September 2017

IFRS® Practice Statement
Project Summary and Feedback Statement

# Making Materiality Judgements

## Practice Statement 2

IFRS®

# Why are we issuing guidance?

## The disclosure problem

The International Accounting Standards Board (Board) has heard from its stakeholders that some companies are unsure how to make materiality judgements.

Rather than using judgement to decide what information to provide in financial statements, they tend to use disclosure requirements in IFRS Standards as if they were items on a checklist.

This contributes to what many have described as a disclosure problem—namely, companies provide too much irrelevant information and not enough relevant information in their financial statements.

## How the Board reacted

Some stakeholders suggested that one factor contributing to the difficulties some companies experience in making materiality judgements was the lack of guidance on materiality in IFRS Standards, particularly on how companies should make materiality judgements about information disclosed in the notes to the financial statements.

In the light of this feedback, the Board decided to provide further guidance and, in October 2015, published the Exposure Draft IFRS Practice Statement *Application of Materiality to Financial Statements* (Exposure Draft).

After considering the feedback on the Exposure Draft, the Board issued the IFRS Practice Statement 2 *Making Materiality Judgements* (Practice Statement) in September 2017.

## Objective of the Practice Statement

- The Practice Statement provides companies with guidance on making materiality judgements when preparing general purpose financial statements in accordance with IFRS Standards.
- The guidance may also help other parties involved in financial reporting to understand how a company makes materiality judgements in the preparation of financial statements.
- The Board's aim is to promote a behavioural change in the way companies prepare their financial statements, encouraging a greater application of judgement.

# Why issue a Practice Statement?

## What is a Practice Statement?

- A Practice Statement is not an IFRS Standard and companies are not required to comply with a Practice Statement to state compliance with IFRS Standards.
- It sets out non-mandatory guidance developed by the Board.

The Board decided to provide guidance in the form of a non-mandatory Practice Statement because issuing new mandatory requirements in a Standard could:

- appear prescriptive, undermining the emphasis on companies applying their judgement in the assessment of materiality; and
- potentially create conflict with local legal or regulatory frameworks.

Moreover, the Practice Statement does not change any requirements in IFRS Standards or introduce any new requirements. The Board considered non-mandatory status more appropriate.

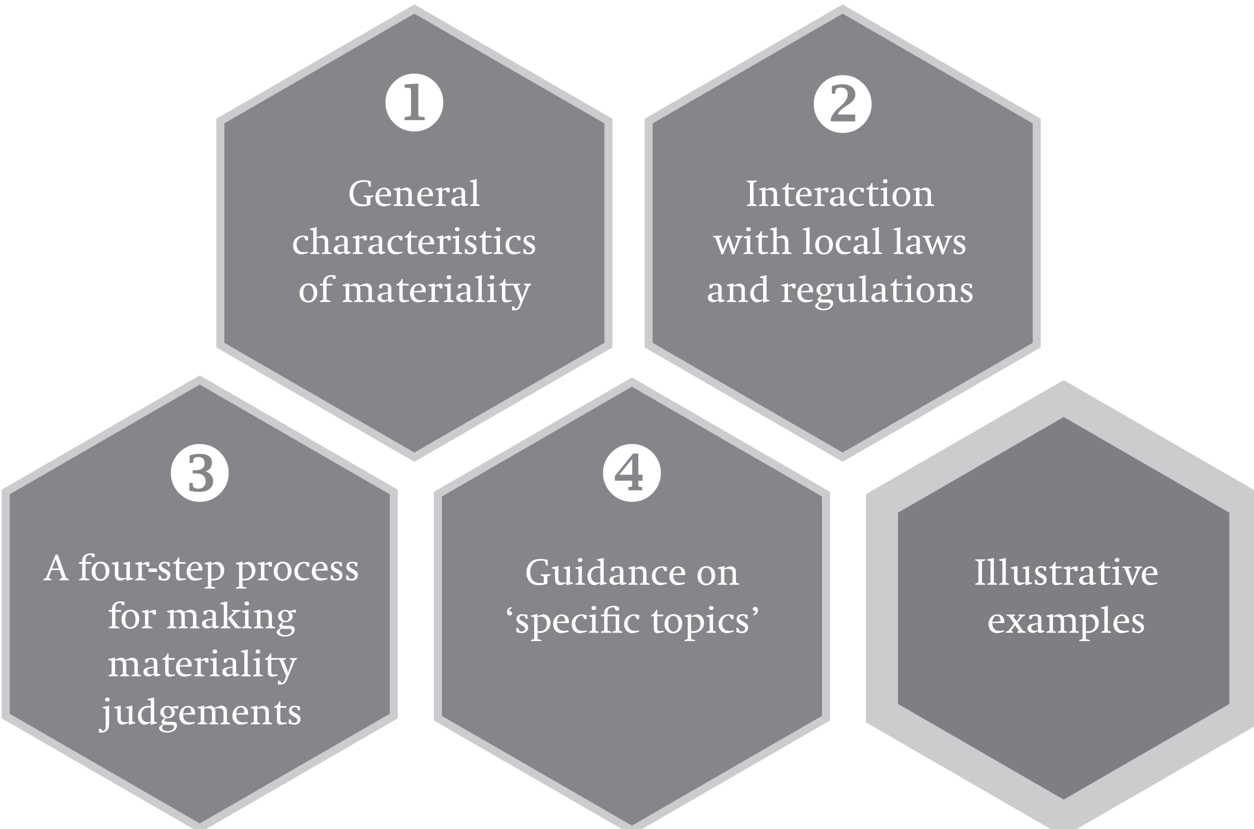
The Board decided that issuing guidance as a separate non-mandatory document, rather than as non-mandatory implementation guidance supporting a specific Standard, would help to emphasise that the concept of materiality is pervasive throughout IFRS Standards.

