

STAFF PAPER

November 2016

IASB Meeting

Project	Disclosure Initiative: Materiality		
Paper topic	Materiality - Cover paper		
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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*.

Purpose of this session

1. The purpose of this session is to ask the International Accounting Standards Board (the Board¹) whether, in the light of comments received on the Exposure Draft IFRS Practice Statement: *Application of Materiality to Financial Statements* (the Exposure Draft¹), members want to change the final IFRS Practice Statement: *Application of Materiality to Financial Statements* (the final *Practice Statement*¹).
2. This paper:
 - (a) provides background information on the Materiality project (Appendix A);
 - (b) provide a summary of the tentative decisions the Board has made so far in the course of redeliberations on the Exposure Draft (Appendix B);
 - (c) introduces the papers that will be discussed during this session; and
 - (d) sets out the next steps of the Materiality project.

¹ This definition has been used consistently in all the Agenda Papers prepared for this meeting.

Papers for this session

3. Each Agenda Paper we prepared for this session focuses on issues raised by respondents regarding the content and/or the form of the Exposure Draft and asks the Board members to discuss the following issues.
4. Summary:
 - (a) Agenda Paper 11A *Errors* addresses issues relating to the application of materiality to errors.
 - (b) Agenda Paper 11B *Covenants* discusses the impact of covenants on the materiality assessment.
 - (c) Agenda Paper 11C *Stewardship* addresses issues related to the impact of stewardship considerations on the materiality assessment.
 - (d) Agenda Paper 11D *Recognition and measurement* discusses whether the final *Practice Statement* should include the guidance on the application of materiality in the context of recognition and measurement throughout, rather than as a separate section.
 - (e) Agenda Paper 11E *Entities applying the IFRS for SMEs Standard* discusses whether the guidance in the final *Practice Statement* should be addressed also to entities applying *IFRS for SMEs*[®] Standard.
 - (f) Agenda Paper 11F *Status and form of the guidance* asks the Board to confirm the *status* (ie mandatory versus non-mandatory guidance) and the *form* that the guidance on applying the concept of materiality to IFRS financial statements should take.
5. The reference CLxx, used throughout the papers, refers to the ID number assigned to the comment letter. The comment letters can be found on the IFRS Foundation website².

² <http://www.ifrs.org/Current-Projects/IASB-Projects/Disclosure-Initiative/Materiality/Exposure-Draft-October-2015/Pages/Comment-letter.aspx>

Next steps

6. At the December 2016 Board meeting we will ask the Board to re-discuss the application of materiality to prior period information. The Board initially discussed this issue during its October 2016 meeting³.
7. We expect to complete the technical deliberations at the December Board meeting. On the basis of the Board decisions we will then start the drafting of the final guidance.
8. We will also bring a paper summarising the due process steps completed to date to the December 2016 Board meeting.

³ See Agenda Paper 11G *Comparative versus corresponding approach and conflicts with local regulations* presented to the Board in October 2016.

Appendix A

Background information

- A1. The Board was informed at the Discussion Forum on Financial Reporting Disclosure in January 2013, in its related survey and by other sources, that there are difficulties applying the concept of materiality when preparing the financial statements. Some interested parties were of the view that these difficulties contribute to a disclosure problem, namely, that there is both too much irrelevant information in financial statements and not enough relevant information.
- A2. The Board heard that there are a number of reasons why materiality is not applied well in practice. One of these is that there is limited guidance on materiality in IFRS Standards and, in particular, on how it should be applied to disclosures in the notes to the financial statements. In the light of this feedback, the Board decided to undertake a project on the application of materiality.
- A3. The Board tentatively decided to provide guidance on the application of materiality in the form of a Practice Statement and published the Exposure Draft IFRS Practice Statement: *Application of Materiality to Financial Statements* (October 2015). The objective of the Exposure Draft was to assist management in applying the concept of materiality to general purpose financial statements prepared applying IFRS Standards.
- A4. We received 95 comment letters and conducted outreach meetings with preparers, standard-setters, auditor and users. A high-level overview of the feedback received was presented to the Board at its April 2016 meeting⁴.
- A5. Feedback on the Exposure Draft was also received from the Accounting Standards Advisory Forum (ASAF) in December 2015 and July 2016 and with the Capital Market Advisory Committee (CMAC) and Global Preparers Forum (GPF) members in November 2015 and June 2016.

