
In brief

A look at current financial reporting issues

19 September 2017

Definition of material and guidance on making materiality judgements

Issue

Exposure draft: Definition of material

On 14 September 2017, the IASB published an exposure draft on the definition of material (Proposed amendments to IAS 1 and IAS 8).

The proposed amendments to IAS 1, 'Presentation of financial statements', and IAS 8, 'Accounting policies, changes in accounting estimates and errors', and consequential amendments to other IFRSs, are intended to: i) use a consistent definition of materiality throughout IFRSs and the Conceptual Framework for Financial Reporting; ii) clarify the explanation of the definition of material; and iii) incorporate some of the existing guidance in IAS 1 about immaterial information.

The proposed definition is:

'Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of a specific reporting entity's general purpose financial statements make on the basis of those financial statements.'

The exposure draft also includes a clarification of the meaning of 'primary users of general purpose financial statements' to whom those financial statements are directed, by defining them as 'existing and potential investors, lenders and other creditors' which have an understanding of the business and analyse the information thoroughly.

Comments on the exposure draft are due by 15 January 2018.

IFRS Practice Statement 2: Making materiality judgements

On 14 September 2017, the IASB published a Practice statement on Making materiality judgements.

The objective of the Practice statement is to provide guidance for reporting entities that are performing materiality assessments when preparing financial statements in accordance with IFRSs. The Practice statement also includes illustrative examples to help with the application of the guidance.

The Practice statement:

- uses a definition of materiality aligned with the definition in the Conceptual framework for Financial reporting, which is based on the same concepts as the definition in the exposure draft detailed above;
- considers materiality judgements in relation to presentation and disclosure, and also for recognition and measurement;
- explains the application of judgement to materiality decisions based on the specific circumstances of the entity and the changes that might occur in those circumstances over time;
- requires an entity to assess whether information is material to the financial statements, even if it is already included in other publicly available information;
- clarifies that the provision of additional information required by local regulations is permitted, but the information should be presented in a way that does not obscure material information; and
- includes a four-step process, the ‘materiality process’, as a guide for materiality judgements, including identification, assessment, organisation of the information and, finally, review.

The Practice statement also addresses:

- **Prior period information:** considering how the materiality of items from prior periods is assessed in the current period.
- **Errors:** considering how errors are assessed, individually and collectively, and the effect of cumulative errors, from both a quantitative and a qualitative perspective.
- **Financial covenants:** explaining how materiality is assessed in relation to the impact of financial covenants, including: i) the materiality of the consequences of breaching a covenant; and ii) the likelihood that the breach would occur.
- **Interim reporting:** considering materiality for the period covered by the interim financial statements under analysis.

The Practice statement is not a standard, and it is not mandatory. It does not override any auditing guidance or specific local materiality guidance. Although the Practice statement is not mandatory, it is intended to be helpful to management, and it can be applied to financial statements prepared from 14 September 2017.

Impact

The proposed amendments to the definition of material are not expected to have a significant impact on the financial statements.

The Practice statement could provide additional information and considerations for management making a materiality assessment in the absence of local materiality guidance. However, we note that the Practice statement is not necessarily consistent with the way in which materiality is considered by some securities regulators.

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