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AASB RESEARCH REPORT 22

MASB RESEARCH REPORT 2

Making Materiality Judgements – Malaysian Preparers and Auditors' Perspectives

A Joint AASB-MASB Project

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Principal Authors

Noor Adwa Sulaiman – Universiti Malaya – Associate Professor
Nahariah Jaffar – Xiamen University Malaysia – Assistant Professor
Siti Noorhawa Omar – Universiti Malaya

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Enquiries
Australian Accounting Standards Board
PO Box 204
Collins Street West,
Victoria, 8007
Australia
Tel: +61 3 9617 7637

Email: standard@aasb.gov.au
Website: www.aasb.gov.au

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Foreword

The concept of materiality plays a significant role in determining what and how information should be presented in financial reports that meet user needs. In 2022, the International Accounting Standards Board (IASB) initiated a call for research, urging a collaborative approach between academics and standard-setters. In response to the call, the Malaysian Accounting Standards Board (MASB), the Australian Accounting Standards Board (AASB), and a team of esteemed Malaysian academic researchers came forward, an example of regional cooperation to address a matter of international interest.

This collaborative effort is more than just a response; it is an example of what can be achieved when global academics and standard-setters working together. By exploring the application of materiality in Malaysia, this research sheds light on the perspectives of both preparers and auditors, providing standard-setters with insights to refine and enhance the accounting standards. Here, we witness the confluence of academic researchers and standard-setters, both driven by the quest for knowledge and the aspiration to uphold the objectives of financial reporting.

We hope that you appreciate the multifaceted messages in this research report: the complex nature of materiality, the commitment of international academics and standard-setters to collaboration, and the unwavering pursuit of excellence in the realm of accounting standards that meet stakeholder needs.

Dr Keith Kendall
Chair
Australian Accounting Standards Board

Datuk Mohd Nasir Ahmad
Chair
Malaysian Accounting Standards Board

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Executive Summary

The objective of this study is to investigate to what extent financial statement preparers and auditors understand and apply the concept of materiality. It also investigates the usefulness of International Financial Reporting Standards (IFRS) guidance on determining materiality, particularly IFRS Practice Statement 2: *Making Materiality Judgements* (PS2).

To do so, this research interviewed 15 financial statement preparers and 20 external auditors in Malaysia, gathering their perspectives and first-hand experiences on the application of materiality in financial statement preparation and the auditing process.

Key Findings

Overall, this study concludes that the IFRS guidance on materiality, such as PS2, has proven beneficial for both preparers and auditors, particularly regarding the consideration and balancing of quantitative and qualitative factors when determining what information is material.

Some key themes that emerged from the interviews are as follows:

- Preparers and auditors generally share a common understanding of the materiality concept that aligns with PS2, agreeing that the materiality concept is integral to both financial statement preparation and auditing processes.
- Almost all preparers and auditors are of the view that PS2 provides valuable complementary guidance that emphasises the importance of professional judgement, considering both quantitative and qualitative factors. They agreed that PS2 helps preparers and auditors to make better decisions regarding the disclosures of material information, thereby enhancing communication and reducing information overload.
- Preparers and auditors are of the view that materiality judgement is closely related to the quality of financial and non-financial information disclosures.
- Materiality judgement is used to determine whether and to what extent other non-financial information should be disclosed, such as pertinent information related to environmental and social metrics.
- Compliance with regulators' expectations is crucial in the context of making materiality judgements.
- Preparers and auditors consider the industry, size, regulatory environment and other relevant factors of an entity when making materiality judgements, highlighting that what may be material for one entity may vary from another.
- The materiality concept is instrumental in determining the critical aspects of financial statements to prioritise, enabling both preparers and auditors to effectively and efficiently allocate their efforts and resources. Auditors highlighted that the outcomes of materiality assessments can have a profound impact on the audit process.

Implications

This study provides the following implications:

- Education and training are important for preparers and auditors to make sound materiality judgements. IFRS guidance, such as PS2 should be integrated into their training programs and professional development efforts.

- As user needs and the information environment may evolve, standard-setters, such as the International Accounting Standards Board (IASB), should continue monitoring practices to determine whether enhancements of guidance on making materiality judgements are necessary.
- Given the complexity of corporate reporting ecosystems, maintaining cross-functional collaboration within an entity is crucial for making consistent materiality judgements across different departments (such as the financial reporting and sustainability reporting teams. This approach ensures adequate identification and proper disclosure of material information, improving the overall coherence and connectivity of information in the reports.

1. Introduction

Users of financial statements rely on the information that entities disclose to make informed decisions. In this regard, preparers of the financial statements and auditors are responsible for applying the materiality concept to ensure that the financial statements contain appropriate information and assurance to meet user needs. The concept of materiality plays a significant role in shaping the decisions made by preparers during the financial statement preparation process, such as deciding how information should be aggregated and presented throughout the financial statements. Applying the materiality concept in financial reporting not only ensures that critical information is highlighted but also helps avoid disclosing unnecessary details on items of little importance to users, and in turn, it enhances the quality of financial statements.

The IASB undertook a series of initiatives under its "Better Communication in Financial Reporting" project. The primary goal of these activities was to improve the effectiveness of disclosures in financial reporting. As part of these efforts, in January 2013, the IASB held a Discussion Forum (the forum) on financial reporting disclosure to foster dialogue between users, preparers, standard-setters, auditors and regulators. Subsequently, in May 2013, the IASB published a Feedback Statement following the forum.[1] This forum considered several initiatives to enhance the quality and relevance of disclosures in financial statements. One of the key initiatives that emerged from these discussions was a project focused on the materiality concept. This project was initiated in March 2014 and aimed to develop guidelines or educational materials specifically designed to assist preparers of financial statements in understanding and applying the concept of materiality effectively. The goal was to provide preparers with practical guidance on assessing and applying materiality considerations when preparing financial statements. The initiatives were carried out due to some claims arguing the inappropriate application of materiality by companies disclosing immaterial information and omitting material information that has contributed to impairing the quality of the financial statements (Ernst and Young, 2018).[2]

1.1 Background

In September 2017, the IASB issued a non-mandatory Practice Statement 2: *Making Materiality Judgements* (PS2) to provide reporting entities with guidance on making materiality judgements when preparing general purpose financial statements in accordance with IFRS Accounting Standards. In addition, in October 2018, the IASB 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 accounting standards and to clarify some aspects of the definition. IAS 1 defines materiality as *'Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the 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'*. Although non-mandatory, entities are expected to use PS2 to understand the overarching materiality concept when applying the accounting standards. Consequently, standard setters such as the Malaysian Accounting Standards Board (MASB) published PS2 and made it available for stakeholders in Malaysia for financial statements prepared from 30

1 IFRS Discussion Forum–Financial Reporting Disclosure Feedback Statement (May 2013)

2 Ernst and Young (2018). IASB issues amendments to the definition of material. IFRS Developments. Issue 138.November 2018.

November 2017.[3] Likewise, the Australian Accounting Standards Board (AASB) released PS2 in December 2022 with an operative date in January 2023.[4]

PS2 aims to provide guidance for applying the concept of materiality in preparing financial statements and it contains three key elements that include:

1) overview of general characteristics of materiality;

2) four steps of the materiality judgements process, which include:

    - identification of information that can be considered material within the requirements of the IFRS Accounting Standards/ Malaysian Financial Reporting Standards (MFRS) while taking into considerations the needs of primary users of the financial statements,

    - assess whether the identified information is, in fact, material by considering both quantitative and qualitative factors related to the entity and its external environments,

    - organisation of the information within the draft financial statements and

    - review the draft financial statements whether all material information has been considered; and

3) materiality judgements in specific circumstances (such as prior-period information, errors, covenants and interim reporting).

PS2 underscores the importance of preparing financial statements from the perspective of the entity's primary users. This approach is justified because the primary purpose of financial reporting is to provide information relevant to the decision-making needs of users, such as investors, creditors, and analysts. PS2 emphasises that materiality should guide decisions related to the presentation and disclosure of information and the recognition and measurement of transactions, events, or conditions in the financial statements. PS2 suggests that entity should regularly reassess their materiality judgements because business circumstances can change over time.

In October 2018, the IASB issued *Definition of Material (Amendments to IAS 1 and IAS 8)* to clarify and align the definition of 'material' and provide guidance to help improve consistency in the application of that concept whenever it is used in IFRS Accounting Standards. The Amendments are consistent with the concept of materiality in PS2, highlighting any information is material if its omission, misstatement or obscuration could be reasonably expected to influence the decision of the primary users of the financial statements. The Amendments emphasise the application of materiality depends on the nature or magnitude of the information. In other words, an entity is required to assess whether the information, either separately or in aggregate with other information, is material in the context of the financial statements.

