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Topic **Summaries of reports on materiality**

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In April 2022 the IASB issued a call for research for interested national standard-setters to partner with academics in their region to investigate the effects of recent changes and additions to the literature published by the IASB on making materiality judgements.

The objective of the research is to provide information to enable the IASB to assess the effects on investors, entities, auditors and regulators of:

- Definition of Material (Amendments to IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*);[1]
- IFRS Practice Statement 2 *Making Materiality Judgements*;[2] and
- the Better Communication Case Studies.[3]

Judgements about materiality are essential to the application of IFRS Accounting Standards. Information about the effects of the documents will help inform the IASB's future discussions about materiality judgements.

Six national standard-setters, in partnership with academics from their jurisdictions, took part in the research, examining the application of materiality in light of one or more of the listed documents.

National standard-setters and academic teams that participated in the materiality research

National standard-setter	Academic team	Research focus
Australian Accounting Standards Board (AASB)	Tom Frick, Brad Potter and Michael Davern, University of Melbourne	Auditors' materiality judgements
AASB and Malaysian Accounting Standards Board (MASB)	Noor Adwa Sulaiman, Universiti Malaya, Nahariah Jaffar, Xiamen University Malaysia, and	Auditors' and preparers' materiality judgements

[1] https://www.ifrs.org/projects/completed-projects/2018/definition-of-material/#final-stage
[2] https://www.ifrs.org/content/dam/ifrs/publications/amendments/english/2017/ifrs-practice-statement-2-making-materiality-judgements.pdf
[3] https://www.ifrs.org/content/dam/ifrs/project/disclosure-initative/better-communication-making-disclosures-more-meaningful.pdf

	Siti Noorhawa Omar, Universiti Malaya	
Botswana Institute of Chartered Accountants (BICA)	Aubrey Mbewe, Edinburgh Business School, and Eugene Mwaba, Botswana Accountancy College	Preparers' materiality judgements
China Accounting Standards Committee (CASC)	Yu Lisheng, Sun Yat-sen University, Wang Yanyan, Xiamen University, and Zhuang Jie, Xiamen University	Preparers' materiality judgements for their investments in joint ventures and associates
Mexican Financial Reporting Standards Board (CINIF)	To be added at a later date	To be added at a later date
External Reporting Board, New Zealand	Nives Botica Redmayne, Dimu Ehalaiye, Fawad Ahmad, Jude Edeigba and Fawzi Laswad, Massey University	Preparers' materiality judgements

Australia

AASB Research Report 21 (October 2023)

Auditors' perspectives: The Impacts of IFRS Practice Statement 2 *Making Materiality Judgments*

Aim: The aim of the study was to investigate whether auditors' familiarity with and application of IFRS Practice Statement 2 influences their materiality judgements. Studying how auditors make materiality judgements is, in the authors' view, important because these judgements influence disclosures of information in the financial statements.

Sample and methods: The sample consists of 42 auditors who responded to an online task that asked them to make a materiality judgement on a restatement of a financial statement line item of a fictitious entity. The auditors came from three regions: Oceania (19%), Asia (23.8%), and South America (57.1%). The auditors had an average of 20.6 years of audit experience, and most of them worked at Big Four accounting firms. The auditors were all from jurisdictions that adopt or align with IFRS Accounting Standards.

Main findings:

- Auditors who are familiar with the four-step process[4] outlined in IFRS Practice Statement 2 are more likely to consider both quantitative and qualitative

[4] IFRS Practice Statement 2 proposes a four-step approach to assessing materiality in the preparation of financial statements: (1) identification of information is potentially material; (2) assessment of whether the information

information, and the relationship between these two types of information, when making materiality judgements.
- No link was found between familiarity with IFRS Practice Statement 2 and explicit consideration of the information needs of users when making materiality judgements.
- A large proportion of auditors are unaware of or cannot explain the content of IFRS Practice Statement 2, and many auditors are not comfortable in making materiality judgements.
- Auditors rely heavily on their firm's guidance, rather than accounting standards or the *Conceptual Framework for Financial Reporting*, to inform their materiality judgements.

Implications: The authors recommend education campaigns to increase awareness and application of IFRS Practice Statement 2 among auditors.

Malaysia

AASB Research Report 22 / MASB Research Report 2 (October 2023)
Making Materiality Judgements—Malaysian Preparers' and Auditors' Perspectives

Aim: The aim of this study was to investigate preparers' and auditors' understanding and application of the concept of materiality in Malaysia. Specifically, the study aimed to investigate the effect of IFRS Practice Statement 2 and the 2018 Amendments to IAS 1 and IAS 8 on the work of preparers and auditors.