Finally, the Board preferred a Practice Statement to educational material because the Practice Statement is subject to full due process, including public consultation, and it is more accessible than educational material.

Responses to the Exposure Draft indicated widespread agreement with the considerations that led the Board to include its guidance in a non-mandatory Practice Statement.

# Overview of the Practice Statement

## Content




## Definition of material

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.

—*Conceptual Framework for Financial Reporting* (*Conceptual Framework*)

IAS 1 *Presentation of Financial Statements* requires a company to consider how primary users of the company's financial statements could reasonably be expected to be influenced in making decisions.

# Fundamentals

## ❶ General characteristics

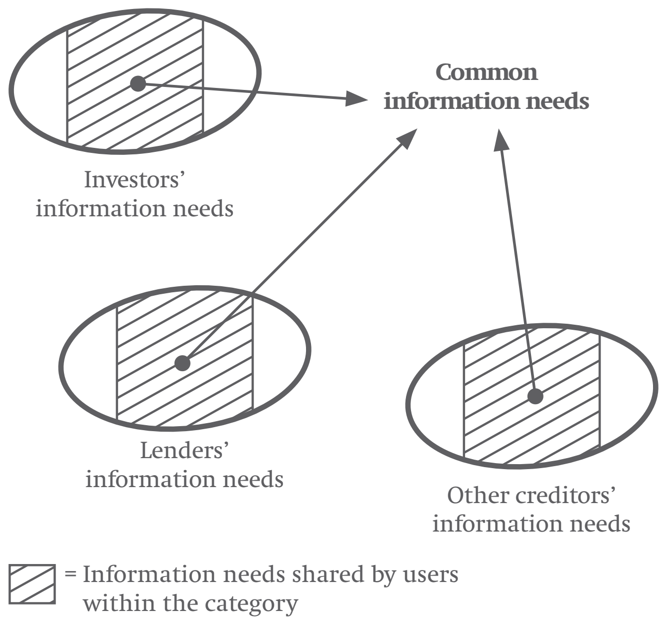
The Practice Statement discusses the general characteristics of materiality. In particular, it notes that:

- the need for materiality judgements is pervasive in the preparation of financial statements. A company makes materiality judgements when making decisions about presentation, disclosure, recognition and measurement.
- requirements in IFRS Standards need only be applied if their effect is material.

The Practice Statement also provides some general guidance on identifying primary users and their information needs. In particular, it clarifies that:

- the primary users the company should consider when making materiality judgements are existing and potential investors, lenders and other creditors, as identified by the *Conceptual Framework*.
- financial statements do not, and cannot, provide all the information that primary users need. Hence, in preparing its financial statements, the company should aim to meet the common information needs of its primary users.

**Diagram 1.1—meeting primary users' information needs**




- the company should assess whether information is material to the financial statements regardless of whether such information is publicly available from other sources.

## ❷ Local laws and regulations

The Practice Statement discusses the interaction between the materiality judgements a company is required to make and local laws and regulations. The Practice Statement clarifies that:

- the company's financial statements must comply with requirements in IFRS Standards, including requirements related to materiality, to state compliance with those Standards. Hence, a company 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.
- providing additional information to meet local legal or regulatory requirements is permitted by IFRS Standards even if, according to IFRS materiality requirements, that information is not material. However, such information must not obscure material information.