In addition, the guidance discussed the importance of excluding immaterial information that could obscure material information, which prepares are expected to consider when preparing financial statements.

3 MFRS Practice Statement 2 *[Making Materiality Judgements]*
4 AASB Practice Statement 2 *[Making Materiality Judgements]*

1.2 Purpose of the Research

This research seeks to examine the extent to which the release of PS2 by the IASB, along with the Amendments, has contributed to the improved understanding and application of the materiality concept among preparers and auditors. With the materiality concept playing a crucial role in projects such as the IASB's Climate-related and Other Uncertainties in the Financial Statements, it is important to gain insights into how it is applied in practice. The findings of this study will help determine whether further efforts are needed to enhance the understanding and application of the materiality concept. Therefore, this report seeks to answer the following research questions (RQ):

RQ1: How do financial statement preparers and external auditors understand and apply the concept of materiality?

RQ2: What are the impacts of the PS2 on practitioners' materiality judgements?

Malaysia is a suitable setting for this research because the Malaysian Financial Reporting Standards (MFRS) are identical to IFRS Accounting Standards. Following this, since 2012 financial statements that have been prepared in accordance with the MFRS shall also make an explicit and unreserved statement of compliance with the IFRS Accounting Standards. In this regard, preparers and auditors in Malaysia are familiar with the IFRS Accounting Standards.

By conducting research on how preparers and auditors in Malaysia apply the concept of materiality, the findings can contribute to a better understanding of how materiality judgements are applied in practice in the application of IFRS Accounting Standards for the preparation of financial statements. Additionally, there has been a strong economic trade relationship between Malaysia and Australia. In 2021, Malaysia was Australia's second-largest trading partner among the ASEAN Member States and the 9th largest partner overall.[5] The investigation on how materiality is understood and applied in Malaysia can have implications for financial reporting involved in cross-border transactions between the two countries. The research findings can help bridge any gaps in applying materiality judgements, ensuring consistency and transparency in financial reporting practices.

1.3 Overview of Methodology

This research gathered the views of 15 preparers of financial statements and 20 external auditors in Malaysia on the understanding and application of materiality judgements in preparing and auditing financial statements. All interviews were audio-recorded, and the length of the interviews ranged from 40 minutes to 90 minutes. This research collected data by means of face-to-face and online semi-structured interviews in the period between October 2022 and May 2023. An interview guide indicating various themes (such as materiality concepts, materiality judgements process and the effects of materiality on issues of recognition and measurements of financial items and presentation and disclosures) was used in the interviews (details of the questions are provided in Appendix 2). The demographic profiles of the research participants are summarised in Figures 1 to 6 below.

5 https://www.dfat.gov.au/geo/malaysia/malaysia-country-brief#:~:text=Trade%20and%20investment,-Australia%27s%20economic%20and&text=In%202021%2C%20Malaysia%20was%20our,free%20and%20open%20trading%20system.

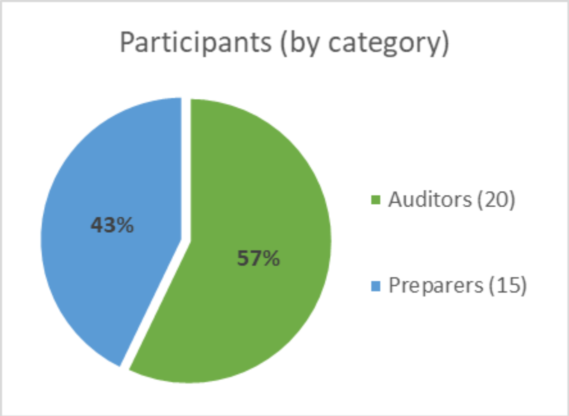

Figure 1: Participants (by category)

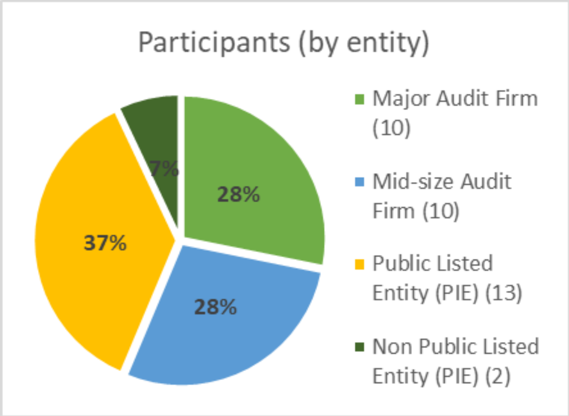

Figure 2: Participants (by entity)

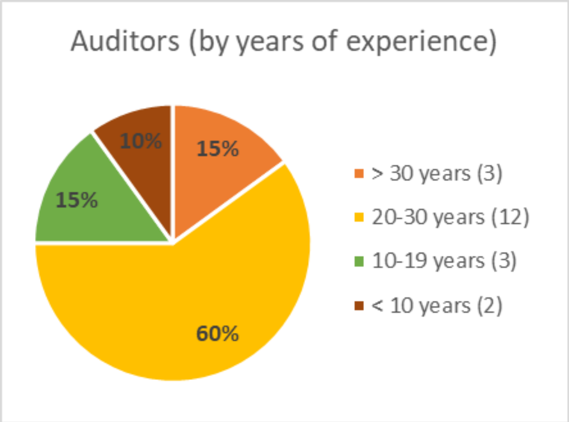

Figure 3: Auditors (by years of experience)

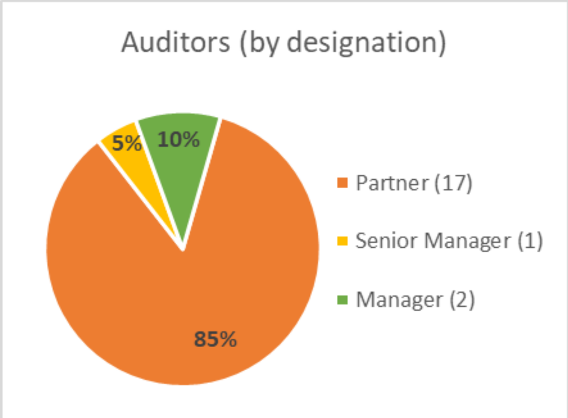

Figure 4: Auditors (by designation)

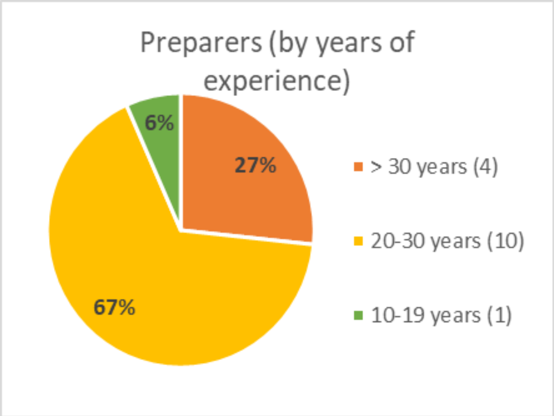

Figure 5: Preparers (by years of experience)

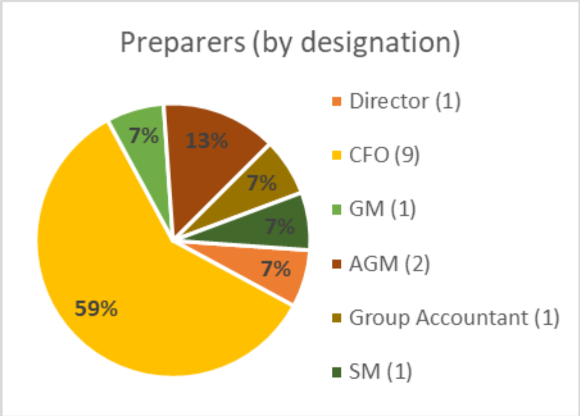

Figure 6: Preparers (by designation)

The interview data underwent a thematic analysis process, which was facilitated using QSR NVIVO software. This analysis method aimed to identify recurring themes and patterns within the data. The analysis encompassed five essential activities:

1) data preparation and organisation - this process includes tasks like transcribing interviews, ensuring data quality, and arranging the data in a manner conducive to analysis;

2) review all data - researchers systematically reviewed all the interview data to gain a comprehensive understanding of its content and context;

3) coding of data - NVIVO is utilised to assign labels or codes to specific segments of the interview data;
4) identification of themes from the coded data - NVIVO aided in the identification of themes by enabling researchers to group coded segments into broader thematic categories; and
5) description of the themes - this involved examining the content of coded segments within each theme and interpreting the meaning and significance of those themes within the context of the research objectives.

