Deloitte.

September 2017

Need to Know

IASB publishes a Practice Statement on Making Materiality Judgements

Contents

The International Accounting Standards Board (IASB) has released a Practice Statement *Making Materiality Judgements*.

- The IASB has issued a non-mandatory Practice Statement providing guidance on how to make materiality judgements when entities prepare financial statements.
- The Practice Statement pulls together the existing materiality guidance from the IASB's Standards, elaborating on those requirements and providing an overview of the general characteristics of materiality, as well as guidance on how to make materiality judgements in specific circumstances.
- The Practice Statement includes a four-step process that an entity can follow in making materiality judgements.
- The guidance is available for immediate use.
- The IASB has also issued a proposal to change the definition of *material* in its Standards.
- Read our publication *Thinking Allowed – Materiality* for further practical insights on how to apply materiality judgements when preparing financial statement disclosures.

Why the practice statement has been issued

Applying materiality requires judgement. Some stakeholders have cited the difficulty and lack of guidance in applying materiality judgements as contributing to the disclosure problem, i.e. disclosing too much irrelevant information and too little relevant information.

To help address these concerns the IASB decided that it should develop a Practice Statement to help those responsible for preparing financial statements. The IASB issued an exposure draft of a draft Practice Statement for comment in October 2015 for which it received widespread support.

The Practice Statement provides guidance to help entities make materiality judgements when preparing financial statements. It also includes 20 examples on how to apply materiality judgement in various scenarios.

For more information please see the following websites:

www.ukaccountingplus.co.uk

www.deloitte.co.uk

Observation
Deloitte Global published *Thinking Allowed:* Materiality in September 2015. The publication sets out various factors that could be helpful in making materiality judgements when preparing financial statements. https://www.iasplus.com/en/publications/global/thinking-allowed/2015/materiality

Non-mandatory status of a practice statement

A practice statement contains non-mandatory guidance. It is not a Standard. Therefore, its application is not required in order to state compliance with IFRS.

This Practice Statement is not intended to change existing materiality requirements or introduce any new requirements. It gathers together guidance on materiality from the IASB's Standards and elaborates on those requirements.

Objective and scope

The objective of the Practice Statement is to help those responsible for financial statements make judgements about what information is likely to be material to the primary users of those financial statements.

The Practice Statement could also help those who use the financial statements understand the steps management take in assessing materiality, which could facilitate dialogue between the parties.

The Practice Statement was not designed for entities applying *IFRS for SMEs*.

Observation
One of the objectives of the Practice Statement is to promote behavioural change. By giving preparers a framework for making materiality judgements, the IASB is trying to encourage entities to apply more judgement when determining whether, and to what extent, information should be disclosed in the financial statements. The IASB hopes that this will discourage entities from treating IFRS disclosure requirements as a compliance checklist exercise, reduce boilerplate disclosures and redundant information, and help achieve the overarching goal of the *Disclosure Initiative* to have entities use their financial statements to communicate financial information effectively.

General characteristics of materiality and specific topics

The Practice Statement pulls together the existing guidance on materiality from the *Conceptual Framework,* IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and elaborates on those requirements. As the objective of financial statements is to provide primary users with financial information that is useful to them in making decisions about providing resources to the entity, the Practice Statement discusses making materiality judgements in the context of meeting the information needs of the primary users. The Practice Statement also addresses a number of other specific topics as regards financial statements preparation.

The Practice Statement emphasises the following points when assessing whether information is material for the purpose of preparing financial statements:

Meeting the information needs of primary users

- The financial statements should address the information needs of existing *and potential* investors, lenders and other creditors, they being the primary users of an entity's financial statements.

- The financial statements should provide information that will satisfy the needs that are *common within each of the three groups* of primary users. In other words, an entity need not address information needs that are unique to particular users or to niche groups. This requirement would also prevent an entity from identifying only those information needs that are simultaneously common to all categories of an entity's primary users, as that might exclude the information needs of only one category.

- When making materiality judgements, an entity needs to assess whether information can *reasonably be expected to influence* primary users' decisions, rather than whether that information alone would be *capable of changing* their decisions.

- The fact that information is available publicly from other sources does not affect the assessment of whether the information is material for the purposes of the financial statements. It also does not relieve the entity of the obligation to disclose that information, if material, in the financial statements.