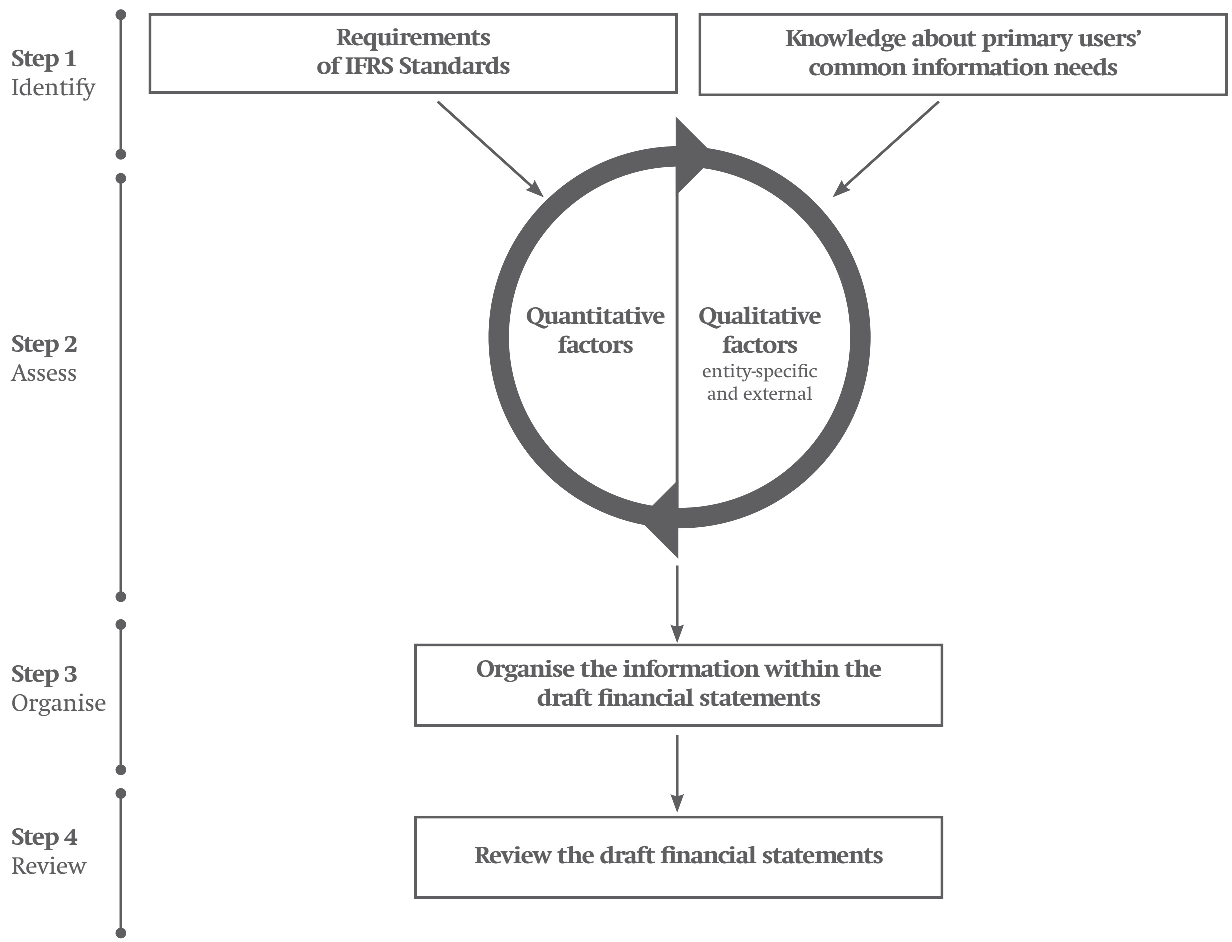
# The materiality process

## ❸ A four-step materiality process

The Practice Statement includes a description of a four-step materiality process. The description provides an overview of the role materiality plays in the preparation of financial statements and focuses on the factors a company should consider when making materiality judgements.

The process illustrates one possible way to make materiality judgements and incorporates the materiality requirements a company must apply to state compliance with IFRS Standards.

**Diagram 3.1—the four-step materiality process**



# Guidance on 'specific topics'

## ❹ Specific topics

The Practice Statement includes specific guidance on how to make materiality judgements on prior-period information, errors and covenants, and in the context of interim reporting.

**Prior-period information**

Assessing whether prior-period information is material to current-period financial statements might lead a company to:

- provide more prior-period information than was included in prior-period financial statements, when that information is necessary to understand current-period financial statements; or
- provide less prior-period information than was included in prior-period financial statements, when that information is not necessary to understand current-period financial statements.

**Errors**

Material errors are omissions and/or misstatements in a company's financial statements that individually or collectively could reasonably be expected to influence decisions that primary users make.

IFRS Standards require the company to correct all material errors.

The Practice Statement clarifies that the company assesses whether an error is material by applying the same considerations as outlined in the materiality process.

**Information about covenants**

The Practice Statement explains that a company should consider both the consequences of a breach of covenant and the likelihood of such a breach occurring when assessing the materiality of information related to covenants.

**Interim reporting**

The Practice Statement clarifies that, when preparing an interim financial report in accordance with IAS 34 *Interim Financial Reporting*, a company considers the same materiality factors it considers in preparing its annual financial statements.

However, the company takes into consideration that the time period and the purpose of an interim financial report differ from those of the annual financial statements. In particular, the interim financial report is intended to provide an update on the latest complete set of annual financial statements.

# Likely effects of the Practice Statement

The Board is committed to assessing and sharing knowledge about the likely costs of implementing proposed new requirements and guidance—the costs and benefits are collectively referred to as 'effects'.