The following section presents the research findings based on the key themes discussed by the participants in interviews. It is not uncommon for the participants mentioned similar perspectives. Thus, recurring themes are explained in this manner: almost all (all except a very small minority), most (a large majority with more than a few exceptions), many (a small majority or large minority), some (a small minority, but more than a few) and a few (a very small minority). It is important to note that in qualitative research, the absence of a concept being mentioned in interviews does not imply its insignificance, and the frequent mention of a concept by various participants does not necessarily indicate its greater importance. Therefore, the findings presented in this report do not aim to validate or generalise how practitioners make materiality judgements but rather provide insights into the perspectives of some preparers and auditors on this matter.

2. Findings

This section presents the research findings and contains two parts. The first part outlines the participants' understanding of the meaning of "materiality". The second part of this section describes the PS2's effects on practitioners' materiality practises.

Part 1: The concept of materiality (RQ1)

To determine the participants' familiarity with the concept and to gauge the degree of alignment or divergence in their understanding from the guidance provided in PS2 and the IFRS Accounting Standards, we first gathered the participants' overall understanding of the materiality concept during the interview.

Overall, the participants highlighted four key characteristics that embody the materiality concept in the context of financial reports, as outlined in Table 1, indicating that the participants' understanding of the materiality concept is consistent with the guidance in PS2 and the IFRS Accounting Standards.

Table 1: Understanding of the concept of materiality

Key themes
Information that is relevant for users' economic decision-making
Adequate presentation and disclosure
Compliance with the accounting standards and regulations
Judgement and perspective

Information that is relevant for users' economic decision-making

During the interviews, almost all preparers defined material information as information that help financial report users make economic decisions. Most preparers considered the purpose of disclosing material information is to effectively "tell the story" of their entities' performance and activities, even if such information is not quantitatively significant. Further, they noted that material information should be relevant, timely and important for users to make informed decisions about the entity. The perspectives shared are consistent with the materiality concept provided in paragraph 10 in PS 2 which states, "*entity must consider whether to provide information not specified by MFRS Standards if that information is necessary for primary users to understand the impact of a particular transaction, other events and conditions on the entity's financial position, financial performance and cash flows*."

For example, a preparer noted that:

> *"Information is considered material when it could move the volatility of the share price which in a way is significant enough for the stakeholders to make decisions whether to invest, to divest or to hold*." (Preparer 2)

Another preparer also shared that:

> *"In order to make effective decisions, our investors particularly foreign investors required timely reporting and real time updating of information via website and instant messaging platform, even if the information is not required by the MFRS but it is material and may affect decision making."* (Preparer 3)

Preparers also acknowledged that material information could affect stakeholders' perceptions of the entity and economic decision-making processes, assisting stakeholders to focus on information that matters to them most.

> "W*hat we have in mind is that it has to go back to what the management thinks that the user would be interested with and the policy that could affect the decision or even the interpretation of the user."* (Preparer 13)

> *"At our AGM, we can see that shareholders ask thoughtful questions, showing that they have read the financial reports and are aware of their contents. They are aware of what to concentrate on so they can ask the management and the board all those challenging questions."* (Preparer 15)

Similar to the preparers of financial statements, almost all auditors interviewed also defined materiality as intrinsically linked to how pertinent the information is to users' economic decisions. Auditors explained that information is deemed material if it has the capacity to influence perceptions of a company's financial position and performance.

> *"Materiality to me is the magnitude of the information that affects the readers thinking. A typical example is that, there was an event but you don't know the effect on the financial statement yet. But should this event be disclosed in the accounts? For example, a company bought some goods from Country C worth less than 5% from the total stocks. But the goods may not pass the QC of Malaysia for whatever reason. Should it be disclosed in reports? 5% may not be material to be under the inventory, but the fact that you bought something that's non-compliant might affect the stakeholders' judgement when it comes to their attention." (External Auditor 5)*

Adequate presentation and disclosure of information

Most preparers mentioned that they apply the materiality concept to ensure the financial reports have adequate presentation and disclosure. Typically, they establish appropriate materiality thresholds or other criteria to identify material information – both financial and non-financial – that could affect users' decisions, including information such as environmental, social, and governance (ESG) metrics, sustainability, political and economic stability. Additionally, they also consider some forward-looking information that can potentially be material, such as insights into future prospects, growth plans, and potential risks that could help investors make informed decisions beyond historical financial data. Preparers also noted that the disclosure of material information should also be timely, for example providing stakeholders access to real-time data through various platforms, including websites and social media.

As illustrated by Preparer 3:

> *"Our users - the foreign investors and some large funds in Malaysia are looking more at these four macro items, i.e., social, economic, politics, and environment. For them, the first thing to consider to invest here in Malaysia is the political stability where it determines the prospects for growth of Malaysia and the banking industry. So, the financial detail is less relevant. They are more forward looking in terms of wanting to forecast the profitability using the macro elements and non-financial info."* (Preparer 3)

Auditors consider materiality assessment as a critical step in the auditing process. It involves assessing whether the inclusion or omission of specific items may affect the users' overall understanding of an entity's financial position and performance, thereby impacting users in making informed economic decisions about an entity. As conveyed by auditors during interviews, materiality encompasses both quantitative and qualitative aspects, indicating that their understanding and application of the materiality concept are consistent with the IFRS guidance.

Most auditors shared that, when performing an audit, quantitative materiality primarily guides the scoping of tasks and the determination of sample sizes for audit examinations, helping in deciding the focus areas and the extent of audit testing. However, materiality in auditing extends beyond just quantitative considerations. For example, when auditors discover errors or discrepancies during the audit, they consider qualitative factors such as the nature of the errors, the risk profile of the company, and the potential impacts on stakeholders' decision-making. Hence, a balanced consideration of both quantitative and qualitative factors is essential to ensure the financial statements present a true and fair view of the entity's financial position.

> *"For example, like MFRS 101 Presentation of Financial Statements, there is a requirement for interest income to be separately presented in P&L. We faced challenges regarding the disaggregation of this information, particularly when the climate change aspect came into play. We questioned why we should separate it when other entities, for example entities in other jurisdictions did not. However, the significance of this amount cannot be overlooked... We view this information as material, even if it's relegated to the notes in the back of the report. It's one aspect of presentation that deserves attention."* (External Auditor 8)

Compliance with the accounting standards and regulations

All preparers acknowledged the crucial role of the materiality assessment process in complying with accounting standards and other regulations. MFRS[6] and IFRS Accounting Standards provide specific guidelines on the recognition, measurement, presentation, and disclosure of financial information, requiring preparers to integrate the materiality concept to comply with the standards.

6 MFRS Standards are word-for-word the IFRS Accounting Standards. In Malaysia, there is a legal requirement for dual assertion, i.e., compliance with MFRS Standards as well as compliance with IFRS Accounting Standards.

Further, compliance with regulatory requirements and governance obligations (such as Bursa Malaysia's requirements) also plays a significant role in determining what should be considered material. In this respect, even if a specific transaction or item is not quantitatively material, it may still need to be disclosed due to the expectations of regulators. Some preparers acknowledged there were times when, despite they are of the view that certain information was not considered to be material, such information was still disclosed in the financial statements to meet the expectations of regulators.

"Nowadays, there's a trend towards disclosure even if something isn't material, driven by governance and regulatory considerations. Personally, I find that materiality always plays a pivotal role in our determinations, especially in cases involving regulatory compliance. When we disclose information, it's often driven by the guidelines of regulatory bodies like the Securities Commission Malaysia (SC). We have frequent reporting obligations to the SC, so we prioritise disclosures that we believe would benefit the regulators or the general investment community, regardless of strict materiality thresholds. In addition, for routine, everyday transactions, materiality does also come into play." (Preparer 8)

"*Our extensive disclosure is also primarily aligned with regulatory expectations. It's because Bank Negara Malaysia (Central Bank) wants it, and the standards require it. Our focus leans more towards compliance other than its relevance to investors. Investors often prioritise macro-level considerations, such as social, economic, political, and environmental factors, when making investment decisions. They seek real-time information and look ahead, emphasising the future potential and opportunities for profit rather than dwelling on historical data. Their perspective is oriented toward assessing the possibility of future returns."* (Preparer 3)

Judgement and perspective

Almost all preparers emphasised that materiality consideration is judgemental and context-dependent, which involves the considerations of many factors such as entity-specific circumstances, the business model, its operations, sources of revenue, financial activities, industry and regulatory environment. They also mentioned that materiality assessment extends beyond numerical values (i.e. quantitative). For example, a preparer mentioned that materiality could vary between industries. The preparer used the construction sectors as an example and shared that information about the potential cost overruns in the construction sector are crucial to investors, therefore such information is deemed to be material even if it is quantitatively immaterial.

