STAFF PAPER

June 2014

REG IASB Meeting

Project	**Conceptual Framework**		
Paper topic	Presentation and disclosure—materiality		
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Purpose of the paper

1. This paper considers whether any changes should be proposed to the concept of materiality in the *Conceptual Framework for Financial Reporting*. The staff recommend that the approach to the concept of materiality adopted in the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the 'Discussion Paper') is retained.

2. This paper belongs to the series of papers on the presentation and disclosure section in the *Conceptual Framework*. The communication aspects of disclosure and presentation requirements are discussed in Agenda Paper 10F for this month's meeting. The staff plan to present to the IASB a paper that discusses the remaining aspects of presentation and disclosure in July 2014.

Structure of paper

3. This paper is structured as follows:

   (a) materiality in the existing *Conceptual Framework* and IAS 1 *Presentation of Financial Statements* (paragraphs 4–6);

   (b) summary of the Discussion Paper (paragraphs 7–8);

   (c) Disclosure Initiative work on materiality (paragraphs 9–11);

   (d) feedback received on the Discussion Paper (paragraphs 12–14);

(e) staff analysis (paragraphs 15–20); and

(f) staff recommendation and a question for the IASB (paragraph 21).

Materiality in the existing *Conceptual Framework* and IAS 1

4. Paragraph QC11 of Chapter 3 *Qualitative characteristics of useful financial information* in the *Conceptual Framework* sets out the concept of materiality as follows:

> Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

5. In addition, IAS 1 defines 'material':

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

6. IAS 1 also states that an entity:

(a) need not provide a specific disclosure required by a Standard if the information is not material; and

(b) should provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Summary of the Discussion Paper

7. In the Discussion Paper, the IASB reviewed the existing concept of materiality and expressed the view that it is clearly described in the existing *Conceptual Framework*. Consequently, the IASB did not propose to amend, or add, to that description.

8. The Discussion Paper acknowledged that how the concept of materiality is *applied* in practice is seen by many as a major cause of the current disclosure problem. The Discussion Paper noted that the IASB is considering providing additional material on the application of materiality in another project (now a research project that is part of the Disclosure Initiative).

Disclosure Initiative work on materiality

9. In March 2014 the IASB decided on the objective, scope and topics of its Disclosure Initiative research project on materiality. In that research project, the IASB will explore the application of materiality around the world by looking at legal cases, accounting and auditing guidance and other literature. The objective of the project is to help preparers, auditors and regulators use judgement when applying the concept of materiality, with a particular focus on the notes to the financial statements.

10. The results of that research will be discussed by the IASB in Quarter 3 of 2014 when the next steps for the project will also be discussed. The next steps could include the publication of a research paper, developing application guidance or developing educational material on materiality.

11. In addition, the March 2014 Exposure Draft *Disclosure Initiative: Proposed amendments to IAS 1* included proposals for amendments to the materiality requirements in IAS 1. Those proposals:

(a) emphasise that entities shall not aggregate or disaggregate information so useful information is obscured;

(b) clarify that materiality applies across the whole of financial statements, including notes; and

(c) emphasise that materiality applies to the information resulting from specific disclosure requirements.

Feedback received on the Discussion Paper

12. Many respondents to the Discussion Paper provided comments on materiality. Of those respondents:

    (a) many agreed with the IASB's proposal not to revise the concept of materiality in the *Conceptual Framework* but to consider providing additional guidance or educational material in the research project on materiality,

    (b) some suggested amendments to the concept of materiality or requested clarifications of that concept,

    (c) some provided comments on the research project on materiality, including comments on the process and the status of the outcome of that research. The detailed comments have been provided to the Disclosure Initiative team for consideration in that research project. Some respondents thought that the additional guidance that may result from that research project should be included in the *Conceptual Framework*.

13. Those respondents who requested clarifications or amendments to the concept of materiality suggested that the IASB should:

    (a) provide more guidance on the application of materiality to qualitative information and to information disclosed in the notes to the financial statements.

    (b) not introduce quantitative thresholds or bright-lines for materiality—however, a few other respondents stated that thresholds for materiality should be introduced.

(c) address immaterial information, for example, clarify that the provision of immaterial information can clutter or obscure the useful information in financial statements. Some even suggested that the IASB should explicitly state that immaterial information should not be disclosed.

(d) clarify that misstatements and omissions are material only if they are 'reasonably expected' to—instead of 'could'—influence the economic decisions of users.

14. Respondents made a number of additional comments on materiality. These comments are included in Appendix A. We do not plan to discuss these comments at this meeting.

