

STAFF PAPER

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IASB® meeting

Project	Management Commentary
Paper topic	Sweep issues—Definition of material information
CONTACT	Joan Brown jbrown@ifrs.org

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Introduction

1. At its October 2020 meeting, the International Accounting Standards Board (Board) gave the staff permission to begin the balloting process for an Exposure Draft of a revised IFRS Practice Statement 1 *Management Commentary* (Practice Statement).
2. In this paper, the staff ask the Board to approve a definition of ‘material information’ to include in the draft Practice Statement.

Background

3. At its meeting in July 2019, the Board tentatively decided to include in the Practice Statement guidance on making materiality judgements in preparing management commentary.
4. In the staff paper for that meeting, the staff suggested that the Practice Statement should define material information, applying the definition in the Board’s *Conceptual Framework for Financial Reporting (Conceptual Framework)*. That definition refers to general purpose financial reports, and therefore encompasses management commentary.

Paragraph 2.11 of the Conceptual Framework

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports, which provide 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.

5. The *Conceptual Framework* definition of material information for financial reports is reflected in a definition of material information for financial statements in IAS 1 *Presentation of Financial Statements*.

Paragraph 7 of IAS 1

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

6. The *Conceptual Framework* defines the primary users of financial reports as 'existing and potential investors, lenders and other creditors'. The draft Practice Statement will use the term 'investors and creditors' to refer to these primary users.

Questions arising in developing the Exposure Draft

7. Two questions have arisen in drafting a definition of material information for the Practice Statement.

Should the definition refer to the related financial statements?

8. The first question is which decisions the definition of material information should refer to. Should it refer to:
 - (a) decisions investors and creditors make on the basis of the management commentary; or
 - (b) decisions they make on the basis of the management commentary and the related financial statements?

9. In support of referring to decisions made on the basis of the management commentary *without* also referring to the financial statements, it can be argued that:
 - (a) IAS 1 defines information material to users of financial statements. That definition refers only to financial statements. For consistency, a definition of information material to users of management commentary should refer only to management commentary.
 - (b) referring to decisions made on the basis of management commentary does not imply that investors and creditors would make any decisions solely on the basis of that management commentary. Investors and creditors make decisions on the basis of information they obtain from many sources. The *Conceptual Framework* definition of materiality refers to decisions made on the basis of financial reports. But in doing so it is not referring to decisions that investors and creditors necessarily make on the basis of financial reports alone. It is referring to decisions investors and creditors make at least in part on the basis of financial reports. To be consistent with the *Conceptual Framework* definition, a definition of information that is material to users of management commentary should refer to decisions they make on the basis of that management commentary.
 - (c) adding a reference to the financial statements could imply that if an entity has presented or disclosed a piece of information somewhere in the financial statements, it never needs to provide that information in its management commentary. Such an implication would be misleading—information

provided in an entity's financial statements should also be provided in management commentary if necessary to meet the disclosure objectives set out in the Practice Statement, or to provide balance or coherence between the management commentary and financial statements.

- (d) there is possibly also a risk that adding a reference to the financial statements could imply that management commentary must provide all material information normally provided in financial statements if the entity's financial statements do not provide that information. An entity's financial statements might not provide that information if, for example, the entity does not apply IFRS Standards for its financial statements but does apply the Practice Statement for its management commentary.¹

10. In support of referring to decisions made on the basis of the management commentary *and* the related financial statements, it can be argued that:

- (a) referring to management commentary only could imply investors can safely make decisions on the basis of the management commentary alone, without also reading the financial statements. This would not be safe because management commentary is not designed to stand alone—it is designed to complement financial statements, providing additional information to enhance investors' and creditor's understanding of the financial performance and financial position depicted in the financial statements.
- (b) management commentary and financial statements contribute to the same objective (the objective of financial reporting set out in the *Conceptual Framework*) and provide information to support the same assessments (assessments the entity's prospects for future cash flows and managements stewardship of the entity's economic resources). Decisions made on the

¹ At its November 2020 meeting, the Board tentatively decided that an entity that complies with the Practice Statement should be permitted to state that fact even if the entity does not prepare its financial statements in accordance with IFRS Standards. The entity would need to state the basis on which its financial statements are prepared.

basis of these assessments would therefore be made on the basis of both management commentary and the related financial statements.

- (c) the fact that the IAS 1 definition of material information refers to financial statements only does not imply that the Practice Statement should refer to management commentary only. Financial statements are not necessarily accompanied by management commentary, or any other report—they are designed so they can stand alone, so the definition of material in the context of financial statements does not need to refer to another report. In contrast, management commentary is designed to accompany financial statements and so the definition of material in the context of management commentary needs to refer to the those related financial statements.
- (d) the Board could avoid the unintended consequences described in paragraph 9(c) by adding further guidance to the Practice Statement. This guidance could clarify the circumstances in which information provided in financial statements would also be provided in management commentary (either directly or by cross referring to the financial statements). It could explain that:
 - (i) management commentary is designed to complement financial statements so, by definition, most information in the financial statements does not need to be duplicated in the financial statements.
 - (ii) information in the financial statements would need to be provided in management commentary to the extent necessary to meet the disclosure objectives set out in the Practice Statement, or to provide balance or coherence between the management commentary and financial statements.

- 11. For the reasons in paragraph 10, the staff conclude that the Practice Statement definition of material information should refer to the decisions investors and creditors make on the basis of that management commentary *and* the related financial statements.

Should the definition include ‘which provide information about a specific reporting entity’?

12. A second question is whether the definition of material information should include an observation that management commentary and the related financial statements ‘provide financial information about a specific reporting entity’.
13. Including this observation would align the definition in the Practice Statement with the definitions in the *Conceptual Framework* and IAS 1.
14. However, the staff have concluded that the observation is not necessary in the Practice Statement definition. In the *Conceptual Framework*, it helps explain how materiality relates to the *Conceptual Framework* qualitative characteristic of relevance. There is no need to explain the relationship in the Practice Statement. Although it is important that management commentary provides entity-specific information, this message will be communicated by the disclosure objectives, other requirements and supporting guidance in the Practice Statement.

Staff recommendations and questions for the Board

15. Reflecting the conclusions reached in paragraphs 11 and 14, the staff recommend that the Practice Statement states that:

Information is material if omitting it from management commentary, or misstating or obscuring it within management commentary, could reasonably be expected to influence decisions that investors and creditors make on the basis of that management commentary and the related financial statements.

Question 1—definition of material information

Do you agree with this definition?

Questions continue/

16. Paragraph 10(d) suggests possible supporting guidance.

Question 2—supporting guidance

Do you have any comments on that guidance?