"Our disclosure practices typically adhere to the guidelines provided by Bursa Malaysia and the necessary interpretations of IFRS Accounting Standards. However, it's important to note that our considerations go beyond mere numbers. We also assess how the disclosed information impacts the interpretation of financial statements and, ultimately, our stakeholders. If something is deemed significant in terms of what readers want to know, including qualitative aspects, we prioritise the disclosure. For instance, litigation cases. While legal cases may be mandatory to disclose in certain instances, we also evaluate them on a case-by-case basis. This aspect of our decision-making process involves a significant degree of judgement, especially when dealing with qualitative factors." (Preparer 12)

"For example, we have infrastructure assets where the amount is not material, we don't even have to disclose it separately, but it represents one of our subsidiary's contracts with one of the external parties, so we disclose it. We wanted the shareholders to know that we are having contracts with external parties." (Preparer 11)

Almost all the auditors stated that determining materiality is not a mechanical or formulaic process. Auditors rely on their judgement, experience, and industry knowledge to assess materiality, determining any misstatements, errors, or omissions in financial information that may impact investors' decision-making.

All auditors mentioned that the materiality concept guides the entire audit process, from planning through testing and reporting. For example, as described by External Auditor 15 in the interview, materiality is a concept used in auditing to determine the significance or importance of certain financial elements when conducting an audit. It is used to assess the impact of misstatements or errors on financial statements and to guide auditors in focusing their efforts on areas that are more likely to affect the decision-making of financial statement users. Also, all auditors stated materiality plays a crucial role in assessing risk and assurance levels in the audit because it helps them determine the extent of testing and the focus on high-risk areas where material misstatements are more likely to occur.

All auditors explained that materiality primarily involves quantitative thresholds. They generally set tolerable error levels and misstatement thresholds to determine when adjustments to financial statements are necessary. These thresholds or percentages are usually around 1-2% of assets or revenue based on standardised methodologies provided by their firms. However, materiality considerations may vary based on the nature of the company and industry. Although quantitative thresholds usually take precedence, qualitative factors are also taken into account. These may include industry-specific considerations and information based on the audit history, such as whether a previous year's report was qualified by another firm. Qualitative factors may lead to adjustments to materiality thresholds.

“Quantitative factors are predominantly employed during audit testing, where precision is crucial. However, we tend to observe more qualitative judgements when assessing the overall report or taking a holistic view. It becomes a secondary process, following comprehensive quantitative testing. The key is to exercise precision in qualitative considerations to ensure alignment with the chosen materiality threshold. While practitioners in audits often lean toward advising the client to make changes when an issue exceeds materiality, there's often a grey area. In some cases, even if a change doesn't impact net assets or profits and the company insists that users don't care about net assets, we begin to contemplate the qualitative dimension. This is why I believe quantitative aspects remain important; you can't merely set a materiality threshold and disregard it. There will always be certain decisions where, despite determining materiality, you have to ask yourself, 'Do users truly want me to emphasise this aspect to such an extent?'” (External Auditor 4)

"Audit firms have their own methodologies to determine what is material, which is often depending on the companies they audit in terms of profit orientation. So, we must strike a balance and determine the most appropriate benchmark. Based on my experience, due to the impact of COVID-19, the approach evolved. For example, the projection of hotel occupancy post-COVID-19. Our firm exercises judgement and may prefer projecting from 2022 rather than delving into historical data for 2020-2021. This demonstrates the challenges and judgement involved, particularly in the context of the COVID-19 pandemic." (External Auditor 5)

Part 2: The Impacts of the PS2 on Practitioners' Materiality Judgements (RQ2)

2.1 Perspectives of Preparers and Auditors Regarding PS2

Participants were asked about their views on the PS2's guidance for the application of materiality during the preparation and/or audit of financial statements. As shown in Table 2, the majority of participants held favourable opinions regarding PS2. They found it beneficial for enhancing better communication in financial reporting and improving their materiality assessments.

Table 2: Perspectives of Preparers and Auditors Regarding PS2

Themes
Provided clearer guidance
Facilitate practitioners' work and decision-making process
Improved understandability in applying the materiality concept

Provided clearer guidance

Almost all participants agreed that PS2 has significantly improved their ability to make materiality judgements in financial reporting. They acknowledged that PS2 has been important in providing much-needed guidance for making more informed materiality judgements. A key aspect emphasised by all auditors is the comprehensive nature of their materiality assessment, now encompassing both quantitative and qualitative factors. This approach applies to the recognition and measurement of transactions, as well as the presentation and disclosure of material information, aligning with PS2. By considering both types of factors, auditors ensure a more holistic assessment of what truly matters in financial reporting. The guidance also reminds auditors to make context-specific materiality determinations. This tailored approach enhances the precision of materiality judgements and ensures they are more relevant to the specific entity.

Another advantage highlighted by auditors is the clarity provided by PS2 regarding the principle-based approach to assessing materiality. This clarity has led to improved decision-making when it comes to including or omitting material information in financial statements. By adhering to these principles, auditors can enhance the transparency and accuracy of financial reporting.

"*The materiality guidance offers essential guidelines for assessing the significance of omitted information and its potential effects on financial statement users. In audit work, the principles outlined in ISA (International Standards on Auditing) are widely employed in every audit file to determine materiality, as well as PS2. This includes consideration of both quantitative and qualitative aspects. In my view, the PS2 guidance is adequate. Striking the right balance is crucial; standards shouldn't be overly prescriptive, allowing practitioners to exercise their judgement. These guidelines provide a helpful framework for everyone to make informed judgements about materiality as they perform audits on financial statements.*" (External Auditor 7)

"*Right now (the PS2 and The Amendments), it is good enough to guide us.*" (Preparer 4)

Most financial statement preparers expressed that their materiality practices are guided by PS2. They also emphasised their commitment to staying up to date with any new or revised financial statement-related standards or guidelines. They achieve this by actively engaging in discussions with auditors or conducting their own research and training. Notably, all preparers from publicly listed entities have underscored the importance of aligning their financial reporting practices with the efforts of regulators and accounting standard setters. They are well-informed about the PS2 guidelines, and their current practices are in harmony with the Listing Requirements set forth by Bursa Malaysia. These Listing Requirements specifically address matters related to the continuous disclosure of material information to the market (Chapter 9 - Continuing Disclosure) and the considerations involved in calculating indicators of transactions' materiality (Chapter 10 – Transactions). Importantly, these Listing Requirements are generally consistent with the principles outlined in PS2.

> "*Being in government linked companies (GLC) must take into account a lot of perspectives, the community, nation and everything so at the same time even though we meet the qualitative and quantitative threshold, we'll make sure that information presented meets the requirements of regulators and stakeholders."* (Preparer 11)

> *"The materiality guidance so far to me has been quite straightforward. Whenever we have doubts on the materiality of certain transactions, we will step back, and refer to the guidelines. If it doesn't look right, we will recommend something different to the auditors. But then you must have a very good basis for your option and decision so that you'll be able to answer to the audit committee."* (Preparer 8)

Most preparers also noted that materiality judgement involves cross-checking information across departments to ensure that everyone shares the same understanding of materiality and follows consistent reporting practices.

Further, prepares noted that materiality plays a significant role when dealing with estimates and judgements in financial reporting. For example, Preparer 9 informed that in industries like construction and property, where estimates are crucial (e.g., percentage completion, profit margins), materiality really helps in ensuring that estimates are as accurate as possible throughout the project's lifecycle.

> *"The PS2 together with Disclosure Initiative (Amendment to MFRS 101) has guide us in terms of disclosing only relevant information such as our policy on Property, Plant, Equipment (PPE) on disposal, liquidation and devaluation of asset, as well as how you do the impairment."* (Preparer 9)

Overall, the participants felt that the IASB had successfully provided them with the guidance they needed for materiality judgements, resulting in a more sufficient and relevant disclosure.

Facilitate practitioners' work and decision-making process

The participants shared their experiences regarding the use of materiality guidance. The consensus among them is that the concept of materiality addressed in PS2 serves as a valuable tool in focusing on what truly matters in financial statements. Both auditors and preparers find it beneficial as it allows them to allocate their time and resources more effectively by concentrating on material issues. This, in turn, contributes to strengthening the credibility of financial reports.

