Applying materiality when preparing financial statements

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KPMG's global IFRS presentation leader

IASB encourages companies to apply materiality judgements

Highlights

- Preparers are encouraged to use materiality as a filter
- Refined definition and existing guidance aim to help preparers apply judgement
- Proposals on accounting policy disclosures
- Further guidance on disclosures

"The recent proposals on accounting policy disclosures could prove helpful for preparers in deciding which accounting policies to disclose in their financial statements. And – if agreed – the focus on entity-specific information would further discourage boilerplate disclosure..."

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Materiality as a filter

Making information in financial statements more relevant and less cluttered is one of the IASB's key focus areas.

Companies make materiality judgements not only when deciding what information to disclose and how to present it, but also when making decisions about recognition and measurement.

However, management are often uncertain about how to apply the concept of materiality to disclosure, and find it easier to defer to using the disclosure requirements within IFRS as a checklist.

To help preparers of financial statements, the IASB has refined its **definition of 'material'**, issued **practical guidance on applying the concept of materiality** and issued **proposals focused on the application of materiality to disclosure of accounting policies**.

Refined definition of material

The IASB refined its definition of material to make it easier to understand. It is now aligned across IFRS® Standards and the Conceptual Framework.

"Information is material if omitting, misstating or ***obscuring*** *it* ***could reasonably be expected*** *to influence decisions that the* ***primary users*** *of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity."* ***[emphasis added]***

The amendments are effective from 1 January 2020 but may be applied earlier. However, the Board does not expect significant change – the refinements are not intended to alter the concept of materiality.

Making it easier to understand and apply

The concept of materiality needs to be clearly understood so that preparers of financial statements can apply it appropriately. The amendments provide a definition and explanatory paragraphs in one place. Some stakeholders were concerned that the previous definition might encourage entities to disclose immaterial information in their financial statements. In response, the Board promoted the concept of 'obscuring' to the definition, alongside the existing references to 'omitting' and 'misstating'. Additionally, the Board increased the threshold of 'could influence' to 'could reasonably be expected to influence'.

However, the Board has also removed the definition of material omissions or misstatements from IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

The refined definition of material complements the guidance the Board released last year, which outlines a **four-step process** that preparers can use to help them make materiality judgements.

Proposals on accounting policy disclosures

As the final piece of the materiality improvements, the Board has **proposed amendments** to IAS 1 *Presentation of Financial Statements* and an update to IFRS Practice Statement 2 *Making Materiality Judgements* to help entities provide useful accounting policy disclosures.

The Board's key proposals include:

- replacing the existing requirement in IAS 1 to disclose *significant* accounting policies with a requirement to disclose ***material*** accounting policies to clarify the threshold for disclosing information;
- clarifying that accounting policies related to immaterial transactions, other events or transactions are themselves immaterial and as such need not to be disclosed; and
- clarifying that not all accounting policies that relate to material transactions, other events or conditions are themselves material to an entity's financial statements.

The proposals build on the refined definition of *material*.

"Information about an accounting policy is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions that primary users of general purpose financial statements make on the basis of those financial statements".

The comment period for the proposed amendments is open until 29 November 2019. We encourage preparers and users of financial statements to read the proposals and take this opportunity to have their say.

Further guidance on disclosures

The Disclosure Initiative is part of the Board's wider work under the theme Better Communication in Financial Reporting (refer to our **Visual Guide**).

For more information on these developments, speak to your KPMG contact.

How do you decide what's relevant when preparing financial statements?

Making information in financial statements more relevant and less cluttered is one of the IASB's key focus areas. Its **guidance** includes a four-step process to help you make materiality judgements:

Identify	Assess	Organise	Review
Identify information that has the potential to be material considering requirements in IFRS and primary users' needs	**Assess whether the information identified is material considering quantitative and qualitative factors**	**Organise the information in a way that communicates the information clearly and concisely to primary users**	**Review the financial statements from a wide perspective and in aggregate**

Management can achieve the right balance by providing relevant information that is specific to their circumstances.

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