Evolution of the Materiality according to the International Accounting Professional Regulatory Bodies

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Abstract

This research provides an extensive discussion of materiality, a cornerstone notion in accounting that guides the decision-making process for financial reporting. Information is material if omitting, misstating, or obscuring it could reasonably be expected to influence the 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.

The use of this notion influences decisions on the recognition, measurement, presentation, and disclosure of particular transactions and information in financial statements or associated notes. Moreover, prominent regulatory and accounting bodies, including the FASB, SEC, AICPA, and IASB, whose responsibility is to establish accounting standards, have devoted decades to examining the notion of materiality till now.

Furthermore, numerous initiatives and projects have been undertaken by these regulatory and accounting bodies to enhance the comprehension and application of the materiality notion in accounting. Consequently, this paper commences by providing a concise overview regarding the progression of materiality notion definition from the perspective of key regulatory and accounting bodies, followed by examining materiality determination process, Finally, it concludes with an analysis of the main projects underlying materiality.

Key words: Materiality, Financial reporting quality, Regulatory and Accounting bodies, Materiality judgement.

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تطور الأهمية النسبية وفقا للهيئات التنظيمية المهنية المحاسبية الدولية

الملخص

يقدم هذا البحث مناقشة على نطاق واسع للأهمية النسبية، وهو مفهوم أساسي في المحاسبة يوجه عملية صنع القرار لإعداد التقارير المالية. تعتبر المعلومات هامة نسبياً إذا كان من المتوقع بشكل معقول أن يؤدي حذفها أو تحريفها أو حجبها إلى التأثير على القرارات التي يتخذها المستخدمون الأساسيون للقوائم المالية ذات الغرض العام على أساس تلك القوائم المالية، التي توفر معلومات مالية عن وحدة محددة للتقرير.

ويؤثر استخدام هذا المفهوم على القرارات المتعلقة بالاعتراف والقياس والعرض والإفصاح عن معاملات ومعلومات محددة في القوائم المالية أو الإيضاحات المرتبطة بها.

علاوة على ذلك، فإن الهيئات التنظيمية والمحاسبية البارزة، بما في ذلك مجلس معايير المحاسبة المالية، ولجنة الأوراق المالية والبورصة، والجمعية الدولية للمحاسبين القانونيين، ومجلس معايير المحاسبة الدولية، والتي تتمثل مسؤوليتها في وضع معايير محاسبية، كرست عقودًا من الزمن لدراسة مفهوم الأهمية النسبية حتى الآن.

بالاضافة إلى، تم تنغذ العديد من المبادرات والمشاريع من قبل هذه الهيئات التنظيمية والمحاسبية لتعزيز فهم وتطبيق مفهوم الأهمية النسبية في المحاسبة.

بالتالي، تبدأ هذه الورقة بتقديم نظرة عامة مختصرة فيما يتعلق بتطور تعريف مفهوم الأهمية النسبية من وجهة نظر الهيئات التنظيمية والمحاسبية الرئيسية، تليها دراسة نهج تحديد الأهمية النسبية. وأخيرا، تختتم الورقة بتحليل المشاريع الرئيسية المتضمنة الأهمية النسبية.

الكلمات المفتاحية: الأهمية النسبية، جودة التقارير المالية، الهيئات التنظيمية والمحاسبية، إصدار الحكم على الأهمية النسبية.

1. Introduction:

Materiality is a pivotal and complex notion in financial accounting. For proper application, the materiality notion needs to be clearly understood. Professional judgement is essential for the effective application of the materiality notion. (IFRS, Discussion Forum, 2013)

Firms, when preparing their financial statements, encounter challenges in making judgements as to materiality. Some firms are not sure how to exercise materiality judgements, and as a result, treat disclosure requirements as if they were checklist items instead of utilizing judgement to ascertain which information ought to be disclosed. As indicated by a number of stakeholders, these challenges and practices contribute to a disclosure issue in which financial statements contain excessive amount of irrelevant information and insufficient amount of relevant information (Karwowski, 2019)

Materiality Notion is applicable to both recognition and measurement within the fundamental financial statements as well as the disclosures incorporated into the notes (IFRS in Focus, 2014). In fact, the majority of definitions of the key notions of “true and fair” or “present fairly” rely on financial information being materially correct.

