

September 2017

IFRS® Practice Statement

Making Materiality Judgements

Practice Statement 2

IASB®



Making Materiality Judgements
Practice Statement 2

IFRS® Practice Statement 2 *Making Materiality Judgements* is published by the International Accounting Standards Board (Board).

Disclaimer: To the extent permitted by applicable law, the Board and the IFRS Foundation (Foundation) expressly disclaim all liability howsoever arising from this publication or any translation thereof whether in contract, tort or otherwise to any person in respect of any claims or losses of any nature including direct, indirect, incidental or consequential loss, punitive damages, penalties or costs.

Information contained in this publication does not constitute advice and should not be substituted for the services of an appropriately qualified professional.

Copyright © 2017 IFRS® Foundation

All rights reserved. Reproduction and use rights are strictly limited. Please contact the Foundation for further details at licences@ifrs.org.

Copies of IASB® publications may be obtained from the Foundation's Publications Department. Please address publication and copyright matters to publications@ifrs.org or visit our web shop at <https://shop.ifrs.org>.



The Foundation has trade marks registered around the world (Marks) including 'IAS®', 'IASB®', the IASB® logo, 'IFRIC®', 'IFRS®', the IFRS® logo, 'IFRS for SMEs®', the IFRS for SMEs® logo, the 'Hexagon Device', 'International Accounting Standards®', 'International Financial Reporting Standards®', 'NIIF®' and 'SIC®'. Further details of the Foundation's Marks are available from the Foundation on request.

The Foundation is a not-for-profit corporation under the General Corporation Law of the State of Delaware, USA and operates in England and Wales as an overseas company (Company number: FC023235) with its principal office at 30 Cannon Street, London, EC4M 6XH.

CONTENTS

	<i>from paragraph</i>
INTRODUCTION	IN1
IFRS PRACTICE STATEMENT 2 MAKING MATERIALITY JUDGEMENTS	
OBJECTIVE	1
SCOPE	3
GENERAL CHARACTERISTICS OF MATERIALITY	5
Definition of material	5
Materiality judgements are pervasive	8
Judgement	11
Primary users and their information needs	13
Decisions made by primary users	16
Meeting primary users' information needs	21
Impact of publicly available information	24
INTERACTION WITH LOCAL LAWS AND REGULATIONS	27
MAKING MATERIALITY JUDGEMENTS	29
Overview of the materiality process	29
A four-step materiality process	33
Step 1—identify	35
Step 2—assess	40
Step 3—organise	56
Step 4—review	60
SPECIFIC TOPICS	66
Prior-period information	66
Prior-period information not previously provided	70
Summarising prior-period information	71
Errors	72
Cumulative errors	77
Information about covenants	81
Materiality judgements for interim reporting	84
Interim reporting estimates	88
APPLICATION DATE	89
APPENDIX	
APPROVAL BY THE BOARD OF THE IFRS PRACTICE STATEMENT 2 MAKING MATERIALITY JUDGEMENTS ISSUED IN SEPTEMBER 2017	
BASIS FOR CONCLUSIONS	

The IFRS Practice Statement 2 *Making Materiality Judgements* (Practice Statement) is set out in paragraphs 1–89. This Practice Statement should be read in the context of its objective and Basis for Conclusions, as well as in the context of the *Preface to International Financial Reporting Standards*, the *Conceptual Framework for Financial Reporting* and IFRS Standards.

Introduction

- IN1 The objective of general purpose financial statements is to provide financial information about a reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. The entity identifies the information necessary to meet that objective by making appropriate materiality judgements.
- IN2 The aim of this IFRS Practice Statement 2 *Making Materiality Judgements* (Practice Statement) is to provide reporting entities with guidance on making materiality judgements when preparing general purpose financial statements in accordance with IFRS Standards. While some of the guidance in this Practice Statement may be useful to entities applying the *IFRS for SMEs*[®] Standard, the Practice Statement is not intended for those entities.
- IN3 The need for materiality judgements is pervasive in the preparation of financial statements. An entity makes materiality judgements when making decisions about recognition and measurement as well as presentation and disclosure. Requirements in IFRS Standards only need to be applied if their effect is material to the complete set of financial statements.
- IN4 This Practice Statement:
- (a) provides an overview of the general characteristics of materiality.
 - (b) presents a four-step process an entity may follow in making materiality judgements when preparing its financial statements (materiality process). The description of the materiality process provides an overview of the role materiality plays in the preparation of financial statements, with a focus on the factors the entity should consider when making materiality judgements.
 - (c) provides guidance on how to make materiality judgements in specific circumstances, namely, how to make materiality judgements about prior-period information, errors and covenants, and in the context of interim reporting.
- IN5 Whether information is material is a matter of judgement and depends on the facts involved and the circumstances of a specific entity. This Practice Statement illustrates the types of factors that the entity should consider when judging whether information is material.
- IN6 A Practice Statement is non-mandatory guidance developed by the International Accounting Standards Board. It is not a Standard. Therefore, its application is not required to state compliance with IFRS Standards.
- IN7 This Practice Statement includes examples illustrating how an entity might apply some of the guidance in the Practice Statement based on the limited facts presented. The analysis in each example is not intended to represent the only manner in which the guidance could be applied.

IFRS Practice Statement 2 *Making Materiality Judgements*

Objective

- 1 This IFRS Practice Statement 2 *Making Materiality Judgements* (Practice Statement) provides reporting entities with non-mandatory guidance on making materiality judgements when preparing general purpose financial statements in accordance with IFRS Standards.
- 2 The guidance may also help other parties involved in financial reporting to understand how an entity makes materiality judgements when preparing such financial statements.

Scope

- 3 The Practice Statement is applicable when preparing financial statements in accordance with IFRS Standards. It is not intended for entities applying the *IFRS for SMEs*[®] Standard.
- 4 The Practice Statement provides non-mandatory guidance; therefore, its application is not required to state compliance with IFRS Standards.

General characteristics of materiality

Definition of material

- 5 The *Conceptual Framework for Financial Reporting (Conceptual Framework)* provides the following definition of material information (IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provide similar definitions¹):

Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report.²

- 6 When making materiality judgements, an entity needs to take into account how information could reasonably be expected to influence the primary users of its

¹ See paragraph 7 of IAS 1 *Presentation of Financial Statements* and paragraph 5 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

² Paragraph QC11 of the *Conceptual Framework for Financial Reporting (Conceptual Framework)*. However, the Exposure Draft ED/2017/6 *Definition of Material (Proposed amendments to IAS 1 and IAS 8)* (Definition of Material ED) proposes to refine the definition of material to 'information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of a specific reporting entity's general purpose financial statements make on the basis of those financial statements'. The Definition of Material ED also identifies consequential amendments to other IFRS Standards, including amendments to the definitions of material in the *Conceptual Framework*, IAS 1 and IAS 8.

financial statements—its primary users—when they make decisions³ on the basis of those statements (see paragraphs 13–23).⁴

- 7 The objective of financial statements is to provide financial information about a reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.⁵ The entity identifies the information necessary to meet that objective by making appropriate materiality judgements.

Materiality judgements are pervasive

- 8 The need for materiality judgements is pervasive in the preparation of financial statements. An entity makes materiality judgements when making decisions about recognition, measurement, presentation and disclosure. Requirements in IFRS Standards only need to be applied if their effect is material to the complete set of financial statements,⁶ which includes the primary financial statements⁷ and the notes. However, it is inappropriate for the entity to make, or leave uncorrected, immaterial departures from IFRS Standards to achieve a particular presentation of its financial position, financial performance or cash flows.⁸

Recognition and measurement

- 9 IFRS Standards set out reporting requirements that the International Accounting Standards Board (Board) has concluded will lead to financial statements that provide information about the financial position, financial performance and cash flows of an entity that is useful to the primary users of those statements. The entity is only required to apply recognition and measurement requirements when the effect of applying them is material.

Example A—materiality judgements on the application of accounting policies

Background

An entity has a policy of capitalising expenditures on items of property, plant and equipment (PP&E) in excess of a specified threshold and recognising any smaller amounts as an expense.

Application

IAS 16 *Property, Plant and Equipment* requires that the cost of an item of PP&E is recognised as an asset when the criteria in paragraph 7 of IAS 16 are met.

continued...

3 Throughout this Practice Statement, the term ‘decisions’ refers to decisions about providing resources to the entity, unless specifically indicated otherwise.