—IFRS Foundation *Due Process Handbook*

The Board expects the Practice Statement will:

- enhance awareness of the role of materiality in helping to promote positive changes in behaviour (eg discourage rigid adherence to checklists);
- encourage companies to exercise judgement to a greater extent, leading to a reduction in boilerplate disclosures and redundant information;
- provide a framework to assess the need for information in the financial statements that is additional to the disclosure requirements specified by IFRS Standards; and
- provide a reference point for discussions between a company and its auditors and regulators on the assessment of materiality, helping those parties to reach agreement.

The Board does not expect any significant costs associated with the application of the Practice Statement because it introduces no new requirements and is not mandatory.

However, companies that have previously relied on a checklist approach when preparing their financial statements might face some implementation costs when making the judgements discussed in the Practice Statement.

The Board concluded that the benefits of higher-quality disclosures and easier access to information for primary users of financial statements exceed the implementation costs companies might incur when applying judgement in preparing financial statements, rather than following a checklist approach.

# Feedback Statement

Prior to publishing the Exposure Draft, the Board undertook extensive outreach to assess whether guidance on materiality should be developed and what should be included in that guidance.

The outreach included discussion with the IFRS Advisory Council; the Accounting Standards Advisory Forum (ASAF); the World Standard-Setters; the Capital Markets Advisory Committee (CMAC); the Global Preparers Forum (GPF); representatives of the International Accounting and Assurance Standards Board and the International Organization of Securities Commissions; and a number of other accounting professionals, academics and representatives of other regulatory bodies.

In addition, the Board considered information from its own review of academic literature and research.

The Board received and analysed 95 comment letters in response to the Exposure Draft.

The Board also conducted additional outreach on the proposals in the Exposure Draft, including consultations with the ASAF, the CMAC and the GPF.

## Summary of feedback

- The Board's response to the feedback on the proposals in the Exposure Draft is summarised in the tables on pages 10–22.
- In the summary, as in the Practice Statement, the broader term 'entities', rather than 'companies', is used.

# Summary

| Proposals in the Exposure Draft | Feedback | The Board's response |
|---|---|---|
| **Status and form of the guidance** | | |
| The Board proposed providing guidance in the form of a non-mandatory Practice Statement. The main reasons, as outlined in the Basis for Conclusions, were:<br>(a) mandatory guidance could create conflicts with national legal frameworks;<br>(b) including mandatory guidance in a Standard could risk appearing prescriptive and undermine the emphasis on management judgement in applying materiality;<br>(c) issuing guidance as a separate, stand-alone, non-mandatory document would emphasise that the concept of materiality is pervasive in IFRS Standards; and<br>(d) the Board preferred using a Practice Statement rather than educational material because a Practice Statement is subject to full due process, including public consultation, and would be more accessible than educational material.<br>The Exposure Draft asked for feedback on the status and form of the guidance proposed by the Board. | Most respondents favoured non-mandatory guidance and supported the Board's reasoning for issuing the guidance in that form. Respondents also acknowledged the challenges of issuing mandatory guidance.<br>Among those who favoured non-mandatory guidance, there were different views on the form the guidance should take:<br>(a) many favoured a non-mandatory Practice Statement. They agreed with the Board's reasoning and welcomed the fact that a Practice Statement is subject to full due process.<br>(b) some other respondents suggested the guidance should take the form of non-mandatory implementation guidance accompanying either a Standard or the *Conceptual Framework*. Their main concern was that a Practice Statement would not be as prominent and accessible as implementation guidance accompanying a Standard.<br>(c) a few respondents suggested it might be more appropriate to provide guidance in the form of educational material, because this would better reflect the nature and intended use of the guidance.<br>Respondents who supported issuing mandatory requirements argued that mandatory requirements would result in consistent application and provide management with a clearer basis for discussion with auditors and regulators. | The Board acknowledged that issuing mandatory guidance might promote greater consistency, but decided that non-mandatory guidance best suits the objective of the Materiality Practice Statement project. Non-mandatory guidance would prevent the risk of:<br>(a) creating conflicts with local legal frameworks; and<br>(b) appearing to be too prescriptive, thereby undermining the emphasis on entities applying their judgement in making materiality judgements.<br>Moreover, the Practice Statement does not change any requirements in IFRS Standards or introduce any new requirements. The Board considered non-mandatory status more appropriate.<br>Regarding the form of the guidance, the Board confirmed its preference for a Practice Statement. A Practice Statement is a formal document, subject to full due process, but with more flexibility than a Standard in terms of content, language and the use of examples.<br>The Board also noted that the stand-alone nature of a Practice Statement would emphasise, more than other alternatives, that the concept of materiality is pervasive in IFRS Standards. |