⁴ <http://www.ifrs.org/Meetings/MeetingDocs/IASB/2016/April/AP11A-Disclosure-Initiative.pdf>

Appendix B

Summary of the Board's tentative decisions

B1. During its October 2016 meeting the Board discussed some of the issues raised by respondents regarding the content of the Exposure Draft and tentatively decided to:

Audience, focus and definition (Agenda Paper 11B)

- (a) clarify that the final *Practice Statement* will address the application of materiality in preparing financial statements and acknowledge that it may benefit other parties in addition to those involved in preparing financial statements;
- (b) replace the term 'management' with the term 'entity' throughout the final *Practice Statement* and refer to applying the concept of materiality only in the preparation of financial statements;
- (c) include in the *Practice Statement* the explanation of the definition of materiality contained in IAS 1 *Presentation of Financial Statements*—that an entity should take into account 'how users could reasonably be expected to be influenced in making economic decisions', and use this interpretation consistently throughout the final *Practice Statement*;
- (d) make no changes to the definition of materiality in IFRS Standards within this project;

Primary users' needs and expectations (Agenda Paper 11C)

- (e) refer to 'primary users' (as defined by the Conceptual Framework for Financial Reporting) throughout the final *Practice Statement* emphasising that they include also potential investors, potential lenders and potential other creditors;
- (f) reconsider references to the 'special needs' of primary users, 'subsets' or 'classes' of primary users and 'expectations' of primary users in the final *Practice Statement*;

- (g) revise the guidance provided on ‘users of the financial statements and their decisions’ in the final *Practice Statement* to convey the concept of ‘meeting the maximum amount of common information needs of an entity’s primary users’;

The materiality process (Agenda Paper 11D)

- (h) include in the final *Practice Statement* a four-step materiality process for applying materiality judgements to an entity’s financial statements;

Primary financial statements vs notes and aggregation / disaggregation of information (Agenda Paper 11E)

- (i) state that a single materiality assessment should be applied to *all* information included in the financial statements and to decide how much to disaggregate information and how much detail to include, in the context of the primary financial statements and the notes;
- (j) explain that an entity should select where to disclose material information within the financial statements (ie primary financial statements or the notes) in a way that communicates the information effectively and efficiently;

Accounting policy disclosures (Agenda Paper 11F)

- (k) not include guidance on the application of materiality to the disclosure of accounting policies in the final *Practice Statement*, as the issues will be considered more broadly in the Principles of Disclosure project;

Comparative versus corresponding approach and conflicts with local regulations (Agenda Paper 11G)

- (l) ask the staff to provide further analysis on the application of materiality to previous period information at a future Board meeting;
- (m) emphasise that the objective of the final *Practice Statement* is to provide guidance on how to interpret and apply the IFRS concept of materiality to IFRS financial statements;
- (n) note that IFRS Standards do not prohibit providing additional information to meet local regulatory requirements (even if that

information is not material for IFRS Standards), unless that information obscures material IFRS information;

Interim reporting (Agenda Paper 11H)

- (o) emphasise that when applying a materiality assessment to the interim financial report an entity needs to consider the same factors as it considers in the assessment for the annual financial statements, taking into account that the context and purposes of the interim financial report are different from those of the annual financial statements;
- (p) specify that although interim measurements may rely more on estimates than annual financial measurements, that fact alone does not make the interim information more material;

Publicly available information (Agenda Paper 11I)

- (q) remove the wording currently used in paragraphs 57–58 of the Exposure Draft and specify that the public availability of information does not affect the materiality assessment; and
- (r) specify that the public availability of information does not relieve an entity of the obligation to disclose material information.