framework* Exposure Draft. This includes clarification that the users to whom the definition refers to are 'primary users' of an entity's financial statements. This clarification responds to concerns that the term 'users' may be interpreted too widely;

   (b) replacing the threshold 'could influence' with 'could reasonably be expected to influence'. This clarification responds to concerns that the threshold 'could influence' is too low and might be applied too broadly;

   (c) including 'obscuring information' in the definition of material. This clarification responds to concerns that the existing definition of material is sometimes perceived by stakeholders to focus only on information that cannot be omitted (material information), and not also on why it is unhelpful to include immaterial information; and

   (d) relocating the description of material misstatements, and other wording that explains rather than defines material, from the definition into the explanatory paragraphs accompanying the definition.

7. In addition, the Exposure Draft proposed updating the wording of the definitions of material in the Materiality Practice Statement and the revised *Conceptual Framework* in order to align with the revised definitions in IAS 1 and IAS 8.

Key messages

8. Almost all respondents supported the proposed amendments to IAS 1 and IAS 8. However, respondents also expressed concerns about some of the specific terminology used in the proposals and suggested amendments for the Board to consider. In particular, respondents had some concerns about introducing the concept of ‘obscuring information’ into the definition of material (paragraphs 15-18).

9. Respondents provided fewer comments about the proposed amendments to the Materiality Practice Statement and revised *Conceptual Framework*. Those that did provide comments supported the Board’s proposal to ensure the definition of material is consistent across the Standards and other IFRS publications (paragraphs 20-21).

Support for the proposals

10. Almost all respondents supported the proposed clarifications to the definition of material because:

    (a) many thought the proposals would remove inconsistencies in the definition of material between the *Conceptual Framework* and the IFRS Standards;

    (b) some thought that the alignment of the definition of material across IFRS Standards and other IFRS publications supports the Board’s objective of better communication in financial reporting;

    (c) some also thought that the amendments addressed the concerns that the former definition was too broad (see paragraphs 5(a) and 5(b)); and

    (d) some respondents said that, in their view, the amendments better emphasise that materiality decisions require the exercise of judgement.

11. Nevertheless, respondents also expressed concerns about some of the specific terminology used in the proposals and suggested some amendments for the Board to consider. Specific feedback received on each element of the proposals is summarised below.

The alignment of the definition of material between IFRS Standards and the *Conceptual Framework*

12. Many of the concerns expressed by respondents related to terminology used in the *Conceptual Framework* Exposure Draft:

    (a) the definition of material in the *Conceptual Framework* Exposure Draft uses the term ‘general purpose financial report’, whilst the Exposure Draft uses the term ‘general purpose financial statements’. Some respondents did not agree with using differing terms and suggested that the Board use consistent terminology to avoid confusion. These respondents preferred the term ‘general purpose financial statements’;

    (b) some respondents did not agree with the change of the term ‘users’ to ‘primary users’. This was because, in their view, ‘primary users’ is too narrow. These respondents consider that financial statements should provide information to a wider range of users such as regulators, government agencies, policy makers and internal stakeholders. However, some other respondents agreed with the term ‘primary users’ because they thought ‘users’ was too broad and could be interpreted in numerous ways. These respondents thought that the term ‘primary users’ would be applied more consistently;

    (c) furthermore, some respondents did not think the proposed additional paragraph defining ‘primary users’ was necessary as this term is already defined in the *Conceptual Framework*. Consequently, these respondents suggested that the Board remove the explanatory paragraph and include a reference to the definition of ‘primary users’ in the *Conceptual Framework*;

    (d) some respondents were confused about the use of the term ‘specific reporting entity’ as opposed to ‘reporting entity’. These respondents suggested that the Board clarify the difference between these terms;

    (e) some respondents expressed concern about how to interpret the term ‘information’ in the proposed definition. In particular, they were not certain whether ‘information’ referred to financial information, non-financial information, or both; and

(f) a few respondents thought that the word 'economic' should not be removed from the definition. These respondents said that 'economic decisions' is a more precise term than 'decisions' and would therefore be more consistently applied.

Replacing the threshold 'could influence' with 'could reasonably be expected to influence'

13. Many respondents agreed with the proposed replacement of 'could influence' with 'could reasonably be expected to influence'. This was because they thought the proposed change might address concerns that the expression 'could influence' is too broad and encompasses too much information.

14. Some other respondents were concerned about the inclusion of the term 'reasonably' within the definition. These respondents thought that this term might be interpreted differently, particularly across different jurisdictions, and that this may result in inconsistencies in how the definition of material is understood and applied in practice. Consequently, these respondents suggested that the Board further explain the meaning of the word 'reasonably'.

