

STAFF PAPER

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[Educational Session]

Project	Disclosure Initiative		
Paper topic	Materiality- Responses from national standard-setters		
CONTACT(S)	Aisling Carney	acarney@ifrs.org	+44 (0) 20 7246 6480
	Michelle Fisher	mfisher@ifrs.org	+44 (0) 20 7246 6918

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Purpose of this paper

1. This paper summarises the main responses from national standard-setters following our request for help in understanding the application of materiality in different jurisdictions.
2. The information in this paper will become an input for a future paper about our research on materiality, which will help the IASB decide whether it needs to undertake further work on the application of materiality.

Structure of this paper

3. This paper is set out as follows:
 - (a) background;
 - (b) details of the respondents;
 - (c) common feedback within the responses;
 - (d) responses to the specific information requested by type of publication:
 - (i) case law and securities law;
 - (ii) requirements issued by regulators;
 - (iii) academic research;

- (iv) local auditing guidance;
 - (v) other local guidance; and
 - (vi) other similar concepts to materiality.
- (e) International Auditing and Assurance Standards Board (IAASB) Exposure Draft; and
- (f) miscellaneous.
4. Some respondents provided very detailed information, including extracts from publications, on instances in which the concept of materiality has been discussed or applied in their jurisdiction. The staff have not included this level of detail in this paper. Staff will provide more detailed feedback from respondents during the IASB re-deliberation process when appropriate. Furthermore, the detail from these publications will be helpful to the staff going forward in deciding if guidance on application of materiality should be developed and, in particular, the type of guidance that might be useful.

Background

5. We wrote to national standard-setters between April and June 2014 to ask them for help in understanding the application of materiality in their jurisdictions, to assist with our research project. In particular, we asked them about instances in which the concept of materiality has been considered/used in case and securities law; guidance issued by a regulator (securities, prudential, enforcer, other); academic research; local auditing guidance; and any other papers and publication of interest. We also asked for information about the use of other concepts that are similar to (but differ from) materiality.

Respondents

6. We heard from 19 jurisdictions. We had three responses from North and Central America, seven from Europe (including two from France), six from Asia and two each from Africa and Oceania.

7. Many of the responses that we got were staff papers and were, therefore, not necessarily the opinion of the national standard-setter. Several of the national standard-setters contacted various organisations and stakeholders within their jurisdictions and presented a collated version of the information they gathered. Based on the responses received, the staff have observed that the types of documents and guidance in which the concept of materiality is used vary across jurisdictions. Consequently, we received a variety of different information from respondents.

Common feedback

8. When materiality is defined in publications, the definitions are similar to each other and the IFRS *Conceptual Framework for Financial Reporting* definition. A high proportion of the sources use the *Conceptual Framework* or the IAASB definitions verbatim. However, there is a slightly different focus in some of the definitions and guidance, for example, more of a focus on the quantitative side of materiality than the qualitative side. Like IFRS, many publications stated that materiality is an entity-specific concept.

Responses to the specific information requested

Case law

9. Taking account of previous feedback, we had expected that respondents would include a large amount of case law relating to materiality in their responses. Before sending our request for information we were aware of three major cases before the US Supreme Court, as well as a high volume before the US District Courts. However, contrary to our expectations, we only received examples of case law from the US Financial Accounting Standards Board (FASB) and the German Accounting Standards Committee.

Securities law

10. A possible reason for the low number of legal cases is, as the staff observes from the responses, the concept of materiality appears to be generally well defined in national

securities laws. Excerpts from securities law were included in the majority of the responses. Respondents also told us that materiality definitions and guidance are also in other legal sources; for example, Companies Acts, Corporation Acts, Financial Statements Acts, the EU Accounting Directive and Commercial Codes.

11. In general, the definitions in the securities laws in the responses received were similar to the *Conceptual Framework* definition. Most definitions state that materiality must affect economic decisions made by the user. However, others refer to decisions that would affect the market price of an entity's securities. Some also referred to decisions regarding management's stewardship of the entity.

