**International Financial Reporting Standard**

# Definition of Material

**October 2018**

**BASES FOR CONCLUSIONS – AMENDMENTS**

**[IFRS 17, IAS 1, IAS 8 and Conceptual Framework]**

**[Related to AASB 2018-7]**

# Amendments to the Basis for Conclusions on IAS 1 *Presentation of Financial Statements*

Paragraphs BC13A–BC13T and their related headings are added.

## Definition of Material (paragraph 7)

### Background

BC13A The Board was informed at the *Discussion Forum on Financial Reporting Disclosure* it hosted in January 2013,[1] through feedback on the amendments to IAS 1 in the 2014 Exposure Draft *Disclosure Initiative*, the 2017 Discussion Paper *Disclosure Initiative—Principles of Disclosure*, and from other sources, that entities experience difficulties in making materiality judgements when preparing financial statements.

BC13B The feedback indicated that difficulties in making materiality judgements are generally behavioural rather than related to the definition of material. That feedback indicated that some entities apply the disclosure requirements in IFRS Standards mechanically, using them as a checklist for disclosures in their financial statements, rather than applying their judgement to determine what information is material. Some entities have said that it is easier to use a checklist approach than to apply judgement because of management resource constraints, and because following a mechanical approach means that their judgement is less likely to be challenged by auditors, regulators or users of their financial statements. Similarly, some entities say that they prefer to be cautious when deciding whether to omit disclosures to avoid the risk of being challenged by these parties.

BC13C The Board concluded that these behavioural difficulties could best be addressed by providing guidance to help entities make materiality judgements, rather than by making substantive changes to the definition of material. Consequently, in September 2017 the Board issued IFRS Practice Statement 2 *Making Materiality Judgements* (Materiality Practice Statement).

BC13D Although many stakeholders agreed that substantive changes to the definition of material were unnecessary, the Board received some feedback that the definition of material might encourage entities to disclose immaterial information in their financial statements. Feedback suggested that the Board should address the following points:

(a) the phrase 'could influence decisions of users', to describe the threshold for deciding whether information is material, may be understood as requiring too much information to be provided, because almost anything 'could' influence the decisions of some users of the financial statements, even if such a possibility were remote;

1 A Feedback Statement summarising the feedback from that forum and from the Board's related survey on financial reporting disclosure is available on the IFRS Foundation website at http://www.ifrs.org/-/media/project/disclosure-initative/feedback-statement-discussion-forum-financial-reporting-disclosure-may-2013.pdf.

 

(b) the phrase 'information is material if omitting it or misstating it' focuses only on information that cannot be omitted (material information) and does not also consider the effect of including immaterial information; and

(c) the definition refers to 'users' but does not specify their characteristics, which is interpreted by some as implying that an entity is required to consider all possible users of its financial statements when deciding what information to disclose.

BC13E The Board also observed that the wording of the definition of material in the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*) differed from the wording used in IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The Board believes that the substance of the definitions is the same because these definitions all cover the omission or misstatement of information that could influence the decisions of users of financial statements. Nevertheless, the existence of more than one definition of material could be confusing and could imply that the Board intended these definitions to have different meanings and be applied differently in practice.

BC13F Consequently, the Board decided to propose refinements to the definition of material and to align the definition across IFRS Standards and other publications. The Board observed that these refinements were intended to make the definition easier to understand and were not intended to alter the concept of materiality in IFRS Standards.

### Refinements to the definition of material

BC13G In September 2017 the Board published the Exposure Draft *Definition of Material* (Proposed amendments to IAS 1 and IAS 8) which proposed a revised definition.

BC13H The Board developed this definition by:

(a) replacing the description of the threshold 'could influence' with 'could reasonably be expected to influence' to incorporate the existing clarification in paragraph 7 of IAS 1 which states: 'Therefore, the assessment needs to take into account how users with such attributes *could reasonably be expected to be influenced* in making economic decisions' [emphasis added]. This wording helps to address concerns raised by some parties that the threshold 'could influence' in the existing definition of material is too low and might be applied too broadly (see paragraph BC13D(a)).