It is not possible to say that financial statements achieve a fair presentation or provide a truthful and fair picture when material information required by a financial reporting standard is omitted or misstated.(Kavanagh, 2019)

2. Progression of materiality notion definition:

2.1 FASB

The FASB position has slightly changed over time. FASB (1980) framework, CON 2, “Qualitative Characteristics of Accounting Information” defines materiality as:

The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item. (FASB, 1980, CON 2, Para. 132).

A joint project initiated in 2004 by the FASB & the IASB to improve their conceptual frameworks. Two chapters of a new Conceptual Framework for Financial Reporting were released in 2010 by the FASB & the IASB. (Common Conceptual Framework 2010), which provides a definition for materiality as:

Information is material if **omitting it or misstating** it could influence

decisions that users make **on the basis of the financial information** of a specific reporting entity. (FASB, 2010, CON 8, Para. QC11).

In a press release in 2015, FASB Chairman Russell G. Golden expressed that stakeholders had pointed out the inconsistency between the existing discussion of materiality in our conceptual framework and the U.S. Supreme Court`s legal materiality notion.

Uncertainty ensued regarding the ability of the board to identify and assess accounting standards` disclosure requirements and the capability of organizations to interpret what disclosures are material. (FASB, 2015, News release)

Subsequently, Two EDs pertaining to the FASB`s disclosure framework project were issued, one of these drafts, which amends FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting, aims to clarify the materiality notion. More precisely, the amendments would be implemented to Chapter 3, Qualitative Characteristics of Useful Financial Information.

FASB`s proposal explicitly states that materiality is a legal notion along with it observes materiality definitions rather than promulgates them.

By adopting such a definition, FASB would be freed of any responsibilities of drawing numerical guidelines for what's and is not material for a firm to report. Due to its adherence to the Supreme Court's definition, the FASB is unable to specify or advise a uniform quantitative threshold for materiality or pre-determine what may be considered material in a certain circumstance.

However, the proposals encountered a barrage of criticism from commenters: (Posner, 2018)

1- Preparers and practitioners opposed calling materiality a legal notion since it implies that materiality judgments are exclusive to legal professionals and that materiality ought to be regarded as an accounting concept.
2- Due to its inception in antifraud litigation, others opposed to the mention of the U.S. Supreme Court's materiality definition.
3- others Still said that the term`s meaning is disputable and there is a concern it may alter.

Certain stakeholders proposed that the definition in Concepts Statement 2 would be more suitable. Subsequent to careful consideration of the feedback received, the Board reached the decision to substitute the existing definition of materiality, with the superseded definition within Concepts Statement 2, which is cited in SEC Staff Accounting Bulletin No. 99, Materiality. According to SAB 99, the definition in Concepts Statement 2 is substantively identical to the U.S. Supreme Court`s definition, consequently, the definition provided in this chapter is substantively identical to the definition found in the auditing standards of the AICPA and the PCAOB. To bring its definition of materiality in alignment with that of other regulatory boards, FASB amended it in August 2018, The new definition is as follows:

The omission or misstatement of an item in a financial report is material if, in light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item (FASB, 2018, Amendments to CON 8, Para. QC11).

2.2 IASB

IASC (1989) defines materiality as follows in its Framework for the Preparation and Presentation of Financial Statements:

Information is material if its omission or misstatement could influence the **economic decisions of users taken on the** basis of the **financial statements**.

Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. (IASC, 1989, IASC framework, Para.30: adopted by IASB in 2001).

Two revised standards - IAS1: Presentation of Financial Statements and IAS 8, which has been given a new title: Accounting Policies, Changes in Accounting Estimates, and Errors were released by the IASB in December 2003, that define materiality as:

“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**” (International Accounting Standard [IAS1], 2003, paragraph 11), (IAS 8, 2003, Paragraph 5)

A joint project initiated in 2004 by the FASB & the IASB to improve their conceptual frameworks. Two chapters of a new conceptual framework for financial reporting were released in 2010 by the FASB & the IASB. (Common Conceptual Framework 2010), which provides a definition for materiality as:

Information is material if omitting it or misstating it could influence

decisions that users make on the basis of the **financial information** of a specific reporting entity. (IASB, 2010, Conceptual framework, Para.QC11).