Incorporating 'obscuring information' into the definition of material

15. Many respondents expressed concern about how to interpret, apply and assess 'obscuring':

(a) some respondents were concerned that the proposals imply that the inclusion of immaterial information in financial statements automatically results in material information being obscured;

(b) some respondents stated that, in their view, it is unclear how to judge whether material information is obscured by immaterial information and as a result the concept may not be applied consistently;

(c) a few respondents thought that 'obscuring' is a subjective and complex concept. These respondents thought that including 'obscuring' in the definition might make it difficult to determine if information is material, and to assess compliance with the definition of material; and

(d) a few stated that, in their view, the example included in the Exposure Draft (see Appendix B) was not helpful as it defines obscuring by referring to obscuring and is consequently too vague to provide helpful application guidance.

16. Consequently, respondents asked the Board to consider the following:

(a) some respondents thought the Board should provide a clearer definition of 'obscuring' within IAS 1 or the Materiality Practice Statement and supplement this with illustrative examples and application guidance in the Materiality Practice Statement;

(b) a few respondents thought that the Board should consider removing the term 'obscuring' altogether and define material information more directly. This was because the term 'obscuring' relates to the principles of faithful representation or communication of information, and not to whether that information is material. Consequently, respondents thought this matter should be addressed separately from the definition of material; and

(c) a few respondents also thought that, in addition to removing the term 'obscuring', the terms 'omitting' and 'misstating' should also be removed from the definition of material. This was because, in their view, the definition would be clearer if these terms were removed and that instead of being in the definition, the Board should explain how 'omitting', 'misstating' and 'obscuring' can affect the information communicated to users.

17. Respondents who suggested that the Board provide additional application guidance and illustrative examples identified a number of scenarios in which they thought it would be difficult to assess what constitutes 'obscuring information'. These respondents asked the Board for specific examples that would address whether information is obscured when:

(a) information about a material event is disclosed in the financial statements but the language is vague and unclear;

(b) information about a material event is presented piecemeal across various notes in the financial statements; and

(c) dissimilar items are inappropriately aggregated or similar items are inappropriately disaggregated.

18. A few respondents added that, in their view, the meaning of the terms 'omitting' and 'misstating' are also unclear and suggested that the Board provide further explanatory paragraphs for each of these terms as well.

Location of the definition of material and explanatory paragraphs

19. Many respondents thought that the definition of material should not be repeated in multiple locations across the Standards. These respondents suggested that the definition of material be included in IAS 1 only and that, when needed, other Standards make reference to that definition. Respondents thought this would avoid repetition and reduce the risk of possible inconsistencies arising as IFRS Standards are revised.

Amendments to the Materiality Practice Statement and the revised *Conceptual Framework*

20. Overall, respondents provided less feedback about the proposal to update the definitions of material in the Materiality Practice Statement and the revised *Conceptual Framework* (see paragraph 7). Those respondents that did provide feedback agreed with aligning the definition of material across all published IFRS documents.

21. However, some of these respondents had the following additional suggestions:

(a) some respondents thought that the Board should also consider using consistent language across all IFRS Standards and suggested that the Standards use terms that are consistent with those used in the Exposure Draft. In other words, they recommended the Board make sure all of its Standards and published documents are aligned to the revised definition of material. These respondents provided the following examples:

(i) replacing the term ‘users’ with ‘primary users’; and

(ii) replacing the term ‘economic decisions’ with ‘decisions’;

(b) a few respondents suggested that it would be useful to have the *Conceptual Framework* refer to the Materiality Practice Statement for explanations on how to make materiality judgements; and

(c) a few respondents thought that it would be appropriate to include any explanatory paragraphs about the definition of material in the *Conceptual Framework* and Materiality Practice Statement instead of in IAS 1 and IAS 8.

Other comments on the proposed amendments

22. Some respondents provided further feedback about the proposals in the Exposure Draft. Of these respondents:

(a) some suggested that the Board make sure the effective date of the amendments aligns with the effective date of other changes being made to IAS 8—ie the maintenance projects Accounting Policy Changes (Amendments to IAS 8) and Accounting Policies and Accounting Estimates (Amendments to IAS 8). In addition, these respondents thought that entities should not be required to disclose any early application of the proposals. This is because the proposals do not fundamentally change the concept of materiality and hence respondents thought there should be no impact on judgements made in the preparation of financial statements; and

(b) a few thought that where the proposals indicate that ‘materiality depends on the nature or magnitude of information or both’, a reference should be made to the Materiality Practice Statement. These respondents thought this would help stakeholders know that additional guidance on this matter exists.

23. A few respondents were also concerned about the use of the term ‘material’ in IFRS Standards. These respondents suggested that the term ‘material’ is used inconsistently across the Standards and is sometimes used in other, narrower contexts (ie not in relation to the financial statements as a whole). For example—IAS 16 *Property, Plant*

and Equipment says that sometimes residual value does not have a material effect on the calculation of depreciation. Consequently, respondents thought that in this context the assessment seems to be whether the depreciation expense is materially affected. Respondents thought this would be a different assessment of material to the one described in the Exposure Draft, which refers to an entity assessing whether information is 'material in the context of its financial statements'.