| Proposals in the Exposure Draft | Feedback | The Board's response |
|---|---|---|
| **Entities applying the *IFRS for SMEs* Standard** | | |
| The Exposure Draft was addressed only to entities applying full IFRS Standards. | The Board received a small number of comments asking it to consider the applicability of the Practice Statement to entities applying the *IFRS for SMEs* Standard. | The Board noted that the *IFRS for SMEs* Standard is a separate and stand-alone accounting framework based on full IFRS Standards with modifications to reflect cost-benefit considerations specific to small and medium-sized entities, and the needs of users of the financial statements of such entities. The *IFRS for SMEs* Standard does not refer to the concept of primary users included in the *Conceptual Framework* and does not include recent changes to IFRS Standards relating to materiality (eg that an entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information).<br>Therefore, the Board decided to state in the Practice Statement that it is not intended for entities applying the *IFRS for SMEs* Standard.<br>The *IFRS for SMEs* Standard permits, but does not require, entities to refer to guidance available in full IFRS Standards. Those entities may therefore refer to the guidance in the Practice Statement in the same way they consider the requirements and guidance in full IFRS Standards dealing with similar and related issues in developing and applying accounting policies when the *IFRS for SMEs* Standard does not specifically address a transaction, other event or condition. |

| Proposals in the Exposure Draft | Feedback | The Board's response |
|---|---|---|
| **Audience and focus** | | |
| The Exposure Draft was primarily addressed to management involved in the preparation of financial statements but made reference to other contexts in which the concept of materiality can be applied (eg legal and regulatory).<br>The Basis for Conclusions on the Exposure Draft also acknowledged that auditors may use similar principles as those used by management when making materiality judgements. | Many respondents suggested broadening the audience of the Practice Statement to include other stakeholders, such as auditors, regulators and enforcers, noting that the policies and procedures of these other stakeholders affect the materiality judgements of preparers. A broader audience could also promote a common understanding of how entities make materiality judgements.<br>Regarding the reference to other contexts in which the concept of materiality can be applied (eg audit of financial statements), respondents' views were divided:<br>(a) some respondents suggested that the relationship between the different contexts in which the concept of materiality is applied should be further explored and better articulated in the Practice Statement; while<br>(b) other respondents considered it would be helpful to explain the areas of potential differences between audit materiality and financial-statements materiality, but suggested that, to avoid creating confusion, the Practice Statement focuses only on the preparation of financial statements. | The Board decided the Practice Statement should only be addressed to those involved in the preparation of the financial statements. This is consistent with the Board's stated objective for publishing the Exposure Draft—to provide entities with guidance on making materiality judgements when preparing their financial statements. Nevertheless, the Board noted that the Practice Statement is likely to help other parties, such as auditors, users, regulators and enforcers, to understand the approach an entity follows in making materiality judgements when preparing its financial statements.<br>Finally, the Board discussed whether to include in the Practice Statement any reference to the assessment of materiality for auditing or other purposes, but decided to focus its guidance on the preparation of financial statements only. Assessing materiality for purposes other than preparation of financial statements is beyond the scope of the Practice Statement and referring to making materiality judgements in other contexts might cause confusion. |

| Proposals in the Exposure Draft | Feedback | The Board's response |
|---|---|---|
| **Definition of material** | | |
| The Exposure Draft quoted the definition of 'material information' included in the *Conceptual Framework* and acknowledged similar definitions in IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.<br>In the Basis for Conclusions on the Exposure Draft, the Board also acknowledged that the definition of material, and whether there is a need to change or clarify it, was being discussed in other Board projects. | Regarding the timing of the publication of the Practice Statement, many respondents were supportive of the final guidance being published without waiting for the Board to finalise its other projects discussing the definition of material information.<br>A few of those respondents agreed with the Board's approach noting that the Board is not planning to change significantly the definition of material in those other projects.<br>Some respondents, however, were reluctant to see guidance finalised when there is a possibility of the definition changing within the next few years. | The Board clarified that making changes to the definition of material is not part of the scope of the Materiality Practice Statement project.<br>In September 2017 the Board published the Exposure Draft *Definition of Material* (*Proposed amendments to IAS 1 and IAS 8*). This Exposure Draft proposes refining the definition of material by incorporating into that definition concepts currently described elsewhere in IFRS Standards.<br>The Board considered whether to postpone issuing the Practice Statement until the completion of the Definition of Material project. However, the Board concluded that it would be useful to provide guidance on making materiality judgements as quickly as possible, in response to requests for guidance.<br>Moreover, the Board observed that, since the proposed amendments to the definition of material do not constitute substantive changes to the existing requirements in IFRS Standards, they are unlikely to result in a change in practice for most entities or to significantly affect entities' financial statements. Therefore, the guidance in the Practice Statement would not be affected by the proposed amendments. |