The IASB in March 2018, during the process of revising the Conceptual Framework, came to the conclusion that the 2010 Conceptual Framework provides a clear description of the notion of materiality. Therefore, the Board made no changes to the materiality description, except for the explicit clarification that the mentioned **users** are the **primary users** of general-purpose financial reports, This clarification underscores that materiality decisions are meant to reflect the primary users` needs and no other group. (IASB, 2018, Conceptual framework, Para.2.11).

The IASB released Definition of Material (Amendments to IAS1 and IAS 8) in October 2018.

The modifications clarify and improve the definition of material in IAS1 “Presentation of Financial Statements” and ensure consistency in the definitions employed throughout IFRS Standards and other publications.

The modified material definition states:

Information is material if o**mitting, misstating, or obscuring** it could reasonably be expected to influence the 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.

(International financial reporting standards [IFRS], 2018, Amendments to IAS1 and IAS 8)

2.3 Security Exchange Commission

The rules incorporating and defining materiality were established by the SEC in 1947, emphasizing that it referred to financial information pertained to investment decisions. According to **Rule 1-02** of **SEC Regulation S-X,** the term material is defined as:

The term "material," when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters about which an average prudent investor ought reasonably to be informed before purchasing the security registered.

The definition of material was modified by the SEC in 1982 to align with the definition of the United States Supreme Court case as follows:

“When used to qualify a requirement for the furnishing of information as to any subject, [materiality] limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered.” (Business Roundtable, 2015)

The SEC issued staff Accounting Bulletins 99, titled “The SEC defines materiality” in August 1999 Its purpose was to address the applicability of materiality thresholds in the preparation and auditing of financial statements.

The definition utilized in SAB 99 is the FASB–adopted definition from SFAC No. 2. (Securities and Exchange Commission [SEC], 1999, Staff Accounting Bulletin No. 99)

2.4 American Institute of Certified Public Accountants (AICPA)

The AICPA’s old definition of materiality was described in Statement on Auditing Standards (SAS) No. 122 (AU-C

Section 320), paragraph 2, December 2012, as “Misstatements, including omissions, are considered to be material if, individually or in aggregate, they could reasonably be expected to influence economic decisions of users that are taken based on the financial statements.” (American Institute of Certified Public Accountants [AICPA], 2020)

This materiality notion description aligns with the definition employed by the International Auditing and Assurance Standards Board (IAASB) and the IASB. (Editorial, 2019)

It is in the public `s best interest, according to the ASB, that the definition of materiality be further aligned with that of other standard setters and regulators, such as the SEC, FASB, PCAOB auditing standards, and the U.S. judicial system. The ASB seeks to remove any inconsistency between the definitions employed by other regulatory bodies in the United States. In 2018, FASB modified its materiality definition to be consistent with the other regulating boards.

In 1954, the first definition was published by the AAA`s Committee on Concepts and Standards as:
“An **item** should be regarded as material if there is a reason to believe that knowledge of it would influence the decisions or attitude of an informed investor.”

Such definition focuses on the extent to which an item has the ability to influence an informed investor`s decisions. An informed investor Presumably comprises both current and prospective investors. As implied by the definition, auditors and stakeholders could be held liable for known, and unknown and unforeseeable investors. The scope of the definition has expanded beyond current and known stockholders.
An item`s materiality can be determined by its nature, its size, or a mix of the two. (American accounting association [AAA], Supplementary Statement no. 8, 1954)

3. Materiality Determination process (The Process followed to determine what is Material)

The IFRS **Practice Statement 2 (PS2),** "**Making Materiality Judgements"**, released by the IASB in September 2017, provides guidance to firms on how to make materiality judgements in the preparation of general-purpose financial statements in compliance with IFRS Standards. (IFRS PS2, 2017)

The materiality process**,** as illustrated in **Figure 2.4,** comprises four steps that an organization may adhere to when making materiality judgements in the preparation of its financial statements.