Interaction with local laws and regulations

- An entity may provide additional information to meet legal or regulatory requirements, even if that information is not material within the context of IFRS requirements. However, such information must not obscure information that is material according to IFRS Standards.

Prior period information

- An entity should provide prior period information to the extent that it is relevant to an understanding of the current period financial statements. This means that an entity should expand or summarise prior period disclosures to suit the needs of the current year, regardless of how much information was included in the prior period financial statements.

Errors

- If an error is assessed to be individually material, it cannot be passed over for correction because of the offsetting effect of other errors.

- In assessing whether errors that have accumulated over time have become material to the current period, an entity should consider whether any further accumulation of errors have occurred in the current period, or whether the circumstances of the entity have changed that would result in a different materiality assessment for the current period.

Observation
The Practice Statement does not provide any guidance on how to correct a material cumulative error, because the IASB considered that the Practice Statement should not deal with the consequences of how an entity has applied its materiality judgement.

Covenants

- In assessing the materiality of information about the existence and the terms of a covenant, or a breach of covenant, an entity should consider both:

  (a) the consequences of breaching a covenant, i.e. the impact a covenant breach would have on the entity's financial position, performance and cash flows. If the consequences would be material, then information about the covenant would likely be material. Conversely, if the consequences would not be material, then disclosures about the covenant might not be needed; and

  (b) the likelihood of breaching a covenant. The more likely the breach, the more likely that information about the covenant would be material.

Interim reporting considerations

- An entity should apply the same materiality process in preparing both the annual and the interim financial statements. However, an entity should take into account that the time period and the purpose of an interim financial report differ from those of an annual report when determining what is material for the purposes of the interim financial statements.

- Information that is material to the interim period, but that was already disclosed in the latest annual financial statements, does not need to be reproduced in the interim financial report, unless something new occurred during the interim period or an update is needed.

A four-step materiality process

The Practice Statement also includes a four-step process as an example of how management could make materiality judgements when preparing financial statements. The steps involved are as follows:

- Step 1 – identify potentially material information, taking into account the requirements of the applicable Standards and the information needs of primary users.

- Step 2 – assess whether the information identified in Step 1 is material by considering quantitative and qualitative factors. The Practice Statement gives various examples of quantitative and qualitative factors, and contains further guidance on how they affect the materiality assessment, both individually and on a combined basis.

- Step 3 – organise the information identified in Step 2 in the draft financial statements in a way that communicates the information effectively and efficiently. The Principles of Disclosure DP includes further proposals on how an entity can organise its financial statements e.g. whether to disclose something in the primary financial statements or in the notes, and the extent to which line items should be disaggregated.

- Step 4 – review the draft financial statements as a whole to determine whether all material information has been identified, including a consideration of materiality from an aggregated perspective. Information that is judged not to be material on its own may be material when considered in combination with other information in the context of a complete set of financial statements.

The process described above is just one example of how the materiality assessment could be performed. Other methods may be appropriate.

Application date

Because it is neither a Standard nor an Interpretation there is no requirement to comply with the Practice Statement in order to meet the requirements of IFRS. However, the Practice Statement is intended to draw together existing IFRS requirements and provide helpful examples to assist those applying IFRS. An entity that chooses to apply the guidance in the Practice Statement can begin to use it immediately.

Further information

The Deloitte publication *Thinking Allowed:* Materiality is available at https://www.iasplus.com/en/publications/global/thinking-allowed/2015/materiality

The IASB's Principles of Disclosure Discussion Paper is available at http://www.ifrs.org/projects/work-plan/principles-of-disclosure/. Comments close on 2 October 2017.

The IASB's Exposure Draft with proposed changes to the definition of materiality is available at http://www.ifrs.org/projects/work-plan/principles-of-disclosure/. Comments close on 15 January 2018.

If you have any questions about materiality judgements, please speak to your usual Deloitte contact.

Deloitte.

This publication has been written in general terms and we recommend that you obtain professional advice before acting or refraining from action on any of the contents of this publication. Deloitte LLP accepts no liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NWE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NWE LLP do not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.

© 2017 Deloitte LLP. All rights reserved.

Designed and produced by The Creative Studio at Deloitte, London. J13416