| Proposals in the Exposure Draft | Feedback | The Board's response |
|---|---|---|
| **Primary users and their information needs** | | |
| The Exposure Draft stated that identifying the entity's primary users and their information needs is part of the materiality assessment.<br>The Exposure Draft proposed guidance on the characteristics of the primary users of financial statements and described the decisions made by those users and their information needs. In particular, the Exposure Draft acknowledged that an entity may have several different types or classes of primary users and suggested an entity should include information in its financial statements to meet the common information needs of a broad range of those classes.<br>The Exposure Draft also stated that information would usually be expected to be material if it is relevant to either a range of different users across different classes or a significant class of primary users. Moreover, it proposed that an entity should consider whether its primary users have any special needs and whether the information provided in financial statements meets or exceeds those needs. | Many respondents agreed that identifying the primary users of an entity's financial statements would be important to decide whether information is material. However, some respondents suggested rewording the proposed guidance so that it focused on the classes of primary users contemplated in the *Conceptual Framework* (existing and potential investors, lenders and other creditors).<br>Different views were also expressed regarding the concept of primary users' 'special needs':<br>(a) some respondents were concerned that this concept was inconsistent with the current definition of general purpose financial statements (which focuses on the common information needs of a wide range of users); and<br>(b) other respondents questioned whether the emphasis on primary users' special needs might suggest to an entity that it should focus only on its existing users, which might lead the entity to narrow the information provided in the financial statements. | The Board clarified that, in making its materiality assessment, an entity should consider the primary users of the entity's financial statements as defined by the *Conceptual Framework*.<br>The Board discussed whether it would be appropriate to emphasise the existence, among those primary users, of different subsets of users whose information needs might differ. However, the Board concluded that requiring an entity to identify different subsets of primary users, or focusing on any special information needs those subsets of users might have, could create a tension with the definition of general purpose financial statements, which are intended to focus on the common information needs of a wide range of users.<br>Furthermore, the Board decided to emphasise in the Practice Statement that primary users include both existing and potential investors, lenders and other creditors. The Board concluded this would address concerns some stakeholders expressed about an inappropriate focus on specific existing users.<br>Finally, the Board clarified that providing all the information primary users need is not the objective of general purpose financial statements. An entity should aim to meet primary users' common information needs, not to address information needs that respond to unique or individual information requests. |

| Proposals in the Exposure Draft | Feedback | The Board's response |
|---|---|---|
| **Stewardship** | | |
| The Exposure Draft referred to information needed to assess how an entity is managed—information about management's stewardship—as information useful to the primary users of an entity's financial statements.<br>It also noted that financial statements show the result of management's stewardship of the entity's resources. | Some respondents supported the reference to stewardship in the Practice Statement, but asked the Board to further clarify the interaction between stewardship and materiality. | The Board clarified the interaction between stewardship and materiality by highlighting that in assessing materiality an entity needs to consider what decisions its primary users make on the basis of the financial statements. These decisions are about providing resources to the entity and depend on the return expected by primary users. Expectations about returns, in turn, depend on primary users' assessment of the amount, timing and uncertainty of the future cash inflows to the entity, together with their assessment of management's stewardship of the entity's resources. |
| **Publicly available information** | | |
| The Exposure Draft acknowledged that the primary users of an entity's financial statements consider information in addition to that provided in the financial statements. Consequently, the assessment of whether and how information should be disclosed in those statements may depend on the availability of other information from publicly accessible sources.<br>Nevertheless, the Exposure Draft stated that the public availability of information does not relieve the entity of the obligation to provide in its financial statements information that is specifically required by IFRS Standards, if that information is material. | Some respondents found the wording in the Exposure Draft confusing and potentially inconsistent, making it unclear whether publicly available information should affect the materiality assessment. | The Board clarified that the financial statements are required to be comprehensive and to provide information about an entity that is useful to its primary users in making decisions.<br>Consequently, an entity assesses whether information is material to the financial statements regardless of whether such information is publicly available from another source. |

| Proposals in the Exposure Draft | Feedback | The Board's response |
|---|---|---|
| **Interaction with local laws and regulations** | | |
| The Exposure Draft specified that IFRS Standards would not prohibit an entity from providing additional information to meet local requirements in a jurisdiction. | Some respondents were concerned about how to apply the guidance in the Exposure Draft in jurisdictions where different local disclosure requirements also apply. They suggested clarifying that the Practice Statement does not limit in any way the information that an entity is required to disclose under local laws or regulations.<br><br>Other respondents highlighted some potential practical issues that might result in the proposed guidance conflicting with local laws and regulations (eg local laws or regulations preventing an entity from providing information required by IFRS Standards in its financial statements). However, no respondents reported examples of situations they had encountered in practice in which the guidance in the Exposure Draft conflicted with local laws or regulations. | The Board clarified that the Practice Statement provides guidance on making materiality judgements when preparing financial statements in accordance with IFRS Standards; it does not aim to provide guidance on how to apply local legal or regulatory requirements.<br><br>Nevertheless, the Board acknowledged that local requirements might affect information included in the financial statements. In these circumstances, if an entity wishes to state compliance with IFRS Standards it must comply with the materiality requirements in IFRS Standards (ie the entity cannot provide less information than the information required by IFRS Standards even if local laws and regulations permit otherwise). However, those Standards do not prohibit the disclosure of additional information required by local laws or regulations, even if that information is not material according to IFRS Standards.<br><br>When information in addition to that required by IFRS Standards is included in the financial statements, paragraph 30A of IAS 1 requires an entity to ensure that material information is not obscured. The Board observed that organising information appropriately in the financial statements would allow an entity to meet that requirement. |