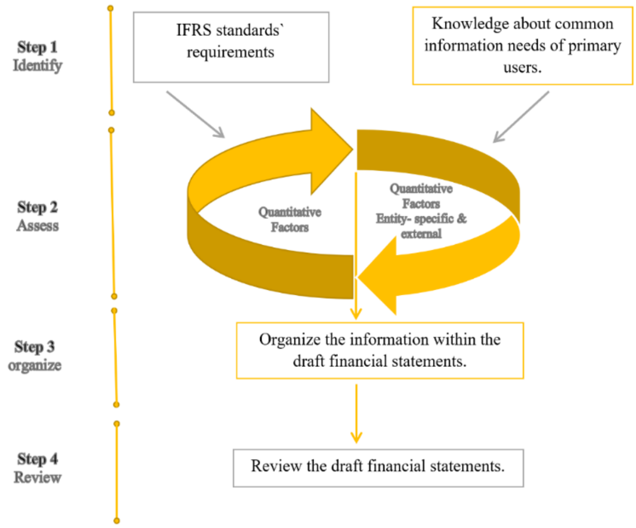
The materiality process refers to the assessment undertaken by an entity to determine if information is material enough to be considered for recognition, measurement, presentation, and disclosure.

The PS 2 provides an illustration of the four-step procedure as follows:

Step 1:

Identify information concerning conditions, transactions, and other events that have the potential to be material in light of IFRS requirements and the organization's awareness of common information needs of its primary user.

Figure 1: The four- step process of materiality



Source (IFRS PS2, 2017)

Step 2:

Assess if the information identified in Step 1 is material in the context of the financial statements as a whole, taking into account both quantitative factors (information impact size against the financial statements` measures) and qualitative factors (the information`s characteristics that increase its likelihood of influencing the primary users` decisions).

Step 3:

Organize material information in the draft financial statements in a manner that facilitate clear and concise communication (e.g., by placing emphasis on material matters, customizing information to the specific circumstances of the organization, focusing on interrelationships among various pieces of information)

Step 4:

Review the complete set of draft financial statements to verify if every material information has been identified, including an aggregated view of materiality. Information deemed non-material alone may turn out to be material when viewed in conjunction with other information within the context of a comprehensive set of financial statements.

This last review may result in the addition of additional information or the removal of information that is now deemed immaterial, the aggregation, disaggregation or reorganization of information or even to start the process over from Step 2.

4. **Main Projects underlying materiality:**

4.1 FASB Disclosure Framework

Much of the contemporary materiality progress originates from the Disclosure Framework project.

Nevertheless, the materiality notion is a crucial component of the Disclosure Framework project as it enables organizations employ discretion in deciding which information to disclose given their specific situations.

In December 2007, Investors Technical Advisory Committee (ITAC) suggested that the FASB insert a "fast-tracked" project, intended to enhance the disclosure framework residing within U.S. GAAP to its working agenda. (Investors Technical Advisory Committee [ITAC], 2007)

The Advisory Committee on Improvements to Financial Reporting (CIFR) suggested in August 2008 that the SEC and the FASB collaborate to establish a framework for disclosure that would serve the following purposes:

1- Incorporate current disclosure requirements from the SEC and FASB into a coherent whole to guarantee logical disclosure presentation and effective communication, based on consistent aims and principles. By doing this, redundancy would be removed and a unified source of disclosure guidance covering all financial reporting standards would be available.

2- Required that the key assumptions, estimates, and sensitivity analyses that potentially have an influence on a company's business be disclosed, furthermore, a qualitative discussion of the main risks and uncertainties that could materially alter these values over time. This extends to include non-recorded events and uncertainties in addition to transactions that are recognized and measured in the financial statements. (Advisory Committee on Improvements to Financial Reporting [CIFR], 2008)

FASB incorporated this project in July 2009 into its agenda in response to requests and suggestions received from various constituents, such as ITAC and CIFR, (FASB, new release, 2009)

The Disclosure Framework project`s aim is to enhance the efficacy of disclosures in financial statements` footnotes by effectively communicating the information mandated by GAAP that is most crucial to the financial statements` users. (FASB, Discussion paper, 2012)

FASB Chairman Leslie F. Seidman stated that:

A number of stakeholders expressed concerns regarding the **relevance** and **sheer volume** of information in financial statement footnotes, as well as the **missing** or **difficulty of finding certain information**. As a result, the FASB is working to enhance its own procedures for setting disclosure requirements and to provide reporting entities with a method to **exercise judgment** about which disclosures are pertinent to them. The ultimate objective is to improve the capabilities of users to analyze the information within the financial statements notes while reducing burdens on reporting entities. (FASB, New release, 2012)

The FASB published in year 2012 a DP titled “Invitation to Comment, Disclosure Framework” with the purpose of gathering stakeholder feedback on its framework development. The framework objective is to enhance the effectiveness, coordination, and redundancy of financial statement disclosures for private, not-for-profit, and public entities.