4 See paragraph 7 of IAS 1.

5 See paragraph OB2 of the *Conceptual Framework*.

6 In this Practice Statement the phrases ‘complete set of financial statements’ and ‘financial statements as a whole’ are used interchangeably.

7 For the purposes of this Practice Statement, the primary financial statements comprise the statement of financial position, statement(s) of financial performance, statement of changes in equity and statement of cash flows.

8 See paragraph 8 of IAS 8.

...continued

The entity has assessed that its accounting policy—not capitalising expenditure below a specific threshold—will not have a material effect on the current-period financial statements or on future financial statements, because information reflecting the capitalisation and amortisation of such expenditure could not reasonably be expected to influence decisions made by the primary users of the entity’s financial statements.

Provided that such a policy does not have a material effect on the financial statements and was not set to intentionally achieve a particular presentation of the entity’s financial position, financial performance or cash flows, the entity’s financial statements comply with IAS 16. Such a policy is nevertheless reassessed each reporting period to ensure that its effect on the entity’s financial statements remains immaterial.

Presentation and disclosure

- 10 An entity need not provide a disclosure specified by an IFRS Standard if the information resulting from that disclosure is not material. This is the case even if the Standard contains a list of specific disclosure requirements or describes them as ‘minimum requirements’. Conversely, the entity must consider whether to provide information not specified by IFRS Standards if that information is necessary for primary users to understand the impact of particular transactions, other events and conditions on the entity’s financial position, financial performance and cash flows.⁹

Example B—materiality judgements on disclosures specified by IFRS Standards

Background

An entity presents property, plant and equipment (PP&E) as a separate line item in its statement of financial position.

Application

IAS 16 *Property, Plant and Equipment* sets out specific disclosure requirements for PP&E, including the disclosure of the amount of contractual commitments for the acquisition of PP&E (paragraph 74(c) of IAS 16).

When preparing its financial statements, the entity assesses whether disclosures specified in IAS 16 are material information. Even if PP&E is presented as a separate line item in the statement of financial position, not all disclosures specified in IAS 16 will automatically be required. In the absence of any qualitative considerations (see paragraphs 46–51), if the amount of contractual commitments for the acquisition of PP&E is not material, the entity is not required to disclose this information.

⁹ See paragraphs 17(c) and 31 of IAS 1.

Example C—materiality judgements that lead to the disclosure of information in addition to the specific disclosure requirements in IFRS Standards

Background

An entity has its main operations in a country that, as part of an international agreement, is committed to introducing regulations to reduce the use of carbon-based energy. The regulations had not yet been enacted in the national legislation of that country at the end of the reporting period.

The entity owns a coal-fired power station in that country. During the reporting period, the entity recorded an impairment loss on its coal-fired power station, reducing the carrying amount of the power station to its recoverable amount. No goodwill or intangible assets with an indefinite useful life were included in the cash-generating unit.

Application

Paragraph 132 of IAS 36 *Impairment of Assets* does not require an entity to disclose the assumptions used to determine the recoverable amount of a tangible asset, unless goodwill or intangible assets with an indefinite useful life are included in the carrying amount of the cash-generating unit.

Nevertheless, the entity has concluded that the assumptions about the likelihood of national enactment of regulations to reduce the use of carbon-based energy, as well as about the enactment plan, it considered in measuring the recoverable amount of its coal-fired power station could reasonably be expected to influence decisions primary users make on the basis of the entity's financial statements. Hence, information about those assumptions is necessary for primary users to understand the impact of the impairment on the entity's financial position, financial performance and cash flows. Therefore, even though not specifically required by IAS 36, the entity concludes that its assumptions about the likelihood of national enactment of regulations to reduce the use of carbon-based energy, as well as about the enactment plan, constitute material information and discloses those assumptions in its financial statements.

Judgement

- 11 When assessing whether information is material to the financial statements, an entity applies judgement to decide whether the information could reasonably be expected to influence decisions that primary users make on the basis of those financial statements. When applying such judgement, the entity considers both its specific circumstances and how the information provided in the financial statements responds to the information needs of primary users.
- 12 Because an entity's circumstances change over time, materiality judgements are reassessed at each reporting date in the light of those changed circumstances.

Primary users and their information needs

- 13 When making materiality judgements, an entity needs to consider the impact information could reasonably be expected to have on the primary users of its financial statements. Those primary users are existing and potential investors, lenders and other creditors—those users who cannot require entities to provide information directly to them and must rely on general purpose financial statements for much of the financial information they need.¹⁰ In addition to those primary users, other parties, such as the entity's management, regulators and members of the public, may be interested in financial information about the entity and may find the financial statements useful. However, the financial statements are not primarily directed at these other parties.¹¹
- 14 Because primary users include potential investors, lenders and other creditors, it would be inappropriate for an entity to narrow the information provided in its financial statements by focusing only on the information needs of existing investors, lenders and other creditors.

Example D—existing and potential investors, lenders and other creditors

Background

An entity is 100 per cent owned by its parent. Its parent provides the entity with semi-finished products that the entity assembles and sells back to the parent. The entity is entirely financed by its parent. The current users of the entity's financial statements include the parent and the entity's creditors (mainly local suppliers).

Application

The entity refers to the *Conceptual Framework for Financial Reporting* to identify the primary users of its financial statements—existing and potential investors, lenders and other creditors who cannot require the entity to provide information directly to them and must rely on general purpose financial statements. When making materiality judgements in the preparation of its financial statements, the entity does not reduce its disclosures to only those of interest to its parent or its existing creditors. The entity also considers the information needs of potential investors, lenders and other creditors when making those judgements.

- 15 When making materiality judgements, an entity also considers that primary users are expected to have a reasonable knowledge of business and economic activities and to review and analyse the information included in the financial statements diligently.¹²

¹⁰ See paragraph OB5 of the *Conceptual Framework*.

¹¹ See paragraphs OB9 and OB10 of the *Conceptual Framework*.

¹² See paragraph QC32 of the *Conceptual Framework*.

Decisions made by primary users

- 16 An entity needs to consider what type of decisions its primary users make on the basis of the financial statements and, consequently, what information they need to make those decisions.
- 17 The primary users of an entity's financial statements make decisions about providing resources to the entity. Those decisions involve: buying, selling or holding equity and debt instruments, providing or settling loans and other forms of credit,¹³ and exercising rights while holding investments (such as the right to vote on or otherwise influence management's actions that affect the use of the entity's economic resources).¹⁴ Such decisions depend on the returns that primary users expect from an investment in those instruments.
- 18 The expectations existing and potential investors, lenders and other creditors have about returns, in turn, depend on their assessment of the amount, timing and uncertainty of the future net cash inflows to an entity,¹⁵ together with their assessment of management's stewardship of the entity's resources.¹⁶
- 19 Consequently, an entity's primary users need information about:
- (a) the resources of the entity (assets), claims against the entity (liabilities and equity) and changes in those resources and claims (income and expenses); and
 - (b) how efficiently and effectively the entity's management and governing board have discharged their responsibility to use the entity's resources.¹⁷
- 20 Financial information can make a difference in decisions if it has predictive value, confirmatory value or both.¹⁸ When making materiality judgements, an entity needs to assess whether information could reasonably be expected to influence primary users' decisions, rather than assessing whether that information alone could reasonably be expected to change their decisions.

Meeting primary users' information needs

- 21 The objective of financial statements is to provide primary users with financial information that is useful to them in making decisions about providing resources to an entity. However, general purpose financial statements do not, and cannot, provide all the information that primary users need.¹⁹ Therefore,

13 See paragraph OB2 of the *Conceptual Framework*.

14 The International Accounting Standards Board (Board) considers primary users' resource allocation decisions to include decisions needed to exercise rights while holding investments, such as rights to vote on or otherwise influence management's actions that affect the use of the entity's economic resources. The Board has tentatively decided to clarify this point, which was previously implicit in the phrase 'decisions to hold equity instruments', as part of its deliberations on the revised *Conceptual Framework*.

15 See paragraph OB3 of the *Conceptual Framework*.

16 Paragraph 1.3 of the Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting* (Conceptual Framework ED) proposed to reintroduce the term 'stewardship' and to explain explicitly that investors', creditors' and other lenders' expectations about returns also depend on their assessment of management's stewardship of the entity's resources. The Board has tentatively decided to confirm this as part of its deliberations on the revised *Conceptual Framework*.

17 See paragraph OB4 of the *Conceptual Framework*.

18 See paragraph QC7 of the *Conceptual Framework*.

19 See paragraph OB6 of the *Conceptual Framework*.

the entity aims to meet the common information needs of its primary users. It does not aim to address specialised information needs—information needs that are unique to particular users.

