

STAFF PAPER

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Project	Conceptual Framework		
Paper topic	Materiality		
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Purpose of paper

1. This paper discusses whether any changes are needed to the discussion of materiality in Chapter 2—*Qualitative characteristics of useful financial information* of the Exposure Draft *Conceptual Framework for Financial Reporting* (‘the Exposure Draft’).

Structure of paper

2. This paper is structured as follows:
 - (a) background:
 - (i) Exposure Draft proposals (paragraphs 3–5);
 - (ii) summary of feedback (paragraphs 6–7);
 - (b) staff analysis and recommendation (paragraphs 8–14).

Background

Exposure Draft proposals (paragraphs 2.11 and BC2.28–BC2.31)

3. In the Exposure Draft, the Board proposed to make no amendments to the concept of materiality in the *Conceptual Framework*, except to clarify that the users mentioned in

the discussion of materiality are the primary users of general purpose financial reports (changes from the existing *Conceptual Framework* are underlined):

2.11. Information is material if omitting it or misstating it could influence decisions that the primary users of general purpose financial reports (see paragraph 1.5) 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~~ IASB cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

4. This clarification was intended to emphasise that decisions about materiality reflect the needs of the primary users, not the needs of any other group.
5. In addition, in the Basis for Conclusions on the Exposure Draft the Board explained that it will consider in the Disclosure Initiative suggestions made by some respondents for amendments to, and clarifications of, the concept of materiality.

Summary of feedback

6. The invitation to comment on the Exposure Draft did not ask a specific question on materiality.
7. Only a few respondents commented on the topic. They suggested that after the work on materiality is completed as part of the Disclosure Initiative, the *Conceptual Framework* should be revised to reflect it.

Staff analysis and recommendation

8. The work on materiality in the Disclosure Initiative focuses on addressing behavioural problems in applying the concept of materiality in practice rather than changing the definition of materiality. This work includes additional guidance on the application of materiality proposed in the Exposure Draft IFRS Practice Statement: *Application of Materiality to Financial Statements*. However, the Principles of Disclosure

Discussion Paper will suggest a number of changes to the existing definition of materiality in IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

9. The existing definition of materiality in IAS 1 and IAS 8 is as follows:
- 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 misstatements judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.¹
10. The Principles of Disclosure Discussion Paper will suggest the following revised definition of materiality:
- Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of financial information about a specific reporting entity.²
11. This definition is broadly consistent with the definition proposed in the Exposure Draft. However, the Principles of Disclosure Discussion Paper suggests the following improvements to the definition in the Exposure Draft:
- (a) clarifying the ‘threshold’ at which information becomes material by replacing ‘could influence’ with ‘could reasonably be expected to influence’; and
 - (b) including reference to ‘obscuring’ information, not only omitting and misstating it.
12. These would not be substantive changes to the existing requirements because both of them are based on the existing guidance on materiality in IAS 1 (see paragraphs 7 and 30A of IAS 1). However, they have not been exposed for public consultation.

¹ See paragraph 7 of IAS 1 (identical wording in paragraph 5 of IAS 8).

² The wording was suggested in May 2016 Agenda Paper 11D [Supporting Material for Agenda Papers 11B and 11C](#).

Therefore, at this time the staff do not recommend amending the definition of materiality as proposed for the revised *Conceptual Framework* in the Exposure Draft. If necessary, the definition of materiality will be updated once the consultation process in the Principles of Disclosure project is complete.

13. The staff suggest making one editorial change to the Exposure Draft definition of materiality—to change the reference to ‘an individual entity’s financial report’ in the second sentence as follows:

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~~ a specific entity’s financial report.

14. The existing reference may be misinterpreted as referring to parent-only or unconsolidated financial statements as opposed to consolidated financial statements. The edit would also make the reference consistent with the rest of the paragraph.

Question to the Board

Do you agree that the revised *Conceptual Framework* should include the definition of materiality proposed in the Exposure Draft without the amendments being discussed in the Principles of Disclosure project?