The topics covered in the invitation to comment are as follows:

- A decision process that could assist the Board to establish requirements for disclosure that address **only relevant** information.
- Flexible requirements for disclosure that each reporting entity could adapt to concentrate on information **relevant** to its particular situations.
- A judgment framework that could assist each reporting entity in determining which disclosures are **relevant** to its particular situations.
- Techniques for Organization and formatting that could make it easier for users to find and understand the information they need.

Disclosure requirements for interim period financial statements are also addressed in the document. (FASB, New release, 2012)

The FASB published an **exposure draft (ED)** putting forth a proposed decision process for the Board and its staff to utilize when evaluating which disclosures ought to be included in notes to interim and annual financial statements. Furthermore, it suggests the kinds of information that ought not to be included in financial statements notes.

According to the ED, it is recommended that the following three types of information be included in the financial statements footnotes rather than being solely shown on the face of the financial statements alone:

- Information regarding particular line items.

- General information regarding the entity`s nature, activities, any applicable special privileges or restrictions, and other advantages as well as disadvantages as compared to other companies.
- Information regarding current situations and past events and conditions that may impact future cash flows but not a specific line item.

The following types of information ought not to be included in the notes:

- Relevant information to resources` providers to a significant number of companies.
- Information that is subject to cost constraints on its disclosure.
- Future-oriented information that pertains to predictions of outcomes that are beyond the company`s control), with the exception of the subsequent information that may hold significance:
    - Estimates and assumptions employed as inputs to measurements.
    - Existing plans and strategies pertaining to issues under the control of the management.
    - The impact of predetermined forthcoming changes in current conditions on particular line items or on the entire entity.

This ED, if given approval, will be added into Concepts Statement No. 8, Conceptual Framework for Financial Reporting as a new chapter. (Mosco & Crowley, 2014)
FASB suggested **Improvements to Materiality** in September 2015 in an effort to improve the effectiveness of financial statements Disclosures.

The FASB published **two EDs** pertaining to its disclosure framework project available for public comment.

The drafts discuss how materiality is utilized in:

- Assisting entities in exercising discretion when deciding which disclosures in financial statements footnotes should be deemed as "material" in their specific circumstances, and
- Assisting the Board in understanding the reporting environment within which financial accounting and reporting standards are set.

The ED, which includes modifications to FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting, aims to clarify the materiality notion. More precisely, these modifications would be applied to Chapter 3, Qualitative Characteristics of Useful Financial Information.

The proposed Accounting Standards Update (ASU), Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material, a component of the "entity decision process," aims to encourage companies to exercise discretion appropriately when determining which disclosures should be deemed material in their specific situations. (FASB, New release, 2015)

This proposed ASU`s amendments aim to provide clarity on how entities should consider materiality when assessing the requirements for providing information in their financial statements' footnotes. This would enhance the efficacy of financial statements footnotes by enabling entities to omit immaterial information and concentrate communication with users on the material and relevant items. The modifications would not alter any particular disclosure requirements. (FASB in Focus, 2015)

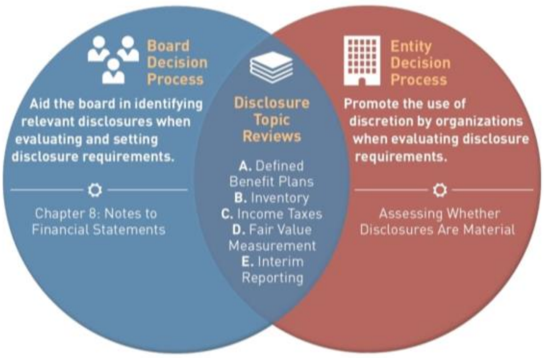
A statement that materiality is a legal notion would be inserted into the proposed ASU. Additionally, the proposal would include a statement that materiality is applicable to both quantitative and qualitative disclosures in the financial statements' footnotes, both individually and collectively, within the context of the financial statements in their entirety. and that some, all, or none of the requirements in a disclosure section may be material. Furthermore, it would affirm that omitting disclosures regarding immaterial information doesn't constitute an accounting error. (Uhl & Berberi, 2015)

The proposed changes to Topic 235 would be applicable to all categories of entities, including employee benefit plans, public and private firms, and not-for-profit organizations.