(b) using the wording of the definition of material in the *Conceptual Framework*.[2] The Board concluded that this wording was clearer than the definition in IAS 1 and IAS 8. However, the Board decided to refer to 'financial statements' rather than 'financial reports' in the amendments

2 The wording in paragraph 2.11 of the *Conceptual Framework* is: 'Information is material if omitting it or misstating it could influence decisions that the primary users of general purpose financial reports make on the basis of those reports, which provide financial information about a specific reporting entity'.

to IAS 1 to be consistent with the scope of that Standard.[3] The *Conceptual Framework* definition also clarifies that the users to whom the definition refers are the primary users of an entity's financial reports or statements. Referring to the primary users in the definition of material in IAS 1 helps to respond to concerns that the term 'users' may be interpreted too widely (see paragraph BC13D(c)).

(c) including 'obscuring' in the definition of material to incorporate the existing concept in paragraph 30A of IAS 1 which states: 'An entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating items that have different natures or functions.' Referring to 'obscuring' in the definition of material is intended to respond to concerns that the effect of including immaterial information should also be considered in addition to 'misstating' and 'omitting' (see paragraphs BC13D(a) and (b)).

(d) relocating wording that explains rather than defines material from the definition itself to its explanatory paragraphs. This reorganisation clarifies which requirements are part of the definition and which paragraphs explain the definition.

BC13I Some parties said that the Board should raise the threshold at which information becomes material by replacing 'could' with 'would' in the definition. However, the Board did not do this because it concluded that using 'would' would be a substantive change that might have unintended consequences. For example, 'would influence decisions' might be interpreted as a presumption that information is not material unless it can be proved otherwise, ie for information to be seen as material it would be necessary to prove that the information would influence the decisions of users of the financial statements.

### Obscuring information

BC13J Responses to the Exposure Draft *Definition of Material* (Proposed amendments to IAS 1 and IAS 8) indicated strong support for the definition of material to be aligned across the *Conceptual Framework* and IFRS Standards. However, many respondents had some concerns—in particular about including the existing concept of 'obscuring' (as set out in paragraph 30A of IAS 1) in the definition of material in the way proposed in the Exposure Draft. Many respondents thought that if the Board were to include this concept in the definition, then 'obscuring information' would need to be more precisely defined or explained than it was in the Exposure Draft.

BC13K The Board agreed with respondents that the concept of 'obscuring information' is inherently more judgemental than 'omitting' or 'misstating' information and considered removing the concept from the definition of material and its explanatory paragraphs altogether. However, the Board decided that the benefit of including 'obscuring' in the definition of material outweighed these concerns. Including this concept emphasises that obscuring information can affect the decisions of primary users just as omitting or misstating that

3 Financial statements are a type of financial report.

 

information can. In particular, including 'obscuring' in the definition of material addresses concerns that the former definition could be perceived by stakeholders as focusing only on information that cannot be omitted (material information) and not also on why it may be unhelpful to include immaterial information.

BC13L The Board did not intend to be prescriptive by including the word 'obscuring' in the definition of material and by further clarifying it—the Board is not prohibiting entities from disclosing immaterial information or introducing a required quality of explanations and information included in the financial statements. For example, the Board did not intend the addition of the word 'obscure' to prevent entities from providing information required by local regulators or prescribe how an entity organises and communicates information in the financial statements. Rather, the Board's intention is to:

(a) support the existing requirements in paragraph 30A of IAS 1 which state that 'An entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions'; and

(b) help entities and other stakeholders avoid instances in which material information may be obscured by immaterial information to the extent that it has a similar effect on the primary users of financial statements to omitting or misstating that information.

### Other amendments

BC13M While the revised definition of material in IAS 1 has been based on the definition of material in the *Conceptual Framework*, some adjustments were made to the *Conceptual Framework* definition to improve clarity and consistency between the *Conceptual Framework* and the IFRS Standards. The definition in the *Conceptual Framework*, however, continues to refer to 'financial reports' rather than 'financial statements'.

BC13N The Board also made amendments to the Materiality Practice Statement to align it with the revised definition of material. The Materiality Practice Statement continues to refer to both 'immaterial' and 'not material' as the Board concluded that these terms have the same meaning.