Example E—primary users' unique or individual information requests

Background

Twenty investors each hold 5 per cent of an entity's voting rights. One of these investors is particularly interested in information about the entity's expenditure in a specific location because that investor operates another business in that location. Such information could not reasonably be expected to influence decisions that other primary users make on the basis of the entity's financial statements.

Application

In making its materiality judgements, the entity does not need to consider the specific information needs of that single investor. The entity concludes that information about its expenditure in the specific location is immaterial information for its primary users as a group and therefore decides not to provide it in its financial statements.

- 22 To meet the common information needs of its primary users, an entity first separately identifies the information needs that are shared by users within one of the three categories of primary users defined in the *Conceptual Framework*—for example investors (existing and potential)—then repeats the assessment for the two remaining categories—namely lenders (existing and potential) and other creditors (existing and potential). The total of the information needs identified is the set of common information needs the entity aims to meet.
- 23 In other words, the assessment of common information needs does not require identifying information needs shared across all existing and potential investors, lenders and other creditors. Some of the identified information needs will be common to all three categories, but others may be specific to only one or two of those categories. If an entity were to focus only on those information needs that are common to all categories of primary users, it might exclude information that meets the needs of only one category.

Impact of publicly available information

- 24 The primary users of financial statements generally consider information from sources other than just the financial statements. For example, they might also consider other sections of the annual report, information about the industry an entity operates in, its competitors and the state of the economy, the entity's press releases as well as other documents the entity has published.
- 25 However, the financial statements are required to be a comprehensive document that provides information about the financial position, financial performance and cash flows of an entity that is useful to primary users in making decisions about providing resources to the entity. Consequently, the entity assesses whether information is material to the financial statements, regardless of whether such information is also publicly available from another source.

- 26 Moreover, public availability of information does not relieve an entity of the obligation to provide material information in its financial statements.

Example F—impact of an entity’s press release on materiality judgements

Background

An entity undertook a business combination in the reporting period. The acquisition doubled the size of the entity’s operations in one of its main markets. On the acquisition date, the entity issued a press release providing an extensive explanation of the primary reasons for the business combination and a description of how it obtained control over the acquired business, together with other information related to the acquisition.

Application

In preparing its financial statements, the entity first considered the disclosure requirements in IFRS 3 *Business Combinations*. Paragraph B64(d) of IFRS 3 requires an entity to disclose, for each business combination that occurs during the reporting period, ‘the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree’.

The entity concludes that information about the business combination is material because the acquisition is expected to have a significant impact on the entity’s operations, due to the overall size of the transaction compared with the size of the entity. In these circumstances, even though information relating to the primary reasons for the business combination and the description of how it obtained control is already included in a public statement, the entity needs to provide the information in its financial statements.

Interaction with local laws and regulations

- 27 An entity’s financial statements must comply with the requirements in IFRS Standards, including requirements related to materiality (materiality requirements), for the entity to state its compliance with those Standards. Hence, an entity that wishes to state compliance with IFRS Standards cannot provide less information than the information required by the Standards, even if local laws and regulations permit otherwise.
- 28 Nevertheless, local laws and regulations may specify requirements that affect what information is provided in the financial statements. In such circumstances, providing information to meet local legal or regulatory requirements is permitted by IFRS Standards, even if that information is not material according to the materiality requirements in the Standards. However, such information must not obscure information that is material according to IFRS Standards.²⁰

²⁰ See paragraph 30A of IAS 1 and paragraph BC30F of the Basis for Conclusions on IAS 1.

Example G—information that is immaterial according to IFRS Standards required by local laws and regulations**Background**

An entity is a food retailer operating in country ABC. In country ABC, investments in research and development (R&D) are generally limited across the industry; nonetheless, the government requires all entities to disclose, in their financial statements, the aggregate amount of R&D expenditure incurred during the period.

In the current reporting period, the entity recognised a small amount of expenditure on R&D activities as an expense. No R&D expenditure was capitalised during the period.

When preparing its financial statements, the entity assessed the disclosure of information about R&D expenditure incurred during the period as immaterial, for IFRS purposes.

Application

To comply with local regulations, the entity discloses in its financial statements information about R&D expenditure incurred during the period. IFRS Standards permit the entity to disclose that information in its financial statements, but the entity needs to organise its disclosures to ensure that material information is not obscured.

Example H—information that is material according to IFRS Standards not required by local laws and regulations**Background**

An entity operates in a country where the government requires the disclosure of the details of property, plant and equipment (PP&E) disposals, but only if their carrying amounts exceed a specified percentage of total assets.

In the current reporting period, the entity disposed of PP&E below the threshold specified in the local regulation. This transaction was with a related party, which paid the entity less than the fair value of the item disposed.

When preparing its financial statements, the entity applied judgement and concluded that information about the details of the disposal was material, mainly because of the terms of the transaction and the fact it was with a related party.

Application

To comply with IFRS Standards, the entity discloses details of that disposal even though local regulations require disclosure of PP&E disposals only if their carrying amount exceeds a specified percentage of total assets.

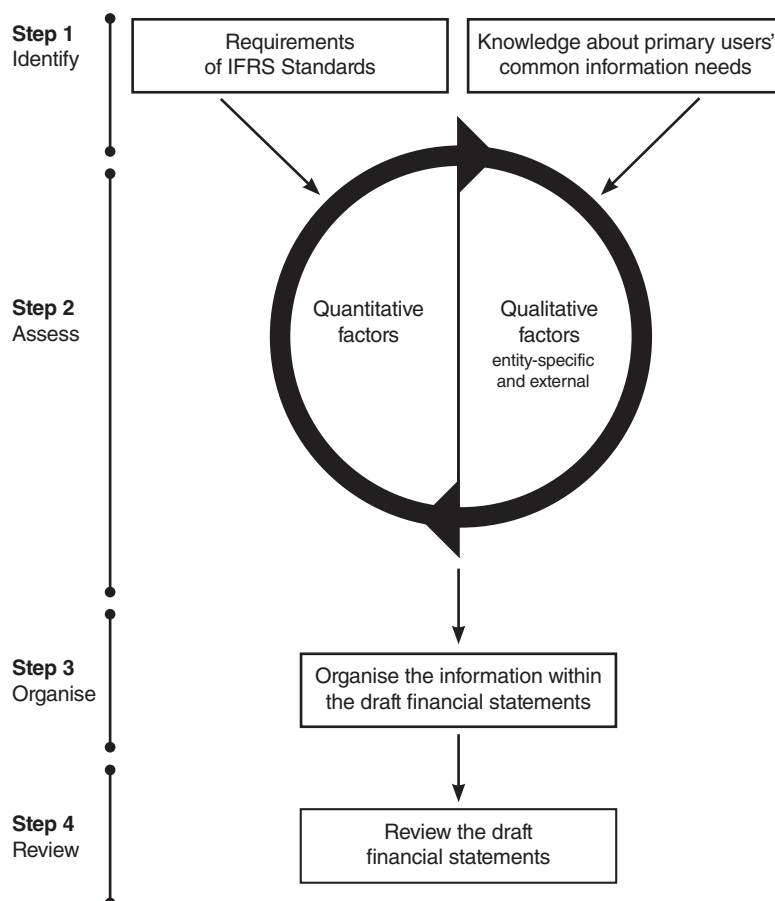
Making materiality judgements

Overview of the materiality process

- 29 An entity may find it helpful to follow a systematic process in making materiality judgements when preparing its financial statements. The four-step process described in the following paragraphs is an example of such a process. This description provides an overview of the role materiality plays in the preparation of financial statements, with a focus on the factors the entity should consider when making materiality judgements. In this Practice Statement, this four-step process is called the ‘materiality process’.
- 30 The materiality process describes how an entity could assess whether information is material for the purposes of presentation and disclosure, as well as for recognition and measurement. The process illustrates one possible way to make materiality judgements, but it incorporates the materiality requirements an entity must apply to state compliance with IFRS Standards. The materiality process considers potential omission and potential misstatement of information, as well as unnecessary inclusion of immaterial information and whether immaterial information obscures material information. In all cases, the entity needs to focus on how the information could reasonably be expected to influence decisions of the primary users of its financial statements.
- 31 Judgement is involved in assessing materiality when preparing financial statements. The materiality process is designed as a practice guide to help an entity apply judgement in an efficient and effective way.
- 32 The materiality process is not intended to describe the assessment of materiality for local legal and regulatory purposes. An entity refers to its local requirements to assess whether it is compliant with local laws and regulations.