Most of the preparers, in particular, emphasised that they consistently apply analytical perspectives when making materiality judgements, especially in the context of recognition and measurement. They routinely assess the reasonableness of numerical data, often on a monthly or quarterly basis. They highlighted that materiality plays a pivotal role in meeting reporting deadlines. These considerations are equally relevant to the presentation and disclosure of material information in financial reporting, especially when an entity operates with a diverse and decentralised structure, encompassing multiple significant business segments managed by different financial teams. Preparers asserted that materiality aids them in identifying and prioritising items that require heightened attention during the preparation of financial reports. Moreover, it promotes a standardised approach across various business units, enhancing the comparability and overall usefulness of the reports, as provided by the following example:

> "*Materiality makes a lot of difference because it means that it facilitates our process in terms of identifying and prioritising what do we look at first, basically, it provides this focus, it provides guidance, and standardises the approach between all the different business segments, in terms of what is the suitable materiality level and threshold, which transaction is misstated, which to be analysed and investigated more, what kind of adjustment to take up, what to be zoomed in and what is not, what is prioritised to be work on and to be disclosed."* (Preparer 15)

Furthermore, auditors highlighted their use of the materiality concept in their audit work. They mentioned that the materiality concept guides them in scoping their audits and in determining which line items and balances should be given particular emphasis during the audit process. This ensures that their audit efforts are focused on areas of greater significance, enhancing the effectiveness and efficiency of their work.

> *"Materiality is only used for two things. It's scoping work, how do you decide which numbers do you want to audit now? Which balances that you want to audit? The other area is in sampling."* (External Auditor 2)

> *"Materiality functions as a guiding principle during audits. It assists us in making decisions, especially when we encounter complex situations with our clients. It helps us judge whether we should insist on making adjustments or disclosing certain information. It involves making determinations. Throughout our conversation, I've used the word "determinations" intentionally because we don't simply set materiality like a mathematical formula. Instead, it involves making judgements and reassessing methods as needed." (External Auditor 17)*

Improved understandability in applying the materiality concept

It is important to note that many participants are of the view that the PS2 has improved preparers' and auditors' understandability in making materiality judgements, the degree of understandability to apply materiality concept in practice may vary depending on factors like work experiences, company size, and the type of firm. Many preparers expressed that their comprehension of applying the materiality concept is improved with the guidance provided in PS2. Most auditors noted that most preparers with audit experience have a better understanding of applying the materiality principle and making materiality judgements (i.e., choosing which facts and figures are most important) during the financial statements' preparation process. This is because they have had direct exposure to assessing materiality in the context of financial statement audits.

> "*The understanding of PS2 affect preparer's application of it differently. For listed companies, the CFOs are members of Malaysian Institute of Accountants and possess professional accounting qualifications. Their finance teams, some may not have professional qualification but they've been working with audit firms for more than 10 years. That is considered competent. Because of the knowledge, qualification, and experience, they can understand and apply the guidance in PS2 better."* (External Auditor 9)

2.2 Impacts on the Materiality Judgement Process

This section outlines participants' experiences in making materiality judgements during financial statement preparation or audit. Key themes include understanding business profiles and users, internal checklists, quantitative and qualitative factors and discussions and reviews (see Table 3).

Table 3: Impacts on the Materiality Judgement Process

Themes
Understanding the business profiles and primary users of financial statements
The utilisation of internal checklists
The utilisation of data analytic tools
Quantitative and qualitative factors:
Quantitative thresholds
a) Common quantitative materiality thresholds: - Profit before tax (5-10%) - Profit after tax (5-10%) - Total asset (0.5-2%) - Equity (3%) - Revenue (0.5-3%) - Operating expenses (0.5-3%)
Qualitative factors
a) Types of companies or industries b) Unprecedented factor c) Users' focus and expectation d) Risk impact-assessment e) Specific transactions f) Financial performance, external environment factors, and prior year audit findings
Presenting material information in the financial statements
Materiality discussions and review process
Documentation of the materiality determination

Understanding the business profiles and primary users of financial statements

Most of the participants highlighted the importance of understanding the entity's business profile and identifying the primary users of financial statements and the users' information needs when applying the concept of materiality. This initial step aligns with the first stage of the PS2 approach, which involves identifying information about transactions, events, or conditions that could be considered material. To illustrate this point:

> *"We generally start with understanding the perspective of users, what we think is material from their perspective. We understand their profile, i.e., is this a regulated company? Does it have multiple or minimal shareholders? Does this company operate in a highly volatile environment or not so volatile? Is it a complex structure company? Do they have multiple subsidiaries? Those are the considerations before we move on to the next step of applying percentage."* (External Auditor 19)

> "*As listed company, we have the benchmark from Bursa - for example, 5% of profit before tax, to decide whether this is required for disclosure in financial statements or not. We're not looking at just numbers. We also consider whether the information affects the interpretation of shareholders such as litigation matters, so we will disclose accordingly."* (Preparer 12)

During the interviews, almost all participants highlighted that identifying primary users of financial statements and their specific needs varies from one company to another. To illustrate, a preparer from a listed construction and property company emphasised that their primary users (individual and institutional shareholders) rely on financial statements and are particularly concerned with information related to the company's operational performance, notably its profitability. In addition to financial performance, these investors also prioritise non-financial factors such as sustainability issues, green initiatives, and social and environmental elements. Most preparers also stated that listed companies' financial reports cater to various other user groups as well such as creditors and bankers that closely scrutinise the entity's financial position, liquidity, and compliance with accounting standards and regulations. Likewise, regulators overseeing the listed companies are interested not only in compliance but also in the entity's disclosure of risks and uncertainties. Furthermore, financial analysts and credit rating agencies primarily focus on financial performance and trends over time. On the other hand, customers and other stakeholders, such as suppliers, are primarily concerned with sustainability issues, financial performance, and compliance with regulations. In comparison, for non-listed companies, which typically have fewer investors with regular access to financial information, the primary users are creditors and regulators, including tax authorities. Overall, preparers do take into consideration their key user needs in financial statements. To illustrate these points:

> *"When we talk about knowing the client, when we do the client acceptance, we will do background check on the key person especially directors or the one running the show… the way they manage the company. Information we obtained from several reports especially regarding internal control, management incentives, etc… the process of understanding the client is very important".* (External Auditor 15)

The utilisation of internal checklists

PS2 - Step 2 (assess) recommends that entities evaluate whether the information identified in Step 1 is, in fact, material and whether it would impact the economic decision-making of primary users. This practice was frequently mentioned by most participants, who often use internal checklists or internally developed guidelines to guide the materiality judgement process. Additionally, most participants, particularly from external auditor groups, utilise data analytic tools to support a quantitative and qualitative assessment of materiality within their firms.

From the interviews, it was revealed that most of the participants used a formal internal checklist to make their materiality determinations. These checklists were developed by the company and/or the auditing firm as part of the company's financial reporting process or the auditing firm's auditing process in order to determine whether the information can be deemed material. The application of formal checklists ensures that all pertinent factors are considered, and consistent evaluation criteria are utilised to determine materiality. To illustrate this:

> "*The basis of what that materiality threshold must be very clear, and why it's relevance and which situation is it relevant to and it becomes a policy so that everyone in the group applies that same threshold."* (Preparer 15)

> *"We have our own guideline (checklist) to guide our staff on how to determine materiality in terms of auditing the financial statements."* (External Auditor 7)

Even though some of the participants did not mention about formal checklist, the materiality process they described during the interview session is quite similar to the materiality determination steps that have been outlined by PS2. For example, the participants mentioned that they identify and consider relevant information and factors when making materiality determinations which is consistent with the approach addressed in PS2. To illustrate this scenario:

> *"We don't have formal checklist to help consider what is material and to decide on whether to disclose or not. We fully use judgement to deal with identifying material information and assessing internal-external factors to be considered. Afterall, unprecedented factor like the previous pandemic or wars that's going to happen in future, warrants no checklist. It goes beyond it".* (Preparer 3)

Overall, almost all the participants mentioned that they determine materiality by assessing both qualitative and quantitative factors, which is consistent with Step 2 of the PS2.

