

Snapshot: IFRS Practice Statement

Application of Materiality to Financial Statements

This Snapshot introduces the IASB's Exposure Draft of an IFRS Practice Statement *Application of Materiality to Financial Statements* (the 'Draft Practice Statement') and provides a high-level summary of the content of the guidance and the IASB's reasons for publishing it.

Project objectives: The Draft Practice Statement proposes guidance to help management apply the concept of materiality when preparing general purpose financial statements in accordance with International Financial Reporting Standards (IFRS).

Project stage: The IASB has published the Draft Practice Statement to obtain feedback from parties with an interest in financial reporting.

Next steps: The IASB will consider the comments received on the Draft Practice Statement and then develop the final guidance. The IASB aims to issue the finalised Practice Statement in 2016.

Comment deadline: 26 February 2016

Background

What is materiality?

According to the *Conceptual Framework for Financial Reporting*, ‘information is material if omitting it or misstating it could influence decisions that users 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 concept of materiality acts as a filter through which management sifts information. This filter ensures that financial statements include all material information—ie the financial information that could influence users’ investment decisions. That filter also enables management to present material information in a clear and effective manner by excluding information that is not material.

Why do some stakeholders find materiality difficult to apply?

- Whether information is material is a matter of judgement based on a range of factors and entity-specific circumstances.
- Some stakeholders have suggested that there is a lack of guidance to help management understand the concept of materiality and how to apply it when preparing financial statements, in particular in the notes to the financial statements.

Why are we issuing guidance?

The IASB was informed at the Discussion Forum on Financial Reporting Disclosure in January 2013, and in its related survey and by other sources, that the poor application of materiality contributes to too much irrelevant information in financial statements and not enough relevant information. In the light of this feedback, the IASB decided to undertake a project on materiality.

Examples that are commonly cited as poor application of materiality, ie where judgement may not have been used appropriately include:

- use of the disclosure requirements as a checklist; and
- describing accounting policies in financial statements using words directly from IFRS, or copying note disclosures from illustrative financial statements without making the information entity-specific (ie boilerplate disclosures).

This Draft Practice Statement is designed to be a tool to help management use their judgement about what information is material and therefore should be included in financial statements. It should also help facilitate management's discussions with auditors and regulators about those judgements.

Why issue a Practice Statement?

A Practice Statement is not a Standard, but is non-mandatory guidance developed by the IASB.

Entities applying IFRS are not required to comply with the Practice Statement, unless their local regulator requires them to.

Furthermore, non-compliance with the Practice Statement will not prevent an entity's financial statements from complying with IFRS, if they otherwise do so.

Why have we proposed to issue this guidance as a Practice Statement?

The IASB proposes to issue this guidance as a non-mandatory Practice Statement, instead of a mandatory Standard because:

- of concerns that mandatory guidance could create conflicts with national legal frameworks; and
- non-mandatory guidance gives the IASB scope to broadly discuss and give examples of good application.

The development of a Practice Statement follows the IASB's full due process procedures, including public consultation before it is finalised.

Does the guidance change the concept of materiality in IFRS?

- The guidance does not change, or affect, the definition of materiality that is currently in IFRS.
- This Practice Statement does not change an entity's obligation to disclose material information.
- There will be a discussion on the definition of materiality in the *Principles of Disclosure* Discussion Paper (see page 6). We do not envisage that it will significantly affect the content of the Practice Statement.

Overview of the Draft Practice Statement

General characteristics

The Draft Practice Statement discusses the characteristics of materiality, including;

- the pervasiveness of the concept in IFRS;
- the importance of management's use of judgement;
- who the primary users of the financial statements are and what decisions they make based on those financial statements;
- the need for a quantitative and qualitative assessment when applying the concept; and
- the need to assess whether information is material, both individually and collectively.

Presentation and disclosure of information in financial statements

The Draft Practice Statement provides guidance to help management make judgements about materiality when deciding how to present and disclose information in the financial statements.