The purpose of these proposals is to provide clarity regarding the materiality notion. By doing so, entities can enhance the efficacy of their disclosures by excluding immaterial information and concentrating communication with users on the material and relevant items. (FASB, New release, 2015).

Figure 2 presents FASB Disclosure Framework

Disclosure Framework Projects



FASB published two modifications to its conceptual framework and two Accounting Standards Updates (ASUs) in

August 2018, aiming at enhancing the efficacy of disclosures in financial statements` notes. (FASB, New release, 2018)

These two modifications to the conceptual framework will aid the board in identifying and evaluating accounting standards` disclosure requirements as well as clarifying the materiality notion.

- **Chapter 8 of the conceptual framework, "Notes to Financial Statements"**

  Elucidates what information the board should take into consideration to be incorporated in financial statements` notes, by delineating the objective of these notes, the proper content nature, and general limitations. It also covers the Board's specific considerations about the disclosure requirements for interim reporting. (FASB, New release, August 2018)

- **Amendments to chapter 3 of the conceptual framework, "Qualitative Characteristics of Useful Financial Information"**

  Modifies the FASB's definition of materiality to be align with the definition employed by the SEC, PCAOB, AICPA, and U.S. judicial system.

4.2 IASB Disclosure Initiative:

In December 2012, The IASB responded to the 2011 agenda consultation by formally adding a disclosure initiative to its work program. The initiative comprises several smaller projects that seek to investigate opportunities for enhancing presentation and disclosure principles and requirements outlined in current Standards.

In carrying out this initiative, the IASB conducted a constituent survey regarding disclosure and convened a disclosure forum with the intention of bringing together preparers, auditors, investors, and securities regulators.

On 28 May 2013, The IASB released a feedback statement discussion forum titled “Financial Reporting Disclosure”, in which the IASB declared its intent to consider a no. of additional initiatives, including both research and short-term projects. These incorporated: (IFRS, Discussion Forum, 2013)

- Narrow-scope modifications to IAS 1 to rectify perceived obstacles to preparers exercising their professional judgement when presenting their financial reports.
- A materiality project, which with the assistance of an advisory group aims to develop an application guidance or educational material on materiality.
- A revised financial statement presentation research project, was carried out alongside the IASB's conceptual framework project, concentrated on disclosure efficacy broader challenges, this may ultimately result in the replacement for IAS1 , IAS 7 and IAS 8 , thereby establishing a disclosure framework for IFRS.

4.2.1 Amendments to IAS 1 Project:

Disclosure Initiative - Amendments to IAS 1 was issued by the IASB in December 2012. The aim of the amendments is to provide clarity regarding IAS 1, with the intention of resolving any perceived obstacles that may prevent preparers from exercising their professional judgement when presenting their financial reports. They are effective for yearly periods starting on or after 1 January 2016, with earlier implementation being allowed.

The following changes are made by the Disclosure Initiative (Amendments to IAS 1) : (IFRS in focus, December 2014)

- **Materiality**

The modifications make it clear that:

(1) By aggregating or disaggregating or by providing immaterial information, Information ought not to be obscured.

(2) Materiality is applicable to the entire set of financial statements, encompassing both the fundamental statements and the footnotes and that disclosures are necessary only if the information is deemed material (materiality is applicable to recognition and measurement in the key financial statements in addition to the incorporation of disclosures in the footnotes)

(3) Materiality is also applicable, if a standard has particular disclosure requirements, even if that standard requires those disclosures "as a minimum".

- **Statement of financial position and statement of profit or loss and other comprehensive income**

The modifications:

(1) Provide a clarification that permits the aggregation and disaggregation of the line items to be presented in these statements as necessary for comprehending the financial performance or position.