| Proposals in the Exposure Draft | Feedback | The Board's response |
|---|---|---|
| **A four-step materiality process** | | |
| The Exposure Draft laid out the general characteristics of materiality and discussed how to make materiality judgements in different situations entities face when preparing financial statements. The proposed guidance was developed on the basis of the requirements and guidance in several IFRS Standards. | Many respondents welcomed the fact the Exposure Draft gathered guidance on materiality from several IFRS Standards.<br>However, respondents suggested it would be useful to also describe the practical steps an entity follows when making materiality judgements in the preparation of its financial statements. | The Board developed a four-step process, the materiality process, which illustrates the role materiality plays in the preparation of financial statements and clarifies how materiality judgements are made. The materiality process also identifies the factors an entity should consider when making materiality judgements.<br>The Board discussed whether to focus its guidance only on the application of judgement rather than also illustrating the overall process of which materiality judgements are a part. However, as some respondents noted, describing the overall process helps an entity understand how materiality judgements can influence the preparation of its financial statements, as well as how the individual materiality decisions are connected with each other.<br>Finally, consistent with the non-mandatory status of the Practice Statement, the Board developed the materiality process as an example of the approach an entity may follow in making materiality judgements, but clarified that the materiality process incorporates the materiality requirements an entity must apply to state compliance with IFRS Standards. |

| Proposals in the Exposure Draft | Feedback | The Board's response |
|---|---|---|
| **Prior-period information** | | |
| The Exposure Draft proposed some guidance and examples on how to make materiality judgements on prior-period information. In particular, it emphasised that information included in prior-period financial statements does not need to be repeated with the same level of detail in current-period financial statements if that information is not material to the current period.<br>The Exposure Draft did not describe or discuss the difference between the 'comparative financial statements' approach and the 'corresponding figures' approach to prior-period information. These two approaches can result in different amounts of prior-period information being included in current-period financial statements (and also in different auditor reporting responsibilities in respect of prior-period information). Which of these two approaches is applied is often specified by local custom, laws or regulations. | Some respondents requested more practical guidance on how to make materiality judgements on prior-period information than provided in the Exposure Draft.<br>In particular, they asked the Board to address situations in which information not included in prior-period financial statements is material to an understanding of current-period financial statements.<br>Moreover, some respondents commented on the consequences of the guidance for audit. They noted that the guidance in the Exposure Draft may be unworkable with existing audit requirements since the approach being suggested appeared to be more aligned with the 'corresponding figures' approach. | The Board acknowledged some legal or regulatory requirements might set out the amount of prior-period information to be included in financial statements. However, the Board decided that it is necessary to provide guidance in the Practice Statement on making materiality judgements about prior-period information.<br>The Board developed the guidance in the Practice Statement in the light of the minimum comparative information required by IAS 1. IAS 1 requires an entity to present comparative information in respect of the preceding period for all amounts reported in current-period financial statements. However, comparative information for narrative and descriptive information is required only if it is necessary to an understanding of current-period financial statements.<br>Consequently, the Board decided to explain that, in its current-period financial statements, an entity may summarise information provided in prior-period financial statements, except when local laws or regulations demand otherwise.<br>The Board also emphasised that, when providing prior-period information in addition to the minimum comparative information required by IFRS Standards, information has to be prepared in accordance with the relevant Standards and should not obscure material information. |

| Proposals in the Exposure Draft | Feedback | The Board’s response |
|---|---|---|
| **Errors** | | |
| In the Exposure Draft the Board provided a description of errors together with a couple of common examples of situations in which management might identify misstated information in the entity’s financial statements. The Exposure Draft also addressed materiality judgements about prior-period errors.<br>Finally, the Exposure Draft included some wording implying that if an entity intentionally misstates or omits information to achieve a particular presentation or result, such an error is always material. | Some respondents commented that the Exposure Draft quoted the requirements in IAS 1 and IAS 8 without providing any additional practical guidance.<br>Some respondents asked the Board to address the situation in which an entity identifies errors generated by the accumulation, over several periods, of errors that were immaterial both in individual prior periods and cumulatively over all prior periods (sometimes called ‘cumulative errors’). These respondents asked whether an entity should correct such errors by restating prior-period information and whether the cumulative effect, if uncorrected, would be considered as a material error for the current period. | The Board noted that the materiality factors an entity should apply to conclude whether an error is material are the same as those described in the materiality process. Consequently, in the ‘Errors’ section of the Practice Statement, the Board suggests an entity refer to the considerations described in the materiality process.<br>The Board also concluded it would be helpful to clarify that, when cumulative errors are identified:<br>(a) materiality judgements about cumulative errors that an entity made at the time prior-period financial statements were authorised for issue need not be revisited in the current period, provided those judgements were reasonable at that time; however<br>(b) the entity needs to assess whether cumulative errors have become material to the current-period financial statements.<br>The Board decided to include in the Practice Statement a statement to remind an entity that a cumulative error shall be corrected if it becomes material to the current period, but concluded that the Practice Statement should focus on how to make materiality judgements, rather than explain how to correct material errors. IAS 8 contains the requirements on the correction of errors.<br>Regarding errors made intentionally to mislead, the Board aligned the wording in the final Practice Statement to the wording from paragraph 41 of IAS 8:<br>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. |