Staff analysis

15. The staff think that the suggestions for amendments to the concept of materiality made by respondents, shown in paragraph 13(a)–(c) relate to the *application* of that concept. Applications of the concept of materiality are outside the scope of the *Conceptual Framework* and are being addressed in the Disclosure Initiative.

16. For example, as discussed in paragraphs 9–10, the application of the concept of materiality to qualitative information and to information disclosed in the notes is being considered in the Disclosure Initiative research project on materiality. Accordingly, those comments from respondents will be considered as part of that project.

17. Likewise, the staff note that the discussion about thresholds for materiality is also an application question instead of a conceptual one. The staff agree with the statement in the existing *Conceptual Framework* that the IASB cannot specify a uniform threshold for materiality or predetermine what would be material in a particular situation. This is because:

(a) materiality is an entity-specific aspect of relevance and must be assessed in the context of an individual entity's financial report. It is therefore impossible for the IASB to set a materiality threshold suitable to all entities.

(b) a quantitative threshold could imply that the concept of materiality applies only to quantitative information, whereas that concept also applies to qualitative information.

(c) a quantitative threshold implies that if an amount is below the threshold then the information is not relevant, which is not always the case.

18. Accordingly, the staff do not believe that introducing thresholds for materiality in the *Conceptual Framework* is appropriate.

19. The March 2014 Exposure Draft *Disclosure Initiative: Proposed amendments to IAS 1* under the Disclosure Initiative address the request for guidance on immaterial information and on how immaterial information could obscure useful information in financial statements. The Exposure Draft *Disclosure Initiative: Proposed amendments to IAS 1* also discusses why the IASB does not propose to prohibit disclosure of immaterial information. The staff believe that it is unnecessary to duplicate this discussion in the *Conceptual Framework.*

20. The staff think that amending the concept of materiality in the *Conceptual Framework* to refer to information being 'reasonably expected' to influence decisions made by users, as opposed to 'could', as discussed in paragraph 13(d), would represent a substantial change to the concept of materiality. Considering such a change would benefit from the further research being undertaken in the Disclosure Initiative. If that research project indicates a need to reconsider the notion that an item is material if it *could influence* decisions made by users then the staff will discuss this with the IASB at a future meeting.

Staff recommendation

21. The staff recommend that no amendments to the concept of materiality in paragraph QC11 of the existing *Conceptual Framework* should be proposed in the Exposure Draft.

Question for the IASB

The staff recommend that no amendments to the concept of materiality in paragraph QC11 of the existing *Conceptual Framework* should be proposed in the Exposure Draft.

Do you agree?

Appendix A

A1. The following comments, which we do not plan to discuss at this IASB meeting, were also raised by a few respondents:

Comment	Staff response
(a) Clarify that materiality is applied to the financial statements as a whole.	This is about the application of materiality and therefore does not need to be addressed in the *Conceptual Framework*.
(b) Materiality should be better co-ordinated with the International Auditing and Assurance Standards Board (IAASB), or should take into account the output of their disclosure project to maintain consistency.	We are working with the IAASB and the International Organization of Securities Commissions (IOSCO) on the Disclosure Initiative research project on materiality.
(c) The *Conceptual Framework* could state that individual Standards may contain minimum disclosures that must be provided even if the required disclosures are not judged to be material to the entity.	Minimum disclosure requirements could result in disclosure that is not relevant.
(d) The IASB should provide examples to clarify how materiality should be evaluated.	Examples would not be appropriate in the *Conceptual Framework*.
(e) The concept of materiality is pervasive. Including materiality only in the presentation and disclosure section implies it is less relevant to other parts of the *Conceptual Framework*.	Although materiality was discussed in the context of presentation and disclosure in the Discussion Paper, the concept of materiality is included in existing Chapter 3 of the *Conceptual Framework* and so is relevant to other parts of the

	Conceptual Framework.
(f) The IASB should specify only those disclosures that it considers are likely to be material in relation to most entities.	Disclosure requirements are developed in order to provide financial information that is likely to be useful to users of financial statements.
(g) Each Standard should state that the disclosure requirements apply only to material items.	This is not a concept and so should not be included in the *Conceptual Framework*.
(h) This section of the Discussion Paper may be misinterpreted as implying that an entity would be permitted to omit disclosures that are deemed immaterial from a purely quantitative perspective.	The description of materiality in the *Conceptual Framework* refers to materiality being based on the nature or magnitude or both of the items. Reference to nature indicates materiality is not assessed only quantitatively.
(i) Entities should be compelled to disclose information beyond the disclosure requirements in Standards to explain the economic substance of transactions or events.	This is an application of materiality and so would be better considered outside of the *Conceptual Framework*. IAS 1 already requires an entity to make additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.