In particular, the guidance covers:

- the objective of the financial statements and how it relates to materiality decisions;
- how to deal with immaterial information;
- when to aggregate and disaggregate information;
- making judgements about materiality in the context of:
 - the face of the financial statements;
 - the notes to the financial statements;
 - the complete set of financial statements (ie considering the financial statements as a whole); and
 - interim reports.

Omissions and misstatements

Omissions and other misstatements of information are material if, individually or collectively, they could reasonably be expected to influence decisions that the primary users of the financial statements make on the basis of those statements.

The Draft Practice Statement includes guidance on:

- assessing whether misstatements are material;
- current period misstatements versus prior period misstatements; and
- dealing with misstatements that are made intentionally to mislead.

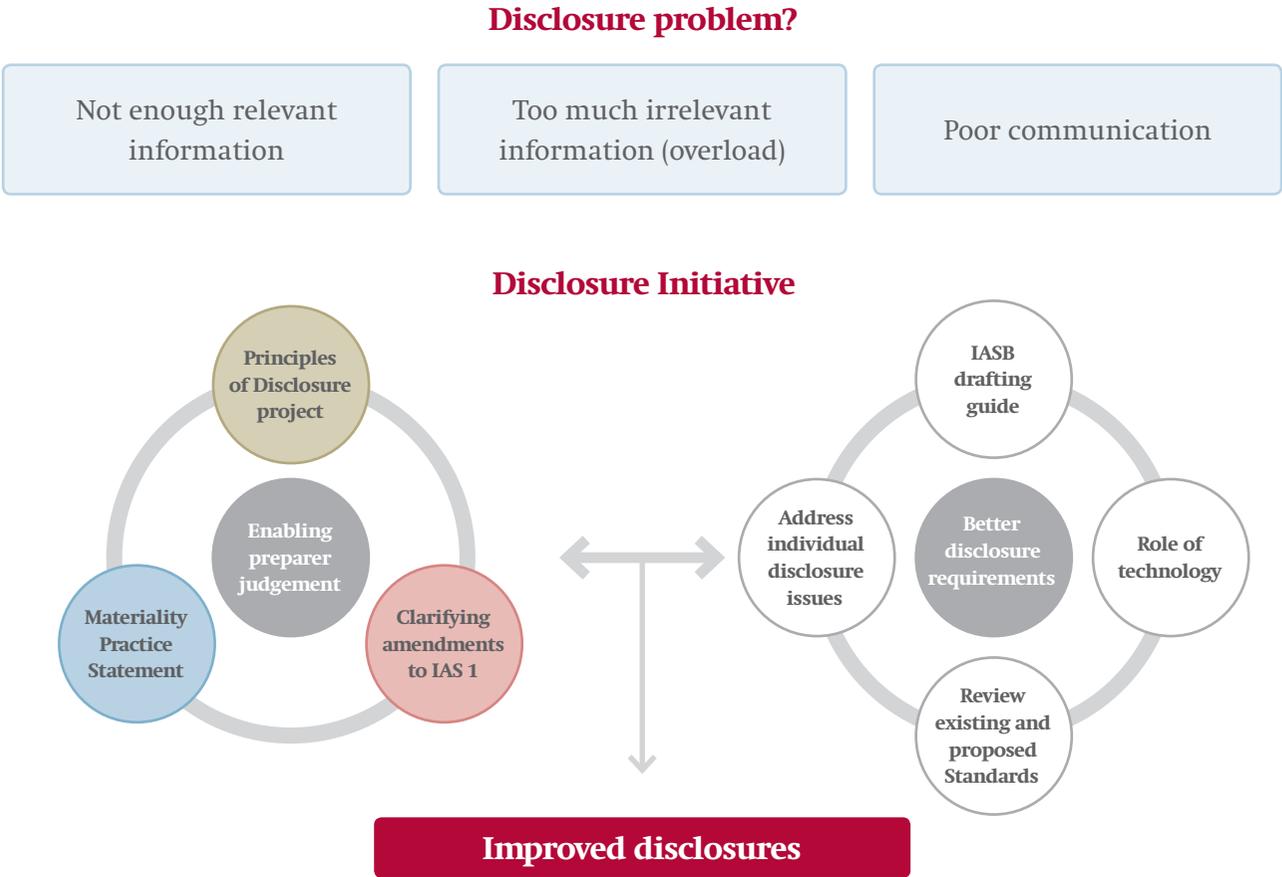
The Draft Practice Statement also provides some guidance on applying the concept of materiality to the recognition and measurement requirements.