| Proposals in the Exposure Draft | Feedback | The Board's response |
|---|---|---|
| **Covenants** | | |
| The Exposure Draft discussed covenant compliance as an example of a situation when materiality judgements would be more sensitive because they relate to areas of particular importance to the primary users of an entity's financial statements. | Some respondents asked for more guidance on assessing whether information about covenants is material. Moreover, they asked the Board to clarify if, and under what circumstances, the materiality assessment may be more sensitive due to the existence of covenants. | The Board identified two concerns from the feedback on the Exposure Draft:<br>(a) do any specific considerations apply when making materiality judgements on information about the existence and the terms of a covenant, or a breach of covenant?<br>(b) does the existence of a covenant influence materiality judgements about other information—other than about the existence of the covenant, or a breach of covenant, included in the financial statements?<br>In respect of the first concern, the Board concluded that, whether information about covenants is material depends on both the consequences of a breach of covenant and the likelihood of that breach occurring.<br>In respect of the second concern, the Board discussed including in the Practice Statement guidance stating that the existence of a covenant should not influence an entity's assessment of the materiality of other information in financial statements. However, some stakeholders observed that such guidance would conflict with existing guidance developed by other parties on the assessment of the materiality of errors. To avoid creating any confusion among preparers and others involved in financial reporting, the Board decided not to include in the Practice Statement the guidance on the impact of covenants on materiality assessments. |

| Proposals in the Exposure Draft | Feedback | The Board's response |
| --- | --- | --- |
| **Interimreporting** | | |
| The Exposure Draft stated that the same principles on the application of materiality to the annual financial statements apply to interim financial reports; however, the context in and objectives to which the principles are applied are different.<br>The Exposure Draft also quoted the observation in IAS 34 that interim financial reports are intended to provide an update on the latest complete set of annual financial statements; accordingly, they focus on new activities, events, and circumstances and do not need to duplicate previously reported information. | Some respondents asked for more practical guidance on how to make materiality judgements when preparing an interim financial report. In particular, they asked the Board to address some practical concerns, such as:<br>(a) how to deal with information deemed material to the interim financial report but not to the annual financial statements and vice versa;<br>(b) whether, in the case of quarterly reporting, the materiality assessment relates to the current interim period only (ie the last three months) or the cumulative year to date (eg nine months); and<br>(c) whether the materiality assessment is affected by the fact that measurements included in the interim financial report often rely more on estimates than do measurements included in the annual financial statements. | The Board concluded that, when preparing an interim financial report in accordance with IAS 34, an entity considers the same materiality factors it considers in preparing its annual financial statements. However, the Board also noted that it would be helpful to explain any additional considerations relevant to making a materiality judgement in the preparation of an interim financial report.<br>In particular, the Board noted that it would be helpful to explain how the different time period and purpose of an interim financial report, compared to the annual financial statements, affect materiality judgements, as well as to address the practical concerns raised by respondents. |

| Proposals in the Exposure Draft | Feedback | The Board's response |
|---|---|---|
| **Examples** | | |
| The Exposure Draft included a number of examples illustrating how an entity might apply the guidance provided. | Many respondents welcomed the inclusion of examples in the Practice Statement. However, some respondents stated that the examples in the Exposure Draft were too vague and lacked sufficient supporting rationale to provide practical guidance. Those respondents suggested the examples should:<br>(a) focus on those situations in which judgement is most difficult to exercise;<br>(b) reflect 'real-world' examples (rather than being collected from existing examples in IFRS Standards);<br>(c) explain clearly the factors that were considered, the thought process the entity followed and how the conclusion was reached; and<br>(d) provide a sufficiently detailed description of the particular circumstances to reduce the risk that the conclusions are inappropriately extrapolated. | The Board decided to include additional detailed examples in the Practice Statement. Each example provides:<br>(a) background—a short description of the facts and circumstances needed for the assessment; and<br>(b) application—an explanation of the factors considered and the thought process the entity followed in reaching its conclusions.<br>All the examples were internally and externally reviewed to help the Board evaluate whether they illustrate how the guidance in the Practice Statement might be applied rather than provide an interpretation of how the requirements in IFRS Standards should be applied. |

# Important information

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