Sample and methods: A group of 15 preparers and 20 auditors in Malaysia were interviewed for this research. Most of the auditors (85%) held partner positions and had between 20 and 30 years of audit experience (60% of auditors). Most of the preparers were chief financial officers (60% of preparers) and had 20–30 years of experience (67% of preparers).

Main findings:
- **Understanding of materiality concept**: Preparers and auditors generally share a common understanding of the materiality concept that aligns with IFRS Practice Statement 2. Their understanding of materiality can be summed up as follows:
    - Material information is important for users' economic decision-making.
    - Materiality judgements are applied to assess whether sufficient and relevant information is disclosed to stakeholders.
    - Deciding what information is material involves consideration of both quantitative information and qualitative information.

identified in the first step is in fact material; (3) organisation of the information in the draft financial statements in a way that communicates clearly and concisely with primary users; and (4) review of the draft financial statements to determine whether all material information has been identified and whether materiality has been considered from a wide perspective and in aggregate, on the basis of the complete set of financial statements.

- The materiality assessment process plays a crucial role in entities' compliance with accounting standards and other regulatory requirements.

- **Views of IFRS Practice Statement 2:** Preparers and auditors generally agree that the practice statement has improved their ability to make materiality judgements in financial reporting. Specifically:
    - The practice statement has helped clarify the application of the principle-based approach to assessing materiality.
    - The practice statement has helped broaden respondents' understanding of the concept of materiality. However, their understanding is still dominated by their own work experiences, including size and type of entity.
    - The guidance on the concept of materiality serves as a valuable resource in the practical task of deciding what to include in financial statements and improving the effectiveness and efficiency of decision-making processes.
- **Effect of IFRS Practice Statement 2**: Most preparers and auditors said the guidance in IFRS Practice Statement 2 has helped them in the process of preparing and auditing financial statements, and to focus on both quantitative information and qualitative information. Specifically:
    - When discussing materiality judgement processes, respondents emphasised the importance of identifying entity-specific information and the information needs of users.
    - In assessing materiality, most preparers and auditors use internal checklists referring to quantitative and qualitative data.
    - For auditors, data analysis tools play a pivotal role in materiality judgement processes—both in quantitative materiality assessment and identification of trends and anomalies within an entity's data.

Implications: The authors conclude that IFRS Practice Statement 2 is working as intended.

Botswana

BICA (September 2023)

Making Materiality Judgements—Investigating the Effects of Definition of Material, IFRS Practice Statement 2 *Making Materiality Judgements* and Better Communication in Financial Disclosures—Making Disclosures More Meaningful

Aim: The aim of this study was to investigate the effects of IASB's materiality guidance on entities' assessment of materiality in preparing financial statements.

Sample and methods: The sample consists of 25 respondents from 21 organisations listed on the Botswana Stock Exchange who participated in semi-structured interviews. The roles of the respondents included chief financial officers, finance directors, finance managers, and heads of finance. Additionally, focus group discussions were conducted with 45 respondents from 25 public interest entities as defined by the Botswana Accountancy Oversight Authority (BAOA). In total, 70 respondents from 46 organisations in a range of industries participated in the study.

Main findings:

- Respondents reported that their entities lacked awareness and application of the IASB's materiality guidance. Most of these entities have outsourced the preparation of their financial statements to audit firms, leading to a gap in in-house knowledge and skills.
- Respondents said their entities primarily depend on their auditors for materiality judgements in the preparation of financial statements.
- Preparers are concerned about financial statement reviews conducted by the accounting regulator (BAOA). This concern has resulted in entities using disclosure requirements in IFRS Accounting Standards as checklists, for fear of falling short in the regulator's assessment, and ignoring materiality.
- Entities do not provide entity-specific definitions of materiality. They mostly rely on quantitative thresholds, often guided by their auditors, without considering the qualitative aspects of materiality.
- While respondents acknowledge the need for better communication in their financial statements, they have not made a conscious effort to align their disclosures with users' information needs or to embrace the disclosure guidance outlined in initiatives like the Better Communication case studies.

Implications: The authors recommend education workshops possibly organised by BICA to guide preparers with the implementation of the IASB's materiality guidance. They also suggest that the regulator needs to be made aware of the amendments to IAS 1 and IAS 8 and of IFRS Practice Statement 2.

China

CASC Research Report

Materiality Judgements: Research on Listed Companies' Judgements on Material Joint Ventures and Associates in China

Aim: The aim of the study is to examine the materiality judgements of a sample of Chinese listed entities for their investments in joint ventures and associates, and analyse how these entities make these materiality judgements.