(2) Provide further guidance regarding subtotals in these statements:

a) Presenting and labeling subtotals in a manner that facilitates understanding is essential.

b) The only line items in subtotals should be composed of amounts recognized and measured in conformity with IFRS.

c) Subtotals ought to maintain consistency across consecutive periods.

d) Subtotals ought not to be prioritized over the subtotals mandated by IFRS.

(3) Make it clear that, the portion of OCI attributable to an entity`s equity-accounted associates and joint ventures shall be presented in aggregate as single line items depending on whether it would be reclassified to profit or loss in future.

- **Notes**

The modifications introduce further examples of potential notes` ordering methods to clarify the importance of comprehensibility and comparability in selecting the order of the notes. Additionally, it illustrates that the notes are not required to be presented in the order currently listed in paragraph 114 of IAS 1.

Additionally, The IASB eliminated examples and guidelines for identifying significant accounting policies that were deemed potentially unhelpful.

4.2.2 Materiality Project:

In March 2014, Materiality project was formally introduced to the agenda of the IASB. As one of the Core problems of Disclosure was how to apply the concept of materiality. (Deloitte, IASB meetings, 2014)

Refining the materiality definition and clarifying its attributes was the aim of this project.

The following will be the project`s main focus: (Deloitte, Materiality Projects)

- The lack of comprehension of materiality notion.
- The Application materiality notion, specifically with regard to disclosures in the financial statements` footnotes, lacks clarity.
- How the requirements of disclosure are written, i.e. the utilization of ambiguous language to delineate disclosure aims and other guidance on disclosure in IFRS.
- Consider whether further guidance that supports organizations in determining material accounting policies, could be developed.

On October 28, 2015, an ED practice statement on materiality titled "Application of Materiality to Financial Statements" was published.

Eventually, it became apparent, nevertheless, that some of the suggested guidelines required to be authoritative to achieve the desired impact, consequently, the project was divided into 2 parts: one focused on publishing a PS, while the other aimed at making amendments to IAS 1 and IAS 8. (Deloitte, IASB News, 2017)

The ED Definition of Material (Proposed amendments to IAS 1 and IAS 8) and the final PS were both issued on September 14, 2017.

4.2.2.1 Final PS, IFRS PS 2: Making Materiality Judgements:

The objective of the final PS:

1- Offers firms guidance on how to exercise materiality judgements in preparing financial statements for general purposes in conformity with IFRS Standards.

2- These guidelines could also assist other parties participating in financial reporting to comprehend how a firm exercises materiality judgement in financial statements preparation.

3- As opposed to utilizing the requirements of IFRS as a checklist, the Board seeks to encourage a behavioral change in the manner firms construct financial statements, promoting larger use of judgement. (IFRS Practice Statement, 2017)

The PS is a non-obligatory document. Firms are not obligated to adhere to it in order to demonstrate conformity with IFRS Standards, as it does not modify or add any new requirements in IFRS. It is permissible for companies to apply the guidelines outlined in the PS when preparing financial statements subsequent to 14 September 2017.

A decision was made by the Board to emphasize that the notion of materiality is prevalent throughout IFRS Standards by issuing guidelines as a separate non-mandatory document, as opposed to non-mandatory implementation guidance supporting a particular Standard. (IFRS Practice Statement, 2017)

The Practice Statement: (IFRS Practice Statement, 2017)

A- Provides an overview of the general attributes of materiality:

- Pervasiveness of materiality judgements:

According to the PS, the necessity for materiality judgements is prevalent in financial statements preparation and impacts recognition, measurement, presentation, and disclosure. Therefore, an organization only has to apply requirements of recognition and measurement if the impact is material and require not to disclose information as specified by an IFRS if the information arising is not material.

- Judgement:

Consideration is given to both the primary users` information needs of the financial statements and the entity`s particular circumstances when determining whether information is material. At each reporting date, Materiality judgements are reassessed.

- Primary users and their information needs:
  - As indicated by the Conceptual Framework, the entity`s primary users to take into account when making materiality judgements are current and prospective investors, lenders, and other creditors.
  - Financial statements cannot give primary users all the information they require. So, the organization should attempt to address primary users` common information needs when preparing its financial statements.
- publicly accessible information influence:

Financial statements must be comprehensive documents, and a firm must determine if information is material to its financial statements, regardless of the possibility that part of the information may be also accessible from other sources.

