

APPLICATION OF MATERIALITY TO FINANCIAL STATEMENTS

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Summary

The International Accounting Standards Board (IASB) has published the Exposure Draft ED/2015/8 *Application of Materiality to Financial Statements* (the ED) on 28 October 2015. The aim of this ED is to provide guidance to assist management in applying the concept of materiality to general purpose financial statements prepared in accordance with International Financial Reporting Standards (IFRS).

A Practice Statement is not a Standard and its application is not required in order to state compliance with IFRS. However, the IASB has noted that a jurisdiction that permits or requires IFRS could choose to formally adopt a Practice Statement into its national financial reporting requirements.

The IASB invites comments on any aspects of this Exposure Draft, particularly on the following topics:

- Form of the Guidance - should the guidance be non-mandatory, and is a Practice Statement the appropriate way to issue this guidance?
- Illustrative Examples - are the proposed illustrative examples helpful, and should any others be added?
- Guidance included in the (draft) Practice Statement - in particular, the characteristics of materiality, the application of the concept of materiality, and how to assess whether omissions and misstatements are material
- The timing of issue of the Practice Statement

The comment deadline for ED/2015/8 *Application of Materiality to Financial Statements* is 26 February 2016.

STATUS

Exposure Draft

EFFECTIVE DATE

To be confirmed

ACCOUNTING IMPACT

May lead to a significant decrease in the amount of immaterial information disclosed in financial statements.

Background

During various stages of its Disclosure Initiative project, the IASB has been informed that there are difficulties around the practical application of materiality, with inappropriate assessments leading to irrelevant information being included, and material information being excluded, from financial statements. It has been suggested that a contributing factor is the lack of guidance in materiality in IFRS.

The concept of materiality links to the objective of general purpose financial reporting, which is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

Whether information is material or not is a matter of judgement that depends on facts and circumstances affecting each entity. The (draft) Practice Statement aims to illustrate the types of factors that management should take into account when considering whether information is material or not. It is important to note that materiality should be considered within the context of a specific entity.

Aspects of the Exposure Draft to comment

Form of the guidance

A Practice Statement is not a Standard. The IASB's reasoning for issuing guidance on applying the concept of materiality in the financial statements in the form of a non-mandatory Practice Statement is based on the following:

- the (draft) Practice Statement will help to promote a greater understanding of the role of materiality in IFRS and how it should be applied in preparing financial statements
- if mandatory guidance was issued in a Standard, concerns could arise about creating conflicts with national legal frameworks
- the IASB would not prohibit an entity from providing additional information in order to meet local requirements in a jurisdiction
- issuing mandatory guidance in a Standard could risk appearing prescriptive and detract from the need for judgement to be applied
- the IASB observed that issuing guidance as a separate non-mandatory document would help to emphasise that the concept of materiality is pervasive throughout IFRS
- the IASB decided that a Practice Statement was preferable to educational material because it will be subject to full due process (including public consultation) and it will be more accessible and formal because it would be included in the IFRS Bound Volume.

Illustrative examples

The (draft) Practice Statement includes a number of illustrative examples, which describe how management could decide which disclosures set out in a particular IFRS should be included in financial statements.

The IASB has requested comments about whether the proposed examples are helpful in the (draft) Practice Statement and whether any additional examples should be included.

Content of the (draft) Practice Statement

The (draft) Practice Statement proposes guidance in three main areas:

- (a) characteristics of materiality
- (b) how to apply the concept of materiality in practice when presenting and disclosing information in the financial statements
- (c) how to assess whether omissions and misstatements of information are material to the financial statements.

The IASB has requested comments on:

- whether any additional content should be included in the (draft) Practice Standard
- whether the guidance will be understandable by, and helpful to, preparers of financial statements
- whether there is any content with which respondents do not agree
- whether any paragraphs/sections are unnecessary
- whether any aspects of the guidance will conflict with any legal requirements related to materiality within constituents' jurisdictions.

Timing

The IASB plans to issue the Practice Statement before the finalisation of its *Principle of Disclosure* project (a Discussion Paper for this latter project is expected to be issued in early 2016).

It is noted that the IASB has tentatively decided that the Discussion Paper for the *Principles of Disclosure* project will include a discussion on the definition of materiality, and whether there is a need to change or clarify that definition within IFRS. However, although consequential amendments may be needed to the Practice Statement, it has been decided to issue this now, rather than wait, due to the need to develop guidance for the application of materiality. The IASB does not expect that significant consequential amendments will be needed, but the Practice Statement will be updated as appropriate following completion of the *Principles of Disclosure* project.

The deadline for comments on ED/2015/8 *Application of Materiality to Financial Statements* is 26 February 2016.



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