> *"When they review the financial statements, they will check through (the checklist for presentation and disclosure) to see whether there is any information that is material and not just for the sake of disclosing… in the preliminary, there is a column for the team to complete the qualitative aspects".* (External Auditor 8)

The use of data analytics tools

Most of the auditors also emphasised using data analytical tools to aid in materiality assessments. These tools enhance their capacity to identify trends, patterns, and anomalies within an entity's data. Auditors rely on data analytics not only during the audit planning phase to establish quantitative thresholds but also in conducting risk assessments, which include determining materiality. Consequently, these tools play a pivotal role in facilitating the materiality judgement process. This finding highlights the increasing significance of data analytics in materiality judgements, particularly among auditors. To illustrate:

> *"One of the key aspects of risk assessment is we require basic data analytics (in this case we're using Power BI) to be performed for account balance to analyse the speed of the account, whether the movement has been significant during the year, if its revenue we want to look at it by product, by recognition type, by month. We want to slice and dice so that we can understand what happened, say during the month of October, or they have this new product, but we did not see the product in the analytics? So, we definitely encourage our people to use analytics as it is the best way to slice and dice the risk assessment needed for materiality determination".* (External Auditor 4)

Quantitative and qualitative factors

Most participants in both groups agreed that qualitative and quantitative factors are considered when making materiality determinations depending on circumstances. Some examples of quantitative considerations are using industry-specific benchmarks and percentages of total assets, profit before taxes, revenue, and equity.

Quantitative thresholds

Common quantitative materiality thresholds

The participants' responses, as presented in Table 3, shed light on the prevalent quantitative thresholds used in determining materiality. These common quantitative materiality thresholds, namely profit before tax (5-10%), total assets (5-10%), revenue (0.5-2%), and equity (3%), serve as fundamental measurement bases for this purpose. However, the choice of which threshold to employ hinges on the specific circumstances and nature of each entity. A notable trend observed among the participants is the prominent utilisation of profit before tax as the primary threshold. This is particularly prominent in profit-oriented entities, such as those that prioritise maximising profits for their shareholders. For such entities, the focus on profitability makes profit before tax a pivotal initial consideration before any other thresholds are factored in. This aligns with shareholders' primary concern, which typically revolves around the entity's profitability.

Conversely, in cases where an entity's and its shareholders' priorities lean more towards financial position and stability, a different threshold might take precedence. For instance, during situations of financial uncertainty during the COVID-19 pandemic, the emphasis might shift to the entity's ability to meet both short-term and long-term financial obligations. Consequently, thresholds such as total assets or total equity could become more significant in this context. In the determination of materiality, an important facet considered is the financial impact of specific transactions in relation to the overall size of the entity. This assessment involves gauging materiality concerning total assets. This approach is particularly relevant for entities operating in fields like investment or fund management, where their asset base assumes considerable importance. Another crucial quantitative threshold for materiality determination is revenue. Participants highlight the significance of evaluating an entity's transactions or events in relation to its revenue.

Overall, the prevalence of several quantitative thresholds in materiality determination, including profit before tax, total assets, revenue, and equity. It is also important to note that materiality is not a one-time assessment but an ongoing process. Factors such as changing circumstances, new transactions, and external expectations may require adjustments to the materiality threshold. As mentioned by Preparer 12, their team continuously assess what information is material and what should be disclosed as new developments or changes occur within the company or the industry. This implies that the predetermined quantitative materiality factors and benchmark might change depending on other qualitative factors. Some preparers mentioned that they have to revisit their assessment on a materiality level due to changes in accounting standards.

> *"We had to apply materiality judgement retrospectively when dealing with certain accounting standards changes. This involved reevaluating past financial data, and sometimes making adjustments, even if the items in question were not materially significant in a strict quantitative sense." (Preparer 12)*

Furthermore, the selection of the most suitable materiality threshold depends on the nature of the entity and its prevailing circumstances. This dynamic interplay between thresholds ensures a nuanced approach to materiality assessment that aligns with the specific priorities and objectives of each entity. To illustrate:

> *"Profit before tax is very suitable for manufacturing or trading company where the focus would really look at the profit for the year. When we refer based on circumstances or industry, say for insurance company, because the business is longer term in nature for life insurance, so the materially setting would actually look at other more suitable benchmark... either using the total assets or the insurance contract as that probably would be a better fit to assess how users of the financial statements would look at the business in the long run."* (External Auditor 18)

> *"For a fund management company like us, typically we use profit before tax (PBT), but in some years when PBT is wildly swinged, then we went to a balance sheet approach because we collect contribution or premium for the next 20-30 years, so we have accumulated a huge balance. I think a balance sheet approach is a much better gauge because for example, we've operated less than 20 years, so sometimes our profitability, whether it's due to regulatory changes or other factors, it can go up and down fairly rapidly."* (Preparer 10)

Some auditors also indicated that the threshold percentage depends on whether the company is listed or non-listed. To illustrate:

> "*If it is listed then your percentage will be smaller but if it is not listed, obviously the risk is lesser. But then, there are other factors to be considered very early on. For example, we use 5% of profit before tax, that's the maximum for a listed company. But of course, if it is a higher risk then we may bring down the 5% to 4% or even 3%. So, depending on the risk type. Normally on the benchmark, if let's say this company is profitable, we set 5% of profit. So, any errors that we discover lower than 5%, that's where we start to conclude that it is not material, so anything above it, then it is material."* (External Auditor 2)

Qualitative factors

Types of companies or industries

Most participants noted that it is important to consider the types of business or industry an entity operates in when making materiality judgement. For example, Investors and regulators generally have an interest in the profitability of a publicly traded entity. However, if an entity is a special purpose vehicle, investors may not only just focus on the profitability but also want to know whether and how the entity has achieved what it is set up to achieve. Some users also expect a particular accounting policy should be used to provide material information in certain industries, for example:

> *"In property development, it is important for us to explain some of the judgement we have made regarding the choice of accounting policy in this industry, such as, on the percentage of completion, how do we apply percentage of sales? In certain circumstances, we might use the completion method or in some other circumstances, the progressive method to apply for our revenue recognition. Those are the things that we have to disclose to the users, which is something different from other industries."* (Preparer 13)

Unprecedented factor

Almost all auditors and a few preparers highlighted that unprecedented factors could significantly impact the judgements made regarding materiality. These factors include the far-reaching effects of the Covid-19 pandemic and geopolitical crises like the ongoing Ukraine-Russia conflict. The participants explained that these extraordinary events have the potential to exert a substantial influence on how judgements about materiality are made. In particular, the participants discussed how they would take into account the repercussions of these unprecedented events on a company's financial statements. They emphasised that they would assess the potential operational and budgetary consequences that could arise. For instance, many businesses have experienced financial losses and faced uncertainties about their ability to continue as a going concern due to the pandemic. These circumstances have led to re-evaluating the conventional benchmarks or thresholds used to determine materiality.

"Even though we are a non-profit organisation, we have public accountability. Generally, entity will use 5% of profit, but we will use less than 5% from equity. 5% is the maximum. Then we also use revenue and asset about 1-3% for materiality level". (Preparer 6)

Thus, the usual criterion of assessing materiality based on profit before tax may no longer be applicable due to the widespread loss-making and going concern challenges experienced by many entities during the pandemic. Consequently, auditors have shifted their focus to alternative benchmarks, such as total assets or equity, to gauge materiality in this evolving landscape. This adaptive approach reflects the acknowledgment that the conventional yardsticks may not accurately reflect the financial reality brought about by these unprecedented events. In summary, the interviews revealed that the interviewed auditors and preparers recognise the exceptional nature of events like the Covid-19 pandemic and geopolitical crises. These events have compelled them to reassess materiality judgements by considering the broader impact on an entity's financial position, taking into account operational and budgetary ramifications. This has led to the utilisation of alternative benchmarks, such as total assets or equity, to better capture the changing dynamics of materiality in these extraordinary times. To illustrate:

"If the company is really impacted by Covid-19, then we will use the loss before tax as a basis. If the loss seems unrecoverable, then we will use the total expenditure." (External Auditor 20)

"The Covid pandemic has impacted us all from different standpoint. For example, Malaysian government has introduced a number of relief measures, one of it is automatic moratorium. As a bank, it is considered modification loss and we need to assess the impact on our book. The number may or may not be material however it is a new thing, never happen before. A special disclosure is needed." (Preparer 4)

Users' focus and expectation

Many participants acknowledged that the materiality judgement process is influenced by the focus and expectations of stakeholders and financial statement users. This involves prioritising what information is relevant and vital for stakeholders to make informed decisions. During the discussions, participants consistently emphasised that, in addition to financial information, non-financial information is of paramount concern to users today, especially investors. They perceive this information as crucial for their investment decisions, whether they are considering new investments or maintaining existing ones. Preparers typically incorporate this type of information into their integrated reporting, covering aspects related to the company's sustainability and its ESG initiatives. In essence, the recognition of stakeholders' changing expectations highlights the increasing importance of non-financial information, particularly to investors, in the materiality judgement process. To illustrate the users' focus and expectations:

"*For start-up companies, the primary focus and the key performance indicator (KPI) based on revenue growth. You're looking at the value creation of the business from a valuation perspective. Then they all tend to agree revenue is the right one to be used as materiality threshold."* (External Auditor 3)

> *"For our primary users, potential and existing investors, in this current situation, they are looking more on the ESG, green initiative. So, our group is moving towards that direction, and we are disclosing that information so that the readers know your effort in that. These are some of the things that may not really have impact in terms of numbers, but it will impact how the group is progressing in terms of ESG. We are considering the readers' viewpoint which we know will give added value to them."* (Preparer 7)

Risk impact-assessment

Some participants also emphasised the importance of qualitative factors related to risk assessment when determining materiality. They highlighted the need to assess how risks associated with specific transactions or events might affect the financial statements. Furthermore, they stressed the importance of conducting a broader risk assessment for the entire company. This risk assessment helps reveal the potential impact of risks on the financial statements and guides the determination of materiality. To illustrate this point:

> *"Auditing is slightly different from accounting when we set the materiality for the auditing is to scope our work. It's not so much of how much we need to disclose."* (External Auditor 2)

> *"For instance, we have an acquisition that although the first seed money is very small but nonetheless, we plan to grow it big and, in this case, we may disclose a little bit more specifically if we think that particular investment could help the investors or could entice investors to invest into the stocks. So, judgement comes into play."* (Preparer 3)

Specific transactions

Furthermore, most of the participants recognised the significant impact of specific transactions or subsequent events on materiality judgements. These events encompass various scenarios, including litigation cases, related party transactions, and other transactions that, if not disclosed, could have a substantial impact on the financial statements. For instance, they could result in a change from profit to loss or vice versa, irrespective of the specific amount. One preparer (Preparer 07) specifically highlighted that materiality judgement involves considering distinct events, such as land acquisitions. In this context, they noted that the acquisition of land for a particular purpose could be deemed material, underscoring a qualitative dimension in their materiality assessment.

> *Related party transaction is always controversial. For example, transfer pricing has to be very transparent. In itself normally we don't even look at materiality and want to make sure that everything is covered. For us, if the number is immaterial, we will treat it as material because of the nature.* (Preparer 8)

> *If it is a recurring issue or correction is needed, no matter how small it is, we will address it because we do not want the issue to continue as an issue and reappearing year after year.* (Preparer 8)

Financial performance, external environment factors, and prior year audit findings

Financial performance, external environment factors, and prior year audit findings, are other contextual factors that have been considered by the participants in materiality determination. In particular, if a company is not making a profit, additional indications like total assets, total revenue, or certain financial ratios may be taken into account in determining materiality.

Broader contextual elements, such as political climate, environmental issues, the state of the world economy, or judicial proceedings, also influence how materiality determinations are made. One preparer who deals with plantation company shared that, "*any potential impact from the flood will be disclosed*" (Preparer 5). Other examples by the participants are:

"Government stability and global recession may impact the investment which cause the company to disclose impairment which is deemed a material information to them. The auditors are also looking at the prior year audit findings, whether there are a lot of adjustments to be made or they have qualified audit report, to determine materiality judgement". (Preparer 6)

"*The report qualified on PPE that is deemed to be of higher risk, then we will look at the associated completeness and existence, and thereafter, we come up with the materiality, focusing our attention on the more higher risk area".* (External Auditor 12)

Presenting material information in the financial statements

Step 3 in the PS2 is about presenting and communicating material information in a clear and concise manner that meets user needs. Judgements should be exercised in communicating the material information effectively by way of ensuring material matters are emphasised. Information should be tailored to the entity's circumstances.

Some participants expressed concerns about non-compliance with accounting standards, which could lead to regulatory queries due to differing views on what should be disclosed in financial statements. Additionally, participants noted that preparers sometimes struggle to understand new changes in complex accounting standards. This lack of understanding can lead to a 'boilerplate' approach, where preparers disclose excessive information, both material and immaterial, solely for the sake of compliance. Both auditors and preparers acknowledged that some preparers may be uncomfortable using judgement, especially in complex transactions reflected in financial statements. This finding underscores the challenges currently faced by financial statement preparers in effectively reporting financial information.

"*Preparers are worried about not being MFRS /IFRS compliant, so they just disclose all information even though such information is immaterial. But preparers should use judgement."* (External Auditor 1)

"The accounting standards are becoming complex…preparers may not have full understanding of the standards and therefore they disclose all information required." (Preparer 14)

Additionally, certain participants have expressed that there are instances where making judgements about whether information is material or could potentially lead to reader misguidance is not a straightforward task.

"For example, there was a breach of covenant. But subsequent to year end, the loan has been redeemed. Question is, should the breach still be disclosed even though it has been settled? Most have problem with telling people that there was actually a breach of covenant. It's a challenge because we don't want to obscure the material information (breach) that might misguide the readers and impact their decision making. So that aspect needs a lot of thought process and come to an agreement". (Partner 8)

A preparer from a listed company that provides financial services mentioned that they had exercised professional judgement and believed that the expected credit loss at the beginning of the year was immaterial to be disclosed in the notes to the financial statements because the amount and the subsequent risk were not significant to the company and users. However, their external auditors requested them to disclose such information, demonstrating that preparers and auditors may not necessarily have the same materiality judgements. It is important to note that this is an isolated example and does not represent the whole population of participants in this study.

Materiality discussions and review process

Most auditors, as revealed during interviews, conduct internal dialogues among the engagement team and partners at various stages of the audit. These discussions aim to ensure that the most appropriate materiality judgement is applied throughout the audit process.

Similarly, some preparers mentioned that they hold discussions with management to ensure that the disclosed information remains relevant and sufficient for stakeholder decision-making. These discussions also serve to incorporate management's perspective and align the disclosed information with the overall strategic direction of the organisation.

> "*In high-risk engagements or situations where materiality judgements are challenging, auditors often consult with other partners or escalate the issue to higher-level committees within the audit firm. This consultation and review process helps ensure that materiality decisions are well-founded and minimise the risk of making incorrect judgements."* (External Auditor 2)

> "*Even if material misstatement has been adjusted, for example due to carelessness, auditors need to discuss among themselves to evaluate the corrected misstatement. If it leads to big issue, then we will leave it up to audit committee."* (External Auditor 17)

Preparers acknowledged the vital role of external auditors in the accuracy and fairness of financial statements, focusing on material information. To enhance the effectiveness of the audit process, most preparers generally discuss their materiality judgements and practices with external auditors.

> *"As a non-profit and public fund manager, we engage external auditor to look at certain areas like contributions received, educational loans, remuneration, and our subsidiaries' transaction. We discussed using net assets as the base to determine materiality threshold."* (Preparer 6)

> *"Firstly, we need to align our approach with the approach external auditor have to avoid redundancy of reviewing on our part, because during audit process, they're going to be guided by the standards. We need to make sure the unaudited numbers disclosed in quarterly reports are very much the same as the audited numbers. We wouldn't want any major adjustments happening in Quarter 4."* (Preparer 15)

Auditors and preparers also recognise the ultimate responsibility or "ownership" of the financial statements, which ultimately rests with the preparers and management. However, these interactions and communications between preparers and auditors serve to align judgements during the recognition, measurement, and disclosure of transactions and events in the financial statements. Consequently, the involvement of dedicated teams in the materiality judgement process may lead to a more effective decision-making process. Auditors and preparers both acknowledged the final responsibility for the financial statements lies with the preparers. Consequently, involving dedicated teams in the materiality judgement process can enhance the effectiveness of the decision-making process. Some participants suggested providing refresher training to preparers and auditors as a means of overcoming these obstacles.