Sample and methods: The researchers interviewed the senior executives of 13 A-share listed entities in China with investments in joint ventures and associates and analysed the disclosure practices of 328 A-share listed entities with joint ventures and associates from 2014 to 2021. The authors used the four-step structure of IFRS Practice Statement 2 (identification, assessment, organisation, review) as a framework for their study.

Main findings:

Step 1—identification:

- Respondents said that entities consider the needs of primary users in making materiality judgements. However, they focus on meeting regulatory requirements.
- All respondents confirmed that they have not changed their approaches for judging materiality since the IASB's guidance on materiality was issued.
- Interview responses indicated managers were confused about applying the principles of IFRS Practice Statement 2 to their operations, especially in the areas of identifying users' information needs and assessing materiality based on entity-specific and external circumstances.
- Some respondents highlighted concerns about costs and complications arising from qualitative judgements. Specifically, the trade-off between costs of revealing trade secrets and benefits of disclosing material information was an important concern.

Step 2—assessment:

- Most respondents understood that quantitative and qualitative factors should be considered jointly. However, these entities relied on quantitative criteria in applying materiality judgements and did not adjust quantitative thresholds based on qualitative factors because of:
  - confusion about how to combine quantitative and qualitative factors; and
  - appreciation of the clarity and applicability quantitative factors provide in meeting regulatory requirements.
- Qualitative factors were either considered as supplementary factors or disregarded altogether because of their high uncertainty and the complexity of considering future circumstances.

Step 3—organisation:

- Respondents expressed concerns that the practice statement provides guidance for individual items but does not solve the problem of information overload because it lacks a holistic perspective.
- Due to local laws, regulations or other external factors, entities cannot arbitrarily omit specific information from the financial statements because it is immaterial.
- Respondents said that coordination between standard-setters and regulatory authorities is needed in providing guidance on making materiality judgements.

Step 4—review:

- The interview responses suggest that conflicts exist between executives involved in making materiality judgements. There might be tension between a secretary of the board whose goal is to create a positive reaction from capital markets, and a chief financial officer who prioritises compliance and accurate disclosures. The chief executive officer, concerned about protecting trade secrets, might also clash with a chief financial officer who prioritises full disclosure.
- Respondents also noted the crucial role auditors play in this process. Auditors' primary focus lies in minimising misstatements and omissions to reduce audit

risk. Nevertheless, conflicts can occasionally arise if listed entities wish to reduce the amount of information disclosed while auditors prioritise compliance.
- A few respondents stated that management in joint ventures or associates might not want the financial information of their entities to be identified as material. The main reason for this lack of disclosure is the potential disclosure of sensitive information to competitors.

Implications: Management often finds inconsistencies between IASB's guidance on materiality and local regulations. Most entities surveyed do not want additional accounting guidance on materiality, emphasising the role of managerial experience and the need for applying judgement.

New Zealand

Massey University Research Report (November 2023)
Applying Materiality Judgements

Aim: The aim of this research was to assess the effects of the IASB's materiality guidance on the materiality judgements of preparers and regulators in New Zealand.

Sample and methods: The researchers conducted in-depth semi-structured interviews with ten chief financial officers and audit committee chairs and four New Zealand regulator representatives. They also analysed the revenue disclosures of 40 entities applying NZ IFRS 15 *Revenue from Contracts with Customers.* The entities were drawn from 12 industries and listed on New Zealand Stock Exchange 50 from 2018 to 2021.

Main findings:
- Preparers:
    - have a good understanding of the concept of materiality and are familiar with the IASB guidance on materiality but prefer using the national regulator's guidance documents and their own business knowledge. Their reasons for not using the IASB's guidance on materiality are that the guidance is not mandatory and not prominent on standard-setters' websites.
    - tend to use quantitative guidelines as a starting point in assessing material information and then adjust their decisions by considering qualitative factors.
    - have increased disclosures in recent years largely due to new standards requiring more detailed disclosures, but also as a result of Covid-19 and new requirements for sustainability-related disclosures.
    - consider that the regulators have an important role to play when it comes to discouraging immaterial disclosures. Regulators are seen by preparers as focused on detail.
- Regulators:
    - are more concerned with the omission of material information than with 'immaterial disclosure'.

    - consider that they, and auditors, have a role to play in discouraging immaterial disclosures.
- The analysis of the financial statement disclosures showed a high level of compliance with NZ IFRS 15 disclosure requirements in New Zealand after the adoption of the new revenue standard. Once established, entities' revenue disclosures seldom changed unless the entity's business activity changed, and this lack of change raises concerns about boilerplate disclosures.

Implications: Because the IASB's practice statements are not reporting standards, most preparers do not perceive Practice Statement 2 as equal in importance or standing to mandatory IFRS Standards. To increase its prominence, standard-setters should communicate more about this document and why it is important and make it more easily accessible.