Requirements issued by regulators

12. Most respondents provided information about requirements issued by regulators. The most common regulators mentioned in the responses were central banks, stock exchanges or insurance regulators. A lot of the requirements referenced the materiality requirements within Basel III. Some regulators have issued regulations that mandate specific disclosure requirements, for example, requirements to disclose items that meet the prescribed thresholds. The requirements varied in their level of detail across the jurisdictions.

Academic research

13. We did not receive a lot of feedback on academic research. Based on the responses received, the staff are of the opinion that most respondents were less familiar with the academic research than they were with other guidance. The majority of the academic research we received focused on the US Supreme Court definition of materiality (which differs from the *Conceptual Framework* definition). We also received a few Asian resources. Much of the academic research considered by respondents focused on setting materiality thresholds within an audit, instead of examining it in a broader sense.

14. The research article listed most regularly by respondents was “*A Review and Integration of Empirical Research on Materiality: Two Decades Later*” by William F. Messier, Jr., Nonna Martinov-Bennie, and Aasmund Eilifsen.¹

Local auditing guidance

15. The majority of the respondents’ local auditing guidance is based on IAASB guidelines and uses its materiality definition. When local guidance exists, it is in line with the objectives of the *Conceptual Framework*’s definition, ie it focuses on users’ needs and its entity-specific nature of materiality.

Local guidance

16. Some respondents referred to local guidance on the application of materiality. For example, standard-setters and regulators in some jurisdictions have written their own guidance to help interested parties in their jurisdictions apply the concept of materiality. This guidance is generally non-mandatory and discursive in nature. However, some guidance prescribes quantitative thresholds. Some national standard-setters said they had withdrawn their existing guidance on materiality as a result of adopting IFRS. This pre-IFRS guidance provides an interesting insight into the historical understanding of materiality and tended to have a quantitative focus. The removal of the former guidance shows a trend towards qualitative materiality considerations.

Other similar concepts

17. The majority of responses encompassed other similar concepts to materiality in their responses. Most of these are used in a similar way to materiality and include words such as ‘important’, ‘significant’, ‘key’ and ‘critical’. There were also inferences to concepts that are similar to ‘immaterial,’ such as ‘clearly trivial’.

¹ The article can be found at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=786688.

IAASB

18. We did not send a request to the IAASB, as our request for help was only sent to national standard-setters. However, as noted in paragraph 15, the audit guidance in many jurisdictions is based on the IAASB's guidelines. Consequently, as the IAASB is carrying out interesting and relevant work on materiality, we have included a very brief outline of its work in this paper.
19. The IAASB published the Exposure Draft Addressing Disclosures in the Audit of Financial Statements in May 2014. The IAASB's definition is very similar to the definition in the *Conceptual Framework*:
- 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.
20. The Exposure Draft aims to clarify and elaborate on the expectations of auditors when evaluating misstatements and forming an opinion through considering;
- (a) evaluating misstatements in disclosures; and
 - (b) evaluating the presentation of the financial statements.

The IAASB is continuing to follow the developments of the IASB and will consider those developments accordingly.

Miscellaneous

National influences on materiality

21. Some respondents noted that they think that the application of the concept of materiality in individual jurisdictions is affected by local laws, local regulations and various local guidance.
22. From the responses we received the staff observed that cultural elements play a role in the application of the concept of materiality and on the kinds of information that users find useful. For example, this was evident from the information we received on the role of materiality within Islamic financial law.

23. The structure of a legal system of a jurisdiction can be key to the application of materiality. We received some helpful feedback from respondents on the role of definitions within administrative law in civil law jurisdictions. This included an explanation of a definition given by a court, as opposed to being included in statute, and its place in the hierarchy of laws. They also clarified the difference between ‘determined materiality’ and ‘undetermined materiality’.

Concerns

24. A few national standard-setters also raised their concerns regarding the future of actions of the IASB with regard to materiality. Some were concerned that any guidance produced by the IASB may be overly prescriptive. For example, some noted that it might cause confusion if jurisdictions have their own conflicting guidance on materiality or if entities file under more than one GAAP, or that it would not improve the effectiveness of disclosure. However, many national standard-setters expressly welcome the IASB’s interest in this area.