BC13O As explained in paragraph BC13H, the amendments incorporate existing guidance from the *Conceptual Framework* and IAS 1 and are not substantive changes to the existing requirements in IFRS Standards. For this reason, the Board concluded that the guidance in the Materiality Practice Statement and the *Conceptual Framework* would not be affected by these amendments.

BC13P Because the amendments are based on existing guidance, they are not considered to be substantive changes. The Board consequently concluded that amendments to other requirements in IFRS Standards are unnecessary, other than to update the definition of material where it is quoted or referred to directly.

 

BC13Q The Board also decided that it was unnecessary to change all instances of 'economic decisions' to 'decisions', and all instances of 'users' to 'the primary users of financial statements' in IFRS Standards. In its Conceptual Framework project, the Board clarified that:

(a) the terms 'primary users' and 'users' are intended to be interpreted the same way and both refer to existing and potential investors, lenders and other creditors who must rely on general purpose financial reports for much of the financial information they need (see the footnote to paragraph 1.5 of the *Conceptual Framework*); and

(b) the terms 'decisions' and 'economic decisions' are intended to be interpreted the same way.

### Likely effects of the amendments to IFRS Standards

BC13R In the Board's view, the amendments will improve understanding of the definition of material by:

(a) aligning the wording of the definition in IFRS Standards and the *Conceptual Framework* to avoid the potential for confusion arising from different definitions;

(b) incorporating supporting requirements in IAS 1 into the definition to give them more prominence and clarify their applicability; and

(c) providing existing guidance on the definition of material in one place, together with the definition.

BC13S The Board concluded that the amendments do not change existing requirements substantively because:

(a) the refinements to the definition of material:

(i) are based on wording in the *Conceptual Framework* that is similar to but clearer than the existing definition in IAS 1 and IAS 8 (see paragraphs BC13E and BC13H(b)); and

(ii) incorporate wording that already exists in IAS 1 (see paragraphs BC13H(a), (c) and (d)).

(b) the clarification that 'users' are the primary users and the description of their characteristics have been taken from the *Conceptual Framework*.

(c) the inclusion of 'obscuring information' reflects the existing requirement, as set out in paragraph 30A of IAS 1, that an entity shall not reduce the understandability of its financial statements by obscuring material information. This amendment is not expected to substantively change an entity's decisions about whether information is material—in no circumstances would obscuring information influence the decisions of users, if omitting or misstating the same information would have no influence on those decisions.

Consequently, the Board expects that the effect of the revised definition will be to help entities to make better materiality judgements.

 

## Effective date of the amendments

BC13T Because the amendments do not substantively change existing requirements, the Board decided that:

(a) prospective application is appropriate;

(b) a long implementation period is unnecessary; and

(c) early adoption of the amendments should be permitted.

## Amendments to the Basis for Conclusions on IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

Paragraph BC21A is added.

BC21A As a consequence of the *Definition of Material* (Amendments to IAS 1 and IAS 8), issued in October 2018, the definition of material and the accompanying explanatory paragraphs have been replaced with a reference to the definition of material and explanatory paragraphs in IAS 1.[3A] The Board made this change to avoid the duplication of the definition of material in the Standards.

[3A] Refer to paragraphs BC13A–BC13T of the Basis for Conclusions on IAS 1.

## Amendments to the bases for conclusions on other IFRS Standards

*The following amendments to the bases for conclusions are a consequence of the amendments to the definition of material in IAS 1 and IAS 8.*

## IFRS 17 *Insurance*

A footnote is added to the definition of material quoted in paragraph BC79.

* Amendments to the definition of material in the *Conceptual Framework for Financial Reporting* were issued in October 2018.

## 2018 *Conceptual Framework for Financial Reporting*

Paragraph BC2.20A is added.

### Materiality (October 2018)

BC2.20A The definition of material in the *Conceptual Framework* was amended to include a reference to 'obscuring information' and to replace the phrase 'could influence decisions' with 'could reasonably be expected to influence decisions'. Paragraphs BC13A–BC13T of the Basis for Conclusions on IAS 1 explains the reasons for those amendments.