> "*If you ask me about the Practice Statement itself, it's there as good information, but a lot of people may not necessarily know about it, so I think maybe a refresher course by, e.g., MICPA (The Malaysian Institute Of Certified Public Accountants) or MIA (Malaysian Institute of Accountants) may bring back the awareness".* (External Auditor 3)

Documentation of the materiality determination

During the interview sessions, several participants stressed the significance of documenting the process of determining materiality when exercising professional judgement. They emphasised that materiality requires comprehensive documentation and a thorough review of financial data to minimise discrepancies. As Preparer 6 mentioned, the preparer's objective is often to achieve the highest level of accuracy and reduce errors in the financial statements. Participants also highlighted that regulators and management expect such documentation for both current and future reference. Consequently, documenting evidence and justifications plays a pivotal role in creating a record that explains the reasoning behind materiality decisions and establishes a clear trail of the evaluation process. This documentation is essential for demonstrating the professional judgement exercised by auditors and preparers and serves as a valuable reference for future audits or reviews. To illustrate these points:

> "*The basis of that threshold must be very clear and objective. We do have that as part of our policy that is documented, so that everyone is aware of the approach that we use"* (Preparer 15)

3. Conclusion and Recommendations

This research investigates financial statements preparers and auditor's understanding of the concept of materiality. In addition, it examines the impact of the guidance provided in PS2 on the practitioners' materiality practices. Based on the research findings, several key conclusions and recommendations can be drawn. First, materiality is a fundamental concept in financial reporting that focuses on providing relevant and significant information to users for economic decision-making. Both preparers and auditors view materiality as a concept that directly relates to the relevance of information in financial statements. Second, materiality is closely tied to the adequate presentation and disclosure of financial information. Preparers emphasise the importance of clear and transparent reporting, which includes presenting both financial and non-financial data in a manner that aids stakeholders' understanding. They stress that timely reporting and real-time access to information are crucial. Third, materiality consideration involves judgement and is context-dependent. It is not solely based on quantitative thresholds but also on qualitative factors. Fourth, this research indicates that the PS2 has generally had positive effects on applying the materiality concept. Overall, the findings suggest that applying the guidance provided in PS2 has contributed to better financial reporting and communication practices among participants, ultimately enhancing the quality and credibility of financial reports.

Based on the findings, this study recommends that entities should invest in ongoing education and training for both preparers and auditors to ensure a clear understanding of the materiality concept. Second, preparers and auditors should engage in open and transparent communication to align their materiality practices. Regular discussions and sharing of insights can help bridge any gaps and ensure that materiality is consistently applied. Third, preparers and auditors should focus on providing material information in financial statements to meet user needs.

Appendix 1

Table A: Demographic information of participants (Preparers of financial statements)

Code of participants	Firms and designation	Working experience	Gender and age group	Location, mode, duration of interview
P1	PIE CFO	20 to 30 years	Female 40-50	Kuala Lumpur Online 30 mins
P2	PIE CFO	10 to 19 years	Male 30-39	Kuala Lumpur Online 41 mins
P3	PIE CFO	More than 30 years	Female > 50	Kuala Lumpur Online 30 mins
P4	PIE CFO	More than 30 years	Female > 50	Kuala Lumpur Face-to-face 39 min
P5	PIE Group Accountant	20 to 30 years	Female 40-50	Kuala Lumpur Online 52 mins
P6	Non-PIE CFO	20 to 30 years	Male 40-50	Kuala Lumpur Online 49 mins
P7	PIE CFO	More than 30 years	Female > 50	Kuala Lumpur Online 38 mins
P8	PIE CFO	20 to 30 years	Male 40-50	Kuala Lumpur Online 33 mins
P9	PIE CFO	20 to 30 years	Male 40-50	Selangor Online 43 mins
P10	PIE CFO	20 to 30 years	Male 40-50	Kuala Lumpur Online 39 mins
P11	PIE SM	20 to 30 years	Female 40-50	Kuala Lumpur Online 22 mins
P12	PIE AGM	20 to 30 years	Male 40-50	Kuala Lumpur Online 18 mins
P13	PIE AGM	20 to 30 years	Male 40-50	Selangor Online 49 mins
P14	Non-PIE Director	More than 30 years	Male > 50	Kuala Lumpur Online 1 hour
P15	PIE General Manager	20 to 30 years	Female 40-50	Kuala Lumpur Online 29 mins

Notes: *PIE – Public Interest Entity * SM – Senior Manager *AGM – Assistant General Manager

Table B: Demographic information of participants (Audit practitioners)

Code of participants – External Auditors	Firms and designation	Years of audit experience	Gender and age group	Location, mode, and duration of interview
EA1	Major Firm Partner	20 to 30 years	Male 40-50	Kuala Lumpur Face-to-face 53 min
EA2	Major Firm Partner	More than 30 years	Male > 50	Kuala Lumpur Face-to-face 47 min
EA3	Major Firm Partner	20 to 30 years	Male 40-50	Kuala Lumpur Online 53 min
EA4	Major Firm Partner	10 to 19 years	Male 30-39	Kuala Lumpur Face-to-face 51 min
EA5	Mid- size Firm Partner	More than 30 years	Male > 50	Kuala Lumpur Face-to-face 54 min
EA6	Major Firm Partner	More than 30 years	Male > 50	Kuala Lumpur Face-to-face 40 min
EA7	Major Firm Partner	10 to 19 years	Female 30-39	Kuala Lumpur Face-to-face 29 min
EA8	Mid-size Firm Partner	20 to 30 years	Male 40-50	Kuala Lumpur Online 53 min
EA9	Mid-size Firm Partner	20 to 30 years	Female 40-50	Kuala Lumpur Online 45 min
EA10	Mid-size Firm Partner	20 to 30 years	Male 40-50	Kuala Lumpur Face-to-face 56 min
EA11	Mid-size Firm Partner	20 to 30 years	Male 40-50	Kuala Lumpur Online 58 min
EA12	Mid-size Firm Partner	20 to 30 years	Male 40-50	Kuala Lumpur Online 31 min
EA13	Mid-size Firm Partner	20 to 30 years	Male 40-50	Kuala Lumpur Online 51 min
EA14	Mid-size Firm Partner	20 to 30 years	Male 40-50	Kuala Lumpur Online 51 min
EA15	Mid-size Firm Partner	20 to 30 years	Male 40-50	Kuala Lumpur Online 47 min
EA16	Major Firm	20 to 30 years	Male	Kuala Lumpur

	Partner		40-50	Online 47 min
EA17	Major Firm Partner	20 to 30 years	Male 40-50	Kuala Lumpur Online 42 min
EA18	Major Firm Senior Manager	10 to 19 years	Female 40-50	Kuala Lumpur Online 31 min
EA19	Major Firm Manager	Less than 10 years	Male 30-39	Kuala Lumpur Online 42 min
EA20	Mid-size Firm Manager	Less than 10 years	Female 30-39	Kuala Lumpur Online 34 min

Appendix 2

Interview guides for participants

AUDIT PRACTITIONERS

Personal Background
Experience, age, qualification, and position

Theme 1: Materiality idea in practice.

1. What do you understand by the term materiality?
2. Who are your financial statements' primary users?
3. How does the concept of materiality help you perform financial statement audits?

Theme 2: The effects of the IASB's materiality (the PS2) guidance on key groups.

1. How can the IASB's materiality guidance be used to make materiality decisions when auditing financial statements for general purposes?
2. How does the IASB's materiality guidance help you determine whether omissions or misstatements have an impact on the financial statements' fair presentation?
3. How does the IASB's materiality guidance help you decide on the process of recognising, measuring, and disclosing transactions and events in financial statements?
4. How have your audit clients' disclosure practises changed since the IASB issued materiality guidance?
5. Please share your experiences with materiality during the audit.

Theme 3: The application of the IASB's materiality guidance (the PS2) on materiality judgements in practice

1. Could you please describe the steps you take to practise materiality?
2. What quantitative bases and percentages did you typically use to determine materiality?
3. What qualitative factors did you consider when determining materiality?
4. How do you integrate quantitative and qualitative factors when making materiality determinations?

PREPARERS

Personal Background
Experience, age, qualification, and position

Theme 1: Materiality idea in practice

1. What do you understand by the term materiality?
2. Who are your financial statements' primary users?
3. How does the concept of materiality assist you in preparing financial statements?

Theme 2: The effects of the IASB's materiality guidance (the PS2) on key groups.

1. How can the IASB's materiality guidelines be used to make decisions about materiality during the preparation of financial statements?
2. How can you determine whether omissions or misstatements have an impact on the economic decisions of the key users of financial statements using the IASB's materiality guidance?
3. How can you decide how to recognise, measure, and disclose transactions and events in the financial statements using the IASB's materiality guidance?
4. How have your company's disclosure practises changed as a result of the materiality guidance from the IASB?
5. Please share your experiences on any challenges encountered when applying materiality.

Theme 3: The application of the IASB's materiality guidance (the PS2) on materiality judgements in practice

1. Could you please describe the steps you take to practise materiality?
2. What quantitative bases and percentages did you typically use to determine materiality?
3. What qualitative factors did you consider when determining materiality?
4. How do you integrate quantitative and qualitative factors when making materiality determinations?