The IASB's Disclosure Initiative: where does the Draft Practice Statement fit in?

The Disclosure Initiative is a portfolio of projects being undertaken with the aim of improving the effectiveness of disclosures in financial reporting.

The current work on materiality builds on the amendments to IAS 1 *Presentation of Financial Statements* in 2014. The amendments clarified that an entity is not required to disclose information if it is immaterial. This is the case even if a Standard contains a list of specific requirements or describes them as minimum requirements. Materiality is being dealt with in two separate parts of the IASB's Disclosure Initiative:

- the definition of materiality and its key characteristics will be discussed in the forthcoming *Principles of Disclosure* Discussion Paper. The IASB does not currently expect to make significant changes to the definition of materiality.
- the Draft Practice Statement.



Further Information

Respondents are invited to respond to any or all of the questions in the Draft Practice Statement and to comment on any other matter that the IASB should consider when finalising the Practice Statement. The IASB's discussions will take place in public meetings.

To access information about those public meetings, to view the Draft Practice Statement and to submit your comments, please visit www.ifrs.org.

The deadline for comments on the Draft Practice Statement is **26 February 2016**.

To stay up to date with the latest developments and to sign up for email alerts about the project, please visit the project homepage on <http://www.ifrs.org/Current-Projects/IASB-Projects/Disclosure-Initiative/Materiality/Pages/Home.aspx>



International Financial Reporting Standards®

IFRS Foundation®

IFRS®

IAS®

IFRIC®

SIC®

IASB®

Contact the IFRS Foundation for details of countries where its Trade Marks are in use and/or have been registered.

International Accounting Standards Board® (IASB®)

The IASB is the independent standard-setting body of the IFRS Foundation®

30 Cannon Street | London EC4M 6XH | United Kingdom

Telephone: +44 (0)20 7246 6410 | Fax: +44 (0)20 7246 6411

Email: info@ifrs.org | Web: www.ifrs.org

Publications Department

Telephone: +44 (0)20 7332 2730 | Fax: +44 (0)20 7332 2749

Email: publications@ifrs.org

Copyright © 2015 IFRS Foundation®

All rights reserved. Reproduction and use rights are strictly limited. No part of this publication may be translated, reprinted, reproduced or used in any form either in whole or in part or by any electronic, mechanical or other means, now known or hereafter invented, including photocopying and recording, or in any information storage and retrieval system, without prior permission in writing from the IFRS Foundation.

The IFRS Foundation logo/the IASB logo/the IFRS for SMEs logo/‘Hexagon Device’, ‘IFRS Foundation’, ‘IFRS Taxonomy’, ‘eIFRS’, ‘IASB’, ‘IFRS for SMEs’, ‘IAS’, ‘IASs’, ‘IFRIC’, ‘IFRS’, ‘IFRSs’, ‘SIC’, ‘International Accounting Standards’ and ‘International Financial Reporting Standards’ are Trade Marks of the IFRS Foundation.

The IFRS Foundation is a not-for-profit corporation under the General Corporation Law of the State of Delaware, USA and operates in England and Wales as an overseas company (Company number: FC023235) with its principal office as above.



Printed on 100 per cent recycled paper