A four-step materiality process

- 33 The steps identified as a possible approach to the assessment of materiality in the preparation of the financial statements are, in summary:
- (a) Step 1—identify. Identify information that has the potential to be material.
 - (b) Step 2—assess. Assess whether the information identified in Step 1 is, in fact, material.
 - (c) Step 3—organise. Organise the information within the draft financial statements in a way that communicates the information clearly and concisely to primary users.
 - (d) Step 4—review. Review the draft financial statements to determine whether all material information has been identified and materiality considered from a wide perspective and in aggregate, on the basis of the complete set of financial statements.
- 34 When preparing its financial statements, an entity may rely on materiality assessments from prior periods, provided that it reconsiders them in the light of any change in circumstances and of any new or updated information.

Diagram—the four-step materiality process**Step 1—identify**

- 35 An entity identifies information about its transactions, other events and conditions that primary users might need to understand to make decisions about providing resources to the entity.
- 36 In identifying this information, an entity considers, as a starting point, the requirements of the IFRS Standards applicable to its transactions, other events and conditions. This is the starting point because, when developing a Standard, the Board identifies the information it expects will meet the needs of a broad range of primary users for a wide variety of entities in a range of circumstances.²¹
- 37 When the Board develops a Standard, it also considers the balance between the benefits of providing information and the costs of complying with the requirements in that Standard. However, the cost of applying the requirements

²¹ See paragraph OB8 of the *Conceptual Framework*.

in the Standards is not a factor for an entity to consider when making materiality judgements—the entity should not consider the cost of complying with requirements in IFRS Standards, unless there is explicit permission in the Standards.

38 An entity also considers its primary users' common information needs (as explained in paragraphs 21–23) to identify any information—in addition to that specified in IFRS Standards—necessary to enable primary users to understand the impact of the entity's transactions, other events and conditions on the entity's financial position, financial performance and cash flows (see paragraph 10). Existing and potential investors, lenders and other creditors need information about the resources of the entity (assets), claims against the entity (liabilities and equity) and changes in those resources and claims (income and expenses), and information that will help them assess how efficiently and effectively the entity's management and governing board have discharged their responsibility to use the entity's resources.²²

39 The output of Step 1 is a set of potentially material information.

Step 2—assess

40 An entity assesses whether the potentially material information identified in Step 1 is, in fact, material. In making this assessment, the entity needs to consider whether its primary users could reasonably be expected to be influenced by the information when making decisions about providing resources to the entity on the basis of the financial statements. The entity performs this assessment in the context of the financial statements as a whole.

41 An entity might conclude that an item of information is material for various reasons. Those reasons include the item's nature or size, or a combination of both, judged in relation to the particular circumstances of the entity.²³ Therefore, making materiality judgements involves both quantitative and qualitative considerations. It would not be appropriate for the entity to rely on purely numerical guidelines or to apply a uniform quantitative threshold for materiality (see paragraphs 53–55).

42 The following paragraphs describe some common 'materiality factors' that an entity should use to help identify when an item of information is material. These factors are organised into the following categories:

- (a) quantitative; and
- (b) qualitative—either entity-specific or external.

43 The output of Step 2 is a preliminary set of material information. For presentation and disclosure, this involves decisions about what information an entity needs to provide in its financial statements, and in how much detail²⁴ (including identifying appropriate levels of aggregation an entity provides in the financial statements). For recognition and measurement, the output of Step 2

²² See paragraph OB4 of the *Conceptual Framework*.

²³ See paragraph 7 of IAS 1 and paragraph 5 of IAS 8.

²⁴ See paragraph 29 of IAS 1.

involves the identification of information that, if not recognised or otherwise misstated, could reasonably be expected to influence primary users' decisions.

Quantitative factors

- 44 An entity ordinarily assesses whether information is quantitatively material by considering the size of the impact of the transaction, other event or condition against measures of the entity's financial position, financial performance and cash flows. The entity makes this assessment by considering not only the size of the impact it recognises in its primary financial statements but also any unrecognised items that could ultimately affect primary users' overall perception of the entity's financial position, financial performance and cash flows (eg contingent liabilities or contingent assets). The entity needs to assess whether the impact is of such a size that information about the transaction, other event or condition could reasonably be expected to influence its primary users' decisions about providing resources to the entity.
- 45 Identifying the measures against which an entity makes this quantitative assessment is a matter of judgement. That judgement depends on which measures are of great interest to the primary users of the entity's financial statements. Examples include measures of the entity's revenues, the entity's profitability, financial position ratios and cash flow measures.

Qualitative factors

- 46 For the purposes of this Practice Statement, qualitative factors are characteristics of an entity's transactions, other events or conditions, or of their context, that, if present, make information more likely to influence the decisions of the primary users of the entity's financial statements. The mere presence of a qualitative factor will not necessarily make the information material, but is likely to increase primary users' interest in that information.
- 47 In making materiality judgements, an entity considers both entity-specific and external qualitative factors. These factors are described separately in the following paragraphs. However, in practice, the entity may need to consider them together.
- 48 An entity-specific qualitative factor is a characteristic of the entity's transaction, other event or condition. Examples of such factors include, but are not limited to:
- (a) involvement of a related party of the entity;
 - (b) uncommon, or non-standard, features of a transaction or other event or condition; or
 - (c) unexpected variation or unexpected changes in trends. In some circumstances, the entity might consider a quantitatively immaterial amount as material because of the unexpected variation compared to the prior-period amount provided in its financial statements.
- 49 The relevance of information to the primary users of an entity's financial statements can also be affected by the context in which the entity operates. An external qualitative factor is a characteristic of the context in which the entity's

transaction, other event or condition occur that, if present, makes information more likely to influence the primary users' decisions. Characteristics of the entity's context that might represent external qualitative factors include, but are not limited to, the entity's geographical location, its industry sector, or the state of the economy or economies in which the entity operates.

50 Due to the nature of external qualitative factors, entities operating in the same context might share a number of external qualitative factors. Moreover, external qualitative factors could remain constant over time or could vary.

51 In some circumstances, if an entity is not exposed to a risk to which other entities in its industry are exposed, that fact could reasonably be expected to influence its primary users' decisions; that is, information about the lack of exposure to that particular risk could be material information.

Interaction of qualitative and quantitative factors

52 An entity could identify an item of information as material on the basis of one or more materiality factors. In general, the more factors that apply to a particular item, or the more significant those factors are, the more likely it is that the item is material.

53 Although there is no hierarchy among materiality factors, assessing an item of information from a quantitative perspective first could be an efficient approach to assessing materiality. If an entity identifies an item of information as material solely on the basis of the size of the impact of the transaction, other event or condition, the entity does not need to assess that item of information further against other materiality factors. In these circumstances, a quantitative threshold—a specified level, rate or amount of one of the measures used in assessing size—can be a helpful tool in making a materiality judgement. However, a quantitative assessment alone is not always sufficient to conclude that an item of information is not material. The entity should further assess the presence of qualitative factors.

54 The presence of a qualitative factor lowers the thresholds for the quantitative assessment. The more significant the qualitative factors, the lower those quantitative thresholds will be. However, in some cases an entity might decide that, despite the presence of qualitative factors, an item of information is not material because its effect on the financial statements is so small that it could not reasonably be expected to influence primary users' decisions.

55 In some other circumstances, an item of information could reasonably be expected to influence primary users' decisions regardless of its size—a quantitative threshold could even reduce to zero. This might happen when information about a transaction, other event or condition is highly scrutinised by the primary users of an entity's financial statements. Moreover, a quantitative assessment is not always possible: non-numeric information might only be assessed from a qualitative perspective.

Example I—information about a related party transaction assessed as material**Background**

An entity has identified measures of its profitability as the measures of great interest to the primary users of its financial statements. In the current reporting period, the entity signed a five-year contract with company ABC. Company ABC will provide the entity with maintenance services for the entity's offices for an annual fee. Company ABC is controlled by a member of the entity's key management personnel. Hence, company ABC is a related party of the entity.

Application

IAS 24 *Related Party Disclosures* requires an entity to disclose, for each related party transaction that occurred during the period, the nature of the related party relationship as well as information about the transaction and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements.

When preparing its financial statements, the entity assessed whether information about the transaction with company ABC was material.

The entity started its assessment from a quantitative perspective and evaluated the impact of the related party transaction against measures of the entity's profitability. Having initially concluded that the impact of the related party transaction was not material from a purely quantitative perspective, the entity further assessed the presence of any qualitative factors.

