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IASB issues amendments to the definition of material

What you need to know

- The IASB's *Disclosure Initiative* consists of research and maintenance projects that address how the effectiveness of disclosures in IFRS financial statements can be improved.
- The IASB issued *Definition of Material* (Amendments to IAS 1 and IAS 8) in October 2018 to clarify and align the definition of material.
- The amendments are intended to improve the understanding of the existing requirements rather than to significantly impact an entity's materiality judgements.
- The amendments must be applied prospectively for annual periods beginning on or after 1 January 2020, with earlier application permitted.

Highlights

In October 2018, the International Accounting Standards Board (IASB or the Board) issued amendments to IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (the amendments) to align the definition of 'material' across the standards and to clarify certain aspects of the definition.

Background

In an attempt to enhance communication in financial reporting, the IASB has made *Better Communication in Financial Reporting* a central theme of its standard-setting activities from 2017 to 2021. The *Disclosure Initiative* is part of the Better Communication theme, and aims to address how the effectiveness of disclosures in IFRS financial statements can be improved.

Many consider the inappropriate application of 'materiality' to be one of the key drivers of disclosure ineffectiveness. It has been observed that, in practice, many entities disclose immaterial information and omit material information, which reduces the decision-usefulness of the financial statements.

In light of this feedback, the IASB undertook a project addressing materiality as part of the *Disclosure Initiative*, which comprises:

- IFRS Practice Statement 2: *Making Materiality Judgements* (the PS)
- Amendments to the definition of material in IAS 1 and IAS 8

The IASB issued the PS in September 2017. The PS represents non-mandatory guidance to help entities to make materiality judgements when preparing general purpose financial statements. The PS proposes a four-step process for applying materiality and includes guidance on how to make materiality judgements in specific circumstances.

New definition of material

The new definition states that "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 those financial statements, which provide financial information about a specific reporting entity."

The amendments clarify that materiality will depend on the nature or magnitude of information. An entity will need to assess whether the information, either individually or in combination with other information, is material in the context of the financial statements. A misstatement of information is material if it could reasonably be expected to influence decisions made by the primary users.

Obscuring information

By including the concept of 'obscuring information' in the new definition, the IASB intends to address concerns that the definition could be perceived by stakeholders to focus only on information that cannot be omitted (material information), but not on why the inclusion of immaterial information could potentially mislead the users of the financial statements. The amendments explain that information is obscured if it is communicated in a way that would have a similar effect as omitting or misstating the information.

The amendments include examples of circumstances that may result in material information being obscured. Material information may be obscured if information regarding a material item, transaction or other event is scattered throughout the financial statements, or disclosed using a language that is vague or unclear. Material information can also be obscured if dissimilar items, transactions or other events are inappropriately aggregated, or conversely, if similar items are inappropriately disaggregated. In addition, the understandability of the financial statements is reduced if material information is hidden because of immaterial information.

New threshold

The IASB replaced the threshold 'could influence' with 'could reasonably be expected to influence' in the defintion of 'material', such that, in the amended definition, it is clarified that the materiality assessment will need to take into account how primary users could reasonably be expected to be influenced in making economic decisions. This wording is intended to address concerns raised that the 'could influence' threshold is too low and might be applied too broadly, with the result that information that is not capable of influencing the decisions of the primary users must be included in the financial statements.

The amendments clarify that, in assessing whether an information could reasonably be expected to influence decisions of the primary users, an entity must consider the characteristics of those users as well as its own circumstances.

Primary users of the financial statements

The current definition refers to 'users' but does not specify their characteristics, which can be interpreted to imply that an entity is required to consider all possible users of the financial statements when deciding what information to disclose. Consequently, the IASB decided to refer to primary users in the new definition to help respond to concerns that the term users may be interpreted too widely.

The amendments explain that many existing and potential investors, lenders and other creditors cannot require reporting entities to provide them with information directly and, as such, they rely on general purpose financial statements for much of the financial information they need. Therefore, these groups are the primary users to whom general purpose financial statements are directed.

Other amendments

The IASB has amended the definition of material in the Conceptual Framework to align it with the revised definition of material in IAS 1 and IAS 8. The Board has also amended the PS to align it with the new definition of material.

The Board does not expect the guidance in the Conceptual Framework and the PS to be affected by these amendments.

Effective date and transition

The amendments to IAS 1 and IAS 8 are required to be applied for annual periods beginning on or after 1 January 2020. The amendments must be applied prospectively and earlier application is permitted.

How we see it

Although the amendments to the definition of material will not have a significant impact on an entity's financial statements, the introduction of the term 'obscuring information' in the definition could potentially impact how materiality judgements are made in practice, by elevating the importance of how the information is organised in the financial statements.

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