- **B- Presents a four-step process companies may follow in making materiality judgements when preparing their financial statements.**
- **C- Discusses the interaction between the materiality judgements a company is required to make and local laws and regulations.**

An organization has the option to provide extra information to fulfill its legal or regulatory requirements, regardless of whether that information is material according to IFRS requirements. Nevertheless, it is crucial that such information does not obscure material information as per the IFRS Standards.

- **D- Provides guidance on how to make materiality judgements in specific circumstances:** (IFRS in focus, 2017)

- Prior period information

An organization must provide previous period information to the degree that it is pertinent for comprehending the financial statements for the current period. An organization is required to expand or summarize disclosures from previous periods to meet the current year's needs, regardless of how much information was incorporated in the previous period financial statements.

- Errors

- An error that is material individually cannot be passed over for correction due to the offsetting effects of other errors.
- When determining if errors that have accumulated over time have become material to the current period, an organization must take into account if any additional

errors have accumulated during the current period, or whether changes in the organization`s circumstances would give rise to a different materiality assessment for the current period.

- Covenants

In determining the materiality of information regarding a covenant`s existence and terms, or a covenant breach, an organization shall take into account both:

a) The ramifications of a covenant breach, specifically the effects it would have on the financial performance, position, and cash flows of the company.

- If the ramifications were material, then information regarding the covenant would presumably be material as well.
- On the contrary, if the ramifications are not material, then disclosures regarding the covenant may not be required.

b) The probability of a covenant breach. The likelihood that information regarding the covenant would be material increases with the likelihood of a breach.

- Interim reporting considerations:

- An organization must apply an identical materiality process for preparing both the yearly and the interim financial statements. Nevertheless, it is important for an organization to consider that the time period and the objective of an interim financial report are distinct from those of an annual report when considering what is material for the purposes of the interim financial statements.
- Unless something new transpired during the interim period or an update is required, material information that is pertinent to the interim period but was previously disclosed in the most recent annual financial statements

is not required to be reiterated in the interim financial report.

4.2.2.2 Definition of Material (Amendments to IAS 1 and IAS 8):

The IASB published modifications to its definition of material in October 2018, thus making it easier for firms to exercise materiality judgements.

The updated definition amends IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

These modifications assist in enhancing consistency in the application of the notion of 'material' whenever it is employed in IFRS Standards by clarifying and aligning its definition and providing guidelines (IFRS, October 2018)

The amendments comprise the following: (EY, IFRS Developments, 2018)

(a) New threshold:

In the definition of material, IASB substituted the threshold 'could influence' with 'could reasonably be expected to influence'.

Because the "could influence" threshold is too low and may be implemented too widely, with the result that information that is not able to impact the primary users` decisions must be incorporated in the financial statements.

(b) Obscuring information:

By incorporating the notion of 'obscuring information' in the new definition of material along with the notions of 'omitting' and 'misstating' information

Obscurement of material information may occur when:

- Information regarding a material item, transaction or other event is scattered throughout the financial statements, or **disclosed** employing a language that is vague or unclear.

- Material information can also be obscured if **dissimilar items**, transactions, or other events are improperly **aggregated**, or conversely, if **similar** items are improperly **disaggregated**.
- Furthermore, the comprehensibility of financial statements is diminished if **material information** is hidden because of **immaterial information**.

(c) Primary users of financial statements:

Stating clearly that the users to whom the definition points out are the primary users of financial statements for general purposes as defined in the conceptual framework.

(d) Other modifications:

To conform to the revised definition of material in IAS 1 and IAS 8, the IASB has modified the Conceptual Framework`s definition of material. Additionally, the PS has been amended by the board to conform to the updated definition of material. The modifications are implemented prospectively for yearly periods starting on or after January 1, 2020, with earlier application allowed.

4.2.3 Amendment to IAS 7 Project:

The IASB issued amendments to IAS 7: statement of cash flows on January 29, 2016. The goal of these amendments is to require companies to give disclosures that allow financial statements` users to assess changes in liabilities resulting from financing activities. (IFRS in focus, 2016)

Disclosure of the subsequent changes in liabilities resulting from financing activities is required by the IASB to the extent required to accomplish this aim: (IFRS, January 2016)

1. Financing