24. Some respondents also thought that the Board should review the use of the terms 'immaterial' and 'not material' throughout IFRS Standards and additional guidance (such as the Materiality Practice Statement). These respondents recommended that the Board use one term consistently, or clarify that the terms 'immaterial' and 'not material' have the same meaning.

25. A few respondents also suggested that the Board liaise with the International Auditing and Assurance Standards Board (IAASB) as they have a more detailed definition of materiality (see Appendix C) and that it would be helpful if the two definitions aligned.

Other feedback on the Materiality Practice Statement

26. Some respondents—in particular accountancy bodies, accounting firms and standard-setting bodies—included feedback on the Materiality Practice Statement in their responses. These respondents thought that the proposed amendments, together with the Materiality Practice Statement, have the potential to help address the behavioural issues identified in the Principles of Disclosure project. They suggested that the combination of the proposed amendments to the definition of material and the guidance in the Materiality Practice Statement might improve entities' understanding of the concept of materiality and increase their confidence in making materiality judgements.

27. Some respondents also said that, in their view, the Materiality Practice Statement is a useful tool for making materiality judgements and supplements existing recognition and measurement criteria. These respondents added that successful application of the proposals in the Exposure Draft and guidance in the Materiality Practice Statement

would require the cooperation and efforts of all stakeholders to correctly interpret and apply materiality in financial statements.

28. A few of these respondents also stated that, in their view, the Materiality Practice Statement is such a useful tool that components of it should be incorporated into IAS 1 or the *Conceptual Framework*. These respondents provided the following specific examples of guidance in the Materiality Practice Statement that they thought the Board should include, or make reference to, in IAS 1 or the *Conceptual Framework*:

    (a) explanatory information on ‘primary users’ and how to assess their information needs, similar to paragraphs 11, 21, 22 and 23 of the Materiality Practice Statement (see Appendix D);

    (b) guidance on how to take into account quantitative and qualitative factors when making a materiality judgement; and

    (c) illustrative examples contained in the Materiality Practice Statement.

29. Conversely, a few respondents were less supportive of the Materiality Practice Statement. This was because they thought the Practice Statement would not help in reducing the current significant documentation burden on businesses—even for clearly immaterial items. In other words, these respondents thought the Materiality Practice Statement would not address the problem of having to justify the exclusion of immaterial information from the financial statements.

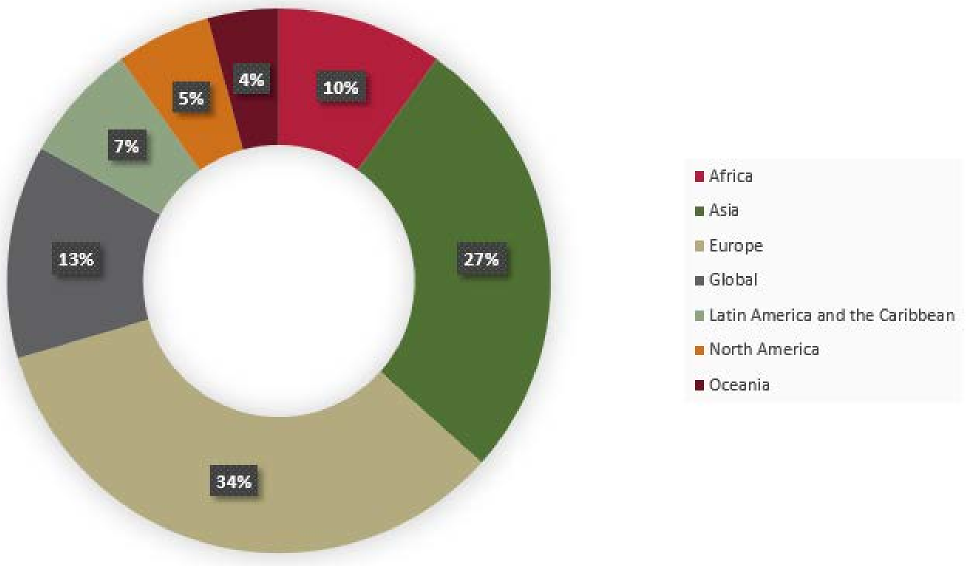
Question for the Board

Question 1
To help us develop our papers for the May 2018 Board meeting, what are the Board’s thoughts on the feedback received from respondents—in particular the feedback relating to ‘obscuring information’ (see paragraphs 15-18)?