As the Board noted in developing IAS 24, related parties may enter into transactions that unrelated parties would not enter into, and the transactions may be priced at amounts that differ from the price for transactions between unrelated parties.

The entity identified the fact that the maintenance agreement was concluded with a related party as a characteristic that makes information about that transaction more likely to influence the decisions of its primary users.

The entity further assessed the transaction from a quantitative perspective to determine whether the impact of the transaction could reasonably be expected to influence primary users' decisions when considered with the fact that the transaction was with a related party (ie the presence of a qualitative factor lowers the quantitative threshold). Having considered that the transaction was with a related party, the entity concluded that the impact was large enough to reasonably be expected to influence primary users' decisions. Hence, the entity assessed information about the transaction with company ABC as material and disclosed that information in its financial statements.

Example J—information about a related party transaction assessed as immaterial**Background**

An entity has identified measures of its profitability as the measures of great interest to the primary users of its financial statements. The entity owns a large fleet of vehicles. In the current reporting period, the entity sold an almost fully depreciated vehicle to company DEF. The entity transferred the vehicle for total consideration consistent with its market value and its carrying amount. Company DEF is controlled by a member of the entity's key management personnel. Hence, company DEF is a related party of the entity.

Application

When preparing its financial statements, the entity assessed whether information about the transaction with company DEF was material.

As in **Example I**, the entity started its assessment from a quantitative perspective and evaluated the impact of the related party transaction against measures of the entity's profitability. Having initially concluded that the impact of the related party transaction was not material from a purely quantitative perspective, the entity further assessed the presence of any qualitative factors.

The entity transferred the vehicle for a total consideration consistent with its market value and its carrying amount. However, the entity identified the fact that the vehicle was sold to a related party as a characteristic that makes information about that transaction more likely to influence the decisions of its primary users.

The entity further assessed the transaction from a quantitative perspective but concluded that its impact was too small to reasonably be expected to influence primary users' decisions, even when considered with the fact that the transaction was with a related party. Information about the transaction with company DEF was consequently assessed as immaterial and not disclosed in the entity's financial statements.

Example K—influence of external qualitative factors on materiality judgements**Background**

An international bank holds a very small amount of debt originating from a country whose national economy is currently experiencing severe financial difficulties. Other international banks that operate in the same sector as the entity hold significant amounts of debt originating from that country and, hence, are significantly affected by the financial difficulties in that country.

continued...

...continued

Application

Paragraph 31 of IFRS 7 *Financial Instruments: Disclosures* requires an entity to disclose information that enables users of its financial statements to evaluate the nature and extent of risk arising from financial instruments to which the entity is exposed at the end of the reporting period.

When preparing its financial statements, the bank assessed whether the fact that it holds a very small amount of debt originating from that country was material information.

In making that assessment, the bank considered the exposure to that particular debt faced by other international banks operating in the same sector (external qualitative factor).

In these circumstances, the fact that the bank is holding a very small amount of debt (or even no debt at all) originating from that country, while other international banks operating in the same sector have significant holdings, provides the entity's primary users with useful information about how effective management has been at protecting the bank's resources from unfavourable effects of the economic conditions in that country.

The bank assessed the information about the lack of exposure to that particular debt as material and disclosed that information in its financial statements.

Step 3—organise

56 Classifying, characterising and presenting information clearly and concisely makes it understandable.²⁵ An entity exercises judgement when deciding how to communicate information clearly and concisely. For example, the entity is more likely to clearly and concisely communicate the material information identified in Step 2 by organising it to:

- (a) emphasise material matters;
- (b) tailor information to the entity's own circumstances;
- (c) describe the entity's transactions, other events and conditions as simply and directly as possible without omitting material information and without unnecessarily increasing the length of the financial statements;
- (d) highlight relationships between different pieces of information;
- (e) provide information in a format that is appropriate for its type, eg tabular or narrative;
- (f) provide information in a way that maximises, to the extent possible, comparability among entities and across reporting periods;

²⁵ See paragraph QC30 of the *Conceptual Framework*.

- (g) avoid or minimise duplication of information in different parts of the financial statements; and
- (h) ensure material information is not obscured by immaterial information.

57 Financial statements are less understandable for primary users if information is organised in an unclear manner. Similarly, financial statements are less understandable if an entity aggregates material items that have different natures or functions, or if material information is obscured,²⁶ for example, by an excessive amount of immaterial information.

58 Furthermore, an entity considers the different roles of primary financial statements and notes in deciding whether to present an item of information separately in the primary financial statements, to aggregate it with other information or to disclose the information in the notes.

59 The output of Step 3 is the draft financial statements.

Step 4—review

60 An entity needs to assess whether information is material both individually and in combination with other information²⁷ in the context of its financial statements as a whole. Even if information is judged not to be material on its own, it might be material when considered in combination with other information in the complete set of financial statements.

61 When reviewing its draft financial statements, an entity draws on its knowledge and experience of its transactions, other events and conditions to identify whether all material information has been provided in the financial statements, and with appropriate prominence.

62 This review gives an entity the opportunity to ‘step back’ and consider the information provided from a wider perspective and in aggregate. This enables the entity to consider the overall picture of its financial position, financial performance and cash flows. In performing this review, the entity also considers whether:

- (a) all relevant relationships between different items of information have been identified. Identifying new relationships between information might lead to that information being identified as material for the first time.
- (b) items of information that are individually immaterial, when considered together, could nevertheless reasonably be expected to influence primary users’ decisions.
- (c) the information in the financial statements is communicated in an effective and understandable way, and organised to avoid obscuring material information.
- (d) the financial statements provide a fair presentation of the entity’s financial position, financial performance and cash flows.²⁸

²⁶ See paragraph 30A of IAS 1.

²⁷ See paragraph 7 of IAS 1 and paragraph 5 of IAS 8.

²⁸ See paragraph 15 of IAS 1.

- 63 The review may lead to:
- (a) additional information being provided in the financial statements;
 - (b) greater disaggregation of information that had already been identified as material;
 - (c) information that had already been identified as immaterial being removed from the financial statements to avoid obscuring material information; or
 - (d) information being reorganised within the financial statements.
- 64 The review in Step 4 may also lead an entity to question the assessment performed in Step 2 and decide to re-perform that assessment. As a result of re-performing its assessment in Step 2, the entity might conclude that information previously identified as material is, in fact, immaterial, and remove it from the financial statements.
- 65 The output of Step 4 is the final financial statements.

Specific topics

Prior-period information

- 66 An entity makes materiality judgements on the complete set of financial statements, including prior-period²⁹ information provided in the financial statements.
- 67 IFRS Standards require an entity to present information in respect of the preceding period for all amounts reported in the current-period financial statements.³⁰ Furthermore, the Standards require the entity to provide prior-period information for narrative and descriptive information if it is relevant to understanding the current-period financial statements.³¹ Finally, the Standards require the entity to present, as a minimum, two statements of financial position, two statements of profit or loss and other comprehensive income, two statements of profit or loss (if presented separately), two statements of cash flows, two statements of changes in equity, and related notes.³² These requirements are the minimum comparative information identified by the Standards.³³
- 68 Assessing whether prior-period information is material to the current-period financial statements might lead an entity to:
- (a) provide more prior-period information than was provided in the prior-period financial statements (see paragraph 70); or

29 For this Practice Statement, 'prior-period' should be read as 'prior-periods' if financial statements include amounts and disclosures for more than one prior period.

30 Except when IFRS Standards permit or require otherwise. See paragraph 38 of IAS 1.

31 See paragraph 38 of IAS 1.

32 See paragraph 38A of IAS 1.

33 Paragraph 10(f) of IAS 1 also requires an entity to provide a statement of financial position as at the beginning of the preceding period when the entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements in accordance with paragraphs 40A–40D of IAS 1.

- (b) provide less prior-period information than was provided in the prior-period financial statements (see paragraph 71).

69 An entity also needs to consider any local laws or regulations, in respect of the prior-period information to be provided in financial statements, when making decisions on what prior-period information to provide in the current-period financial statements. Those local laws or regulations might require the entity to provide in the financial statements prior-period information in addition to the minimum comparative information required by the Standards. The Standards permit the inclusion of such additional information, but require that it is prepared in accordance with the Standards³⁴ and does not obscure material information.³⁵ However, an entity that wishes to state compliance with IFRS Standards cannot provide less information than required by the Standards, even if local laws and regulations permit otherwise.