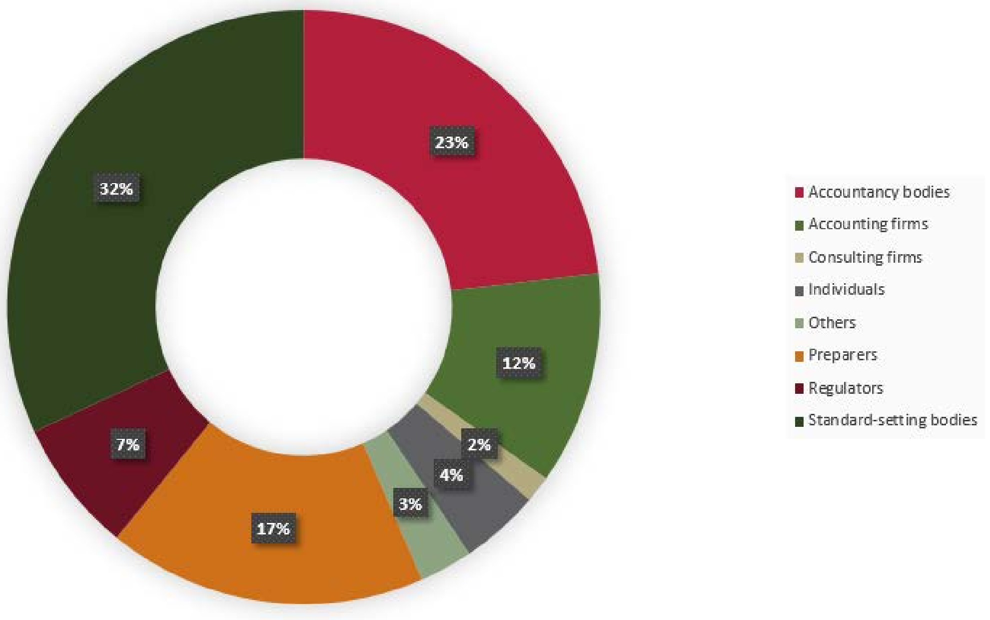
Appendix A—Demographic information

A1. The following is a summary of the 71 comment letters received.

A2. This pie chart illustrates the breakdown of comment letters by geographical region:



A3. This pie chart illustrates the breakdown of comment letters by respondent type:



Appendix B—Proposed amendments to IAS 1 *Presentation of Financial Statements*

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 the primary users of a specific reporting entity's general purpose financial statements make on the basis of those ~~the~~ financial statements.

Materiality depends on the ~~size and~~ nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its 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 it is not communicated clearly—for example, if it is obscured by immaterial information. A misstatement of information is material if it could reasonably be expected to influence decisions made by the primary users.

Assessing whether information ~~an omission or misstatement~~ could reasonably be expected to influence ~~economic~~ decisions of the primary users of general purpose financial statements~~, and so be material,~~ requires consideration of the characteristics of those users judged in the entity's circumstances.

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 statements are directed. Financial statements 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.

…

Appendix C—Extract from ISA 320 *Materiality in Planning and Performing an Audit*

Materiality in the Context of an Audit

2. Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:

   - Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;
   - Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and
   - Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

3. Such a discussion, if present in the applicable financial reporting framework, provides a frame of reference to the auditor in determining materiality for the audit. If the applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred to in paragraph 2 provide the auditor with such a frame of reference.

4. The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, it is reasonable for the auditor to assume that users:

   a) Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;

   b) Understand that financial statements are prepared, presented and audited to levels of materiality;

   c) Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and

   d) Make reasonable economic decisions on the basis of the information in the financial statements.

Appendix D—Extracts from the Materiality Practice Statement: paragraphs 11, 21, 22 and 23

11. When assessing whether information is material to the financial statements, an entity applies judgement to decide whether the information could reasonably be expected to influence decisions that primary users make on the basis of those financial statements. When applying such judgement, the entity considers both its specific circumstances and how the information provided in the financial statements responds to the information needs of primary users.

21. The objective of the financial statements is to provide primary users with financial information that is useful to them in making decisions about providing resources to an entity. However, general purpose financial statements do not, and cannot, provide all the information that primary users need. Therefore, the entity aims to meet the common information needs of its primary users. It does not aim to address specialised information needs—information needs that are unique to particular users.

22. To meet the common information needs of its primary users, an entity first separately identifies the information needs that are shared by users within one of the three categories of primary users identified in the *Conceptual Framework*—for example investors (existing and potential)—then repeats the assessment for the two remaining categories—namely lenders (existing and potential) and other creditors (existing and potential). The total of the information needs identified is the set of common information needs the entity aims to meet.

23. In other words, the assessment of common information needs does not require identifying information needs shared across all existing and potential investors, lenders and other creditors. Some of the identified information needs will be common to all three categories, but others may be specific to only one or two of those categories. If an entity were to focus on those information needs that are common to all three categories of primary users, it might exclude information that meets the needs of only one category.