Prior-period information not previously provided

70 An entity must provide prior-period information needed to understand the current-period financial statements,³⁶ regardless of whether that information was provided in the prior-period financial statements—this requirement is not conditional on whether the prior-period information was provided in the prior-period financial statements. Consequently, the inclusion of prior-period information not previously included would be required if this is necessary for the primary users to understand the current-period financial statements.

Example L—prior-period information not previously provided

Background

In the prior period, an entity had a very small amount of debt outstanding. Information about this debt was appropriately assessed as immaterial in the prior period, and so the entity did not disclose any maturity analysis showing the remaining contractual maturities or other information that would otherwise be required by paragraph 39(a) of IFRS 7 *Financial Instruments: Disclosures*.

In the current period, the entity issued a large amount of debt. The entity concluded that information about debt maturity was material information and disclosed it, in the form of a table, in the current-period financial statements.

Application

The entity might conclude that including a prior-period debt maturity analysis in the financial statements would be necessary for primary users to understand the current-period financial statements. In these circumstances, a narrative description of the maturity of the prior-period balances of the outstanding debt might be sufficient.

³⁴ See paragraph 38C of IAS 1.

³⁵ See paragraph 30A of IAS 1 and paragraph BC30F of the Basis for Conclusions on IAS 1.

³⁶ See paragraph 38 of IAS 1.

Summarising prior-period information

- 71 Except to the extent required to comply with any local laws or regulations affecting the preparation of financial statements or their audit, an entity does not automatically reproduce in the current-period financial statements all the information provided in the prior-period financial statements. Instead, the entity may summarise prior-period information, retaining the information necessary for primary users to understand the current-period financial statements.

Example M—summarising prior-period information

Background

An entity disclosed, in the prior-period financial statements, details of a legal dispute which led to the recognition, in that period, of a provision. In accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* the entity disclosed in the prior-period financial statements a detailed description of uncertainties about the amount and timing of possible cash outflows, in respect of the dispute, together with the major assumptions made concerning future events.

Most of the uncertainties have been resolved in the current period, and, even though the liability has not been settled, a court pronouncement confirmed the amount already recognised in the financial statements by the entity.

The entity considered the relevant local laws, regulations and other reporting requirements and concluded that there were no locally prescribed obligations relating to the inclusion of prior-period information in the current-period financial statements.

Application

In these circumstances, on the basis of the requirements in IFRS Standards, the entity may not need to reproduce in the current-period financial statements all of the information about the legal dispute provided in the prior-period financial statements. Because most of the uncertainties have been resolved, users of the financial statements for the current period may no longer need detailed information about those uncertainties. Instead, information about those uncertainties might be summarised and updated to reflect the current-period events and circumstances and the resolution of previously reported uncertainties.

Errors

- 72 Errors are omissions from and/or misstatements in an entity's financial statements arising from a failure to use, or misuse of, reliable information that is available, or could reasonably be expected to be obtained.³⁷ Material errors are errors that individually or collectively could reasonably be expected to influence decisions that primary users make on the basis of those financial statements.

³⁷ See paragraph 5 of IAS 8 (derived from the definition of prior-period errors).

Errors may affect narrative descriptions disclosed in the notes as well as amounts reported in the primary financial statements or in the notes.

- 73 An entity must correct all material errors, as well as any immaterial errors made intentionally to achieve a particular presentation of its financial position, financial performance or cash flows, to ensure compliance with IFRS Standards.³⁸ The entity should refer to IAS 8 for guidance on how to correct an error.
- 74 Immaterial errors, if not made intentionally to achieve a particular presentation, do not need to be corrected to ensure compliance with IFRS Standards. However, correcting all errors (including those that are not material) in the preparation of the financial statements lowers the risk that immaterial errors will accumulate over reporting periods and become material.
- 75 An entity assesses whether an error is material by applying the same considerations as outlined in the description of the materiality process. Making materiality judgements about errors involves both quantitative and qualitative considerations. The entity identifies information that, if misstated or omitted, could reasonably be expected to influence primary users' decisions (as described in Step 1 and Step 2 of the materiality process). The entity also considers whether any identified errors are material on a collective basis (as described in Step 4 of the materiality process).
- 76 If an error is judged not to be material on its own, it might be regarded as material when considered in combination with other information. However, in general, if an error is individually assessed as material to an entity's financial statements, the existence of other errors that affect the entity's financial position, financial performance or cash flows in the opposite way, does not make the error immaterial, nor does it eliminate the need to correct the error.

Example N—individual and collective assessment of errors

Background

An entity has identified measures of its profitability as the measures of great interest to the primary users of its financial statements. During the current reporting period, the entity recognised:

- (a) an expense accrual of CU100^(a) that should not have been recognised. The accrual affected the line item 'cost of services'.
- (b) the reversal of a provision of CU80 recognised in the previous period that should not have been reversed. The reversal affected the line item 'other operating income (expense)'.

continued...

³⁸ See paragraph 41 of IAS 8.

...continued

Application

In assessing whether these errors are material to its financial statements, the entity did not identify the presence of any qualitative factors and thus made its materiality judgement solely from a quantitative perspective. The entity concluded that both errors were individually material because of their impact on its profit.

In these circumstances, it would be inappropriate to consider the quantitative effect of the errors on a net basis, ie as a CU20 overstatement of expenses, thereby concluding that the identified errors do not need to be corrected. If an error is individually assessed as material to the entity's financial statements, the existence of other errors that affect the entity's financial position, financial performance or cash flows in an opposite way, does not eliminate the need to correct it, or make the error immaterial.

(a) In this example, currency amounts are denominated in 'currency units' (CU).

Cumulative errors

- 77 An entity may, over a number of reporting periods, accumulate errors that were immaterial, both in individual prior periods and cumulatively over all prior periods. Uncorrected errors that have accumulated over more than one period are sometimes called 'cumulative errors'.
- 78 Materiality judgements about cumulative errors in prior-period financial statements that an entity made at the time those statements were authorised for issue need not be revisited in subsequent periods unless the entity failed to use, or misused, information that:
- (a) was available when financial statements for those periods were authorised for issue; and
 - (b) could reasonably be expected to have been obtained and taken into account in the preparation of those financial statements.³⁹
- 79 To assess whether a cumulative error has become material to the current-period financial statements, an entity considers whether, in the current period:
- (a) the entity's circumstances have changed, leading to a different materiality assessment for the current period; or
 - (b) further accumulation of a current-period error onto the cumulative error has occurred.
- 80 An entity must correct cumulative errors if they have become material to the current-period financial statements.

³⁹ See paragraph 5 of IAS 8.

Example O—current-period assessment of cumulative errors**Background**

An entity, three years ago, purchased a plant. The plant has a useful life of 50 years and a residual value amounting to 20 per cent of the plant cost. The entity started to use the plant three years ago, but has not recognised any depreciation for it (cumulative error). In each prior period, the entity assessed the error of not depreciating its plant as being individually and cumulatively immaterial to the financial statements for that period. There is no indication that the materiality judgements of prior periods were wrong.

In the current period, the entity started depreciating the plant.

In the same period, the entity experienced a significant reduction in profitability (the type of circumstance referred to in paragraph 79(a) of the Practice Statement).

Application

When making its materiality judgements in the preparation of the current-period financial statements, the entity concluded that the cumulative error was material to the current-period financial statements.

In this scenario, the entity does not need to revisit the materiality assessments it made in prior periods. However, because in the current period the cumulative error has become material to the current-period financial statements, the entity must apply the requirements in IAS 8 to correct it.

Information about covenants

- 81 An entity assesses the materiality of information about the existence and terms of a loan agreement clause (covenant), or of a covenant breach, to decide whether to provide information related to the covenant in the financial statements. This assessment is made in the same way as for other information, that is, by considering whether that information could reasonably be expected to influence decisions that its primary users make on the basis of the entity's financial statements (see 'A four-step materiality process', from paragraph 33).
- 82 In particular, when a covenant exists, an entity considers both:
- (a) the consequences of a breach occurring, that is, the impact a covenant breach would have on the entity's financial position, financial performance and cash flows. If those consequences would affect the entity's financial position, financial performance or cash flows in a way that could reasonably be expected to influence primary users' decisions, then the information about the existence of the covenant and its terms is likely to be material. Conversely, if the consequences of a covenant breach would not affect the entity's financial position, financial performance or cash flows in such a way, then disclosures about the covenant might not be needed.

- (b) the likelihood of a covenant breach occurring. The more likely it is that a covenant breach would occur, the more likely it is that information about the existence and terms of the covenant would be material.

83 In assessing whether information about a covenant is material, a combination of the considerations in paragraph 82(a)–82(b) applies. Information about a covenant for which the consequences of a breach would affect an entity's financial position, financial performance or cash flows in a way that could reasonably be expected to influence primary users' decisions, but for which there is only a remote likelihood of the breach occurring, is not material.

Example P—assessing whether information about covenants is material

Background

An entity has rapidly grown over the past five years and recently suffered some liquidity problems. A long-term loan was granted to the entity in the current reporting period. The loan agreement includes a clause that requires the entity to maintain a ratio of debt to equity below a specified threshold, to be measured at each reporting date (the covenant). According to the loan agreement, the debt-to-equity ratio has to be calculated on the basis of debt and equity figures as presented in the entity's IFRS financial statements. If the entity breaches the covenant, the entire loan becomes payable on demand. The disclosure of covenant terms in an entity's financial statements is not required by any local laws or regulations.

Application

Paragraph 31 of IFRS 7 *Financial Instruments: Disclosures* requires an entity to disclose information that enables users of its financial statements to evaluate the nature and extent of risk arising from financial instruments to which the entity is exposed at the end of the reporting period.

In the preparation of its financial statements, the entity assesses whether information about the existence of the covenant and its terms is material information, considering both the consequences and the likelihood of a breach occurring.

In these circumstances, the entity concluded that, considering its recent liquidity problem, any acceleration of the long-term loan repayment plan (the consequence of the covenant breach occurring) would affect the entity's financial position and cash flows in a way that could reasonably be expected to influence primary users' decisions.

The entity also considered the likelihood of a breach occurring.

continued...

...continued

Scenario 1—the lender defined the covenant threshold on the basis of the three-year business plan prepared by the entity, adding a 10 per cent tolerance to the forecast figures

In this scenario, even though the entity has historically met its past business plans, it assessed the likelihood of a breach occurring as higher than remote. Therefore, information about the existence of the covenant and its terms was assessed as material and disclosed in the entity's financial statements.

Scenario 2—the lender defined the covenant threshold on the basis of the three-year business plan prepared by the entity, adding a 200 per cent tolerance to the forecast figures

In this scenario, the entity assessed the likelihood of a breach occurring as remote, on the basis of its historical track record of meeting its past business plans and the magnitude of the tolerance included in the covenant threshold. Therefore, although the consequences of the covenant breach would affect the entity's financial position and cash flows in a way that could reasonably be expected to influence primary users' decisions, the entity concluded that information about the existence of the covenant and its terms was not material.

Materiality judgements for interim reporting

- 84 An entity makes materiality judgements in preparing both annual financial statements and interim financial reports prepared in accordance with IAS 34 *Interim Financial Reporting*. In either case, the entity could apply the materiality process described in paragraphs 29–65. For its interim financial report, the entity considers the same materiality factors as in its annual assessment. However, it takes into consideration that the time period and the purpose of an interim financial report differ from those of the annual financial statements.
- 85 In making materiality judgements on its interim financial report, an entity focuses on the period covered by that report, that is:
- (a) it assesses whether information in the interim financial report is material in relation to the interim period financial data, not annual data.⁴⁰
 - (b) it applies the materiality factors on the basis of both the current interim period data and also, whenever there is more than one interim period (eg in the case of quarterly reporting), the data for the current financial year to date.⁴¹

⁴⁰ See paragraphs 23 and 25 of IAS 34 *Interim Financial Reporting*.

⁴¹ Paragraph 20 of IAS 34 requires an entity to include in the interim financial report the statements of profit or loss and other comprehensive income for both periods, the current interim period and the current financial year to date.

- (c) it may consider whether to provide in the interim financial report information that is expected to be material to the annual financial statements. However, information that is expected to be material to the annual financial statements need not be provided in the interim financial report if it is not material to the interim financial report.

Example Q—information that is expected to be material to the annual financial statements

Background

An entity sells mainly standardised products to private customers in its home market. In the first half of the reporting period, 98 per cent of the entity's revenue was generated by sales of Product X. The remaining revenue was principally derived from a pilot sale of a new product line—Product Y—that the entity planned to launch in the third quarter of the year. The entity expects revenue from Product Y to increase significantly by the end of the annual reporting period, so that Product Y will provide approximately 20 per cent of the entity's revenue for the full annual period.

Application

Paragraph 114 of IFRS 15 *Revenue from Contracts with Customers* requires an entity to disaggregate revenue recognised from contracts into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

The entity did not identify any qualitative factors that made the amount of revenues from Product Y material to the interim period.

In these circumstances, the entity concluded that the information about disaggregation of revenue by product lines was not material to the interim financial report and did not disclose it. In the preparation of the interim financial report, the entity is not required to disaggregate its revenue by product lines even if a greater level of disaggregation is expected to be required for the subsequent annual financial statements. In other words, although the entity expects that revenue by product lines will be material information for the annual financial statements, that fact does not influence the materiality assessment in the preparation of the entity's interim financial report.

- 86 Similarly, an entity may consider whether to provide information in the annual financial statements that is only material to the interim financial report. However, if information is material to the interim financial report, it need not be presented or disclosed subsequently in the annual financial statements if it is not material to those statements.

Example R—information that is only material to the interim financial report**Background**

An entity has identified measures of its profitability and cash flows as the measures of great interest to the primary users of its financial statements. During the interim period, the entity constructed a new chemical handling process to enable it to comply with environmental requirements for the production and storage of dangerous chemicals. Such an item of property, plant and equipment (PP&E) qualifies for recognition as an asset in accordance with paragraph 11 of IAS 16 *Property, Plant and Equipment*.

Application

Paragraph 74(b) of IAS 16 requires the disclosure of the expenditure recognised in the carrying amount of an item of PP&E in the course of its construction.

In the preparation of the interim financial report, the entity assessed, both from a quantitative and qualitative perspective, the information about expenditure recognised in the carrying amount of the chemical handling process, concluded that information was material to the interim financial report and disclosed it.

The entity incurred no further expenditure related to the chemical handling process in the second half of the annual reporting period. In the preparation of its annual financial statements, the entity assessed the expenditure recognised in the carrying amount of the chemical handling process against its annual profitability and cash flow measures and concluded that this information was not material to the annual financial statements. In reaching that conclusion, the entity did not identify any qualitative factors leading to a different assessment.

The entity is not required to disclose information about the expenditure recognised in the carrying amount of its chemical handling process in its annual financial statements.

- 87 In assessing materiality, an entity also considers the purpose of interim financial reports, which differs from the purpose of annual financial statements. An interim financial report is intended to provide an update on the latest complete set of annual financial statements.⁴² Information that is material to the interim period, but was already provided in the latest annual financial statements, does not need to be reproduced in the interim financial report, unless something new occurs or an update is needed.⁴³

Interim reporting estimates

- 88 When an entity concludes that information about estimation uncertainty is material, the entity needs to disclose that information. Measurements included

⁴² See paragraph 6 of IAS 34.

⁴³ See paragraphs 15–15A of IAS 34.

in interim financial reports often rely more on estimates than measurements included in the annual financial statements.⁴⁴ That fact does not, in itself, make the estimated measurements material. Nevertheless, relying on estimates for interim financial data to a greater extent than for annual financial data might result in more disclosures about such uncertainties being material, and thus being provided in the interim financial report, compared with the annual financial statements.

Application date

- 89 This Practice Statement does not change any requirements in IFRS Standards or introduce any new requirements. An entity that chooses to apply the guidance in the Practice Statement is permitted to apply it to financial statements prepared from 14 September 2017.

⁴⁴ See paragraph 41 of IAS 34.

Appendix

References to the *Conceptual Framework for Financial Reporting* and IFRS Standards

Extracts from the *Conceptual Framework for Financial Reporting*⁴⁵

Paragraph OB2

Referred to in paragraphs 7 and 17 of the Practice Statement

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.

Paragraph OB3

Referred to in paragraph 18 of the Practice Statement

Decisions by existing and potential investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases. Similarly, decisions by existing and potential lenders and other creditors about providing or settling loans and other forms of credit depend on the principal and interest payments or other returns that they expect. Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity. Consequently, existing and potential investors, lenders and other creditors need information to help them assess the prospects for future net cash inflows to an entity.

Paragraph OB4

Referred to in paragraphs 19 and 38 of the Practice Statement

To assess an entity's prospects for future net cash inflows, existing and potential investors, lenders and other creditors need information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources. Examples of such responsibilities include protecting the entity's resources from unfavourable effects of economic factors such as price and technological changes and ensuring that the entity complies with applicable laws, regulations and contractual provisions. Information about management's discharge of its responsibilities is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions.

⁴⁵ References to the *Conceptual Framework for Financial Reporting* in this Practice Statement will be updated once the revised *Conceptual Framework* is issued.

Paragraph OB5

Referred to in paragraph 13 of the Practice Statement

Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial reports are directed.

Paragraph OB6

Referred to in paragraph 21 of the Practice Statement

However, general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks.

Paragraph OB8

Referred to in paragraph 36 of the Practice Statement

Individual primary users have different, and possibly conflicting, information needs and desires. The Board, in developing financial reporting standards, will seek to provide the information set that will meet the needs of the maximum number of primary users. However, focusing on common information needs does not prevent the reporting entity from including additional information that is most useful to a particular subset of primary users.

Paragraph OB9

Referred to in paragraph 13 of the Practice Statement

The management of a reporting entity is also interested in financial information about the entity. However, management need not rely on general purpose financial reports because it is able to obtain the financial information it needs internally.

Paragraph OB10

Referred to in paragraph 13 of the Practice Statement

Other parties, such as regulators and members of the public other than investors, lenders and other creditors, may also find general purpose financial reports useful. However, those reports are not primarily directed to these other groups.

Paragraph QC7

Referred to in paragraph 20 of the Practice Statement

Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.

Paragraph QC11

Referred to in paragraph 5 of the Practice Statement

Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

Paragraph QC30

Referred to in paragraph 56 of the Practice Statement

Classifying, characterising and presenting information clearly and concisely makes it *understandable*.

Paragraph QC32

Referred to in paragraph 15 of the Practice Statement

Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

Extracts from IAS 1 *Presentation of Financial Statements*

Paragraph 7 (and paragraph 5 of IAS 8)

Referred to in paragraphs 5, 41 and 60 of the Practice Statement

Material Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

Paragraph 7

Referred to in paragraph 6 of the Practice Statement

Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. [...] Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.

Paragraph 15

Referred to in paragraph 62 of the Practice Statement

Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.

Paragraph 17

Referred to in paragraph 10 of the Practice Statement

In virtually all circumstances, an entity achieves a fair presentation by compliance with applicable IFRSs. A fair presentation also requires an entity:

- (a) to select and apply accounting policies in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. IAS 8 sets out a hierarchy of authoritative guidance that management considers in the absence of an IFRS that specifically applies to an item.
- (b) to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
- (c) to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Paragraph 29

Referred to in paragraph 43 of the Practice Statement

An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial.

Paragraph 30A

Referred to in paragraphs 28, 57 and 69 of the Practice Statement

When applying this and other IFRSs an entity shall decide, taking into consideration all relevant facts and circumstances, how it aggregates information in the financial statements, which include the notes. 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.

Paragraph 31

Referred to in paragraph 10 of the Practice Statement

Some IFRSs specify information that is required to be included in the financial statements, which include the notes. An entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material. This is the case even if the IFRS contains a list of specific requirements or describes them as minimum requirements. An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Paragraph 38

Referred to in paragraphs 67 and 70 of the Practice Statement

Except when IFRSs permit or require otherwise, an entity shall present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information if it is relevant to understanding the current period's financial statements.

Paragraph 38A

Referred to in paragraph 67 of the Practice Statement

An entity shall present, as a minimum, two statements of financial position, two statements of profit or loss and other comprehensive income, two separate statements of profit or loss (if presented), two statements of cash flows and two statements of changes in equity, and related notes.

Paragraph 38C

Referred to in paragraph 69 of the Practice Statement

An entity may present comparative information in addition to the minimum comparative financial statements required by IFRSs, as long as that information is prepared in accordance with IFRSs. This comparative information may consist of one or more statements referred to in paragraph 10, but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.

Paragraph BC30F of the Basis for Conclusions

Referred to in paragraphs 28 and 69 of the Practice Statement

Paragraph 30A was added to IAS 1 to highlight that when an entity decides how it aggregates information in the financial statements, it should take into consideration all relevant facts and circumstances. Paragraph 30A emphasises that an entity should not reduce the understandability of its financial statements by providing immaterial information that obscures the material information in financial statements or by aggregating material items that have different natures or functions. Obscuring material information with immaterial information in financial statements makes the material information less visible and therefore makes the financial statements less understandable. The amendments do not actually prohibit entities from disclosing immaterial information, because the Board thinks that such a requirement would not be operational; however, the amendments emphasise that disclosure should not result in material information being obscured.

Extracts from IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

Paragraph 5 (and paragraph 7 of IAS 1)

Referred to in paragraphs 5, 41 and 60 of the Practice Statement

Material Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

Paragraph 5

Referred to in paragraphs 72 and 78 of the Practice Statement

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- (a) was available when financial statements for those periods were authorised for issue; and**
- (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.**

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Paragraph 8

Referred to in paragraph 8 of the Practice Statement

IFRSs set out accounting policies that the IASB has concluded result in financial statements containing relevant and reliable information about the transactions, other events and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial. However, it is inappropriate to make, or leave uncorrected, immaterial departures from IFRSs to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

Paragraph 41

Referred to in paragraph 73 of the Practice Statement

Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with IFRSs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are authorised for issue. However, material errors are sometimes not discovered

until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs 42–47).

Extracts from IAS 34 *Interim Financial Reporting*

Paragraph 6

Referred to in paragraph 87 of the Practice Statement

In the interest of timeliness and cost considerations and to avoid repetition of information previously reported, an entity may be required to or may elect to provide less information at interim dates as compared with its annual financial statements. This Standard defines the minimum content of an interim financial report as including condensed financial statements and selected explanatory notes. The interim financial report is intended to provide an update on the latest complete set of annual financial statements. Accordingly, it focuses on new activities, events, and circumstances and does not duplicate information previously reported.

Paragraph 15

Referred to in paragraph 87 of the Practice Statement

An entity shall include in its interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. Information disclosed in relation to those events and transactions shall update the relevant information presented in the most recent annual financial report.

Paragraph 15A

Referred to in paragraph 87 of the Practice Statement

A user of an entity's interim financial report will have access to the most recent annual financial report of that entity. Therefore, it is unnecessary for the notes to an interim financial report to provide relatively insignificant updates to the information that was reported in the notes in the most recent annual financial report.

Paragraph 20

Referred to in paragraph 85 of the Practice Statement

Interim reports shall include interim financial statements (condensed or complete) for periods as follows:

- (a) **statement of financial position as of the end of the current interim period and a comparative statement of financial position as of the end of the immediately preceding financial year.**
- (b) **statements of profit or loss and other comprehensive income for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit or loss and other comprehensive income for the comparable interim periods (current and year-to-date) of the immediately preceding financial year. As permitted by IAS 1 (as amended in 2011), an**

interim report may present for each period a statement or statements of profit or loss and other comprehensive income.

- (c) statement of changes in equity cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.**
- (d) statement of cash flows cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.**

Paragraph 23

Referred to in paragraph 85 of the Practice Statement

In deciding how to recognise, measure, classify, or disclose an item for interim financial reporting purposes, materiality shall be assessed in relation to the interim period financial data. In making assessments of materiality, it shall be recognised that interim measurements may rely on estimates to a greater extent than measurements of annual financial data.

Paragraph 25

Referred to in paragraph 85 of the Practice Statement

While judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual items, changes in accounting policies or estimates, and errors are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period.

Paragraph 41

Referred to in paragraph 88 of the Practice Statement

The measurement procedures to be followed in an interim financial report shall be designed to ensure that the resulting information is reliable and that all material financial information that is relevant to an understanding of the financial position or performance of the entity is appropriately disclosed. While measurements in both annual and interim financial reports are often based on reasonable estimates, the preparation of interim financial reports generally will require a greater use of estimation methods than annual financial reports.



International Financial Reporting Standards®

IFRS Foundation®

IFRS®

IAS®

IFRIC®

SIC®

IASB®

Contact the IFRS Foundation for details of countries where its trade marks are in use or have been registered.

The International Accounting Standards Board is the
independent standard-setting body of the IFRS Foundation

30 Cannon Street | London EC4M 6XH | United Kingdom

Telephone: +44 (0)20 7246 6410

Email: info@ifrs.org | Web: www.ifrs.org

Publications Department

Telephone: +44 (0)20 7332 2730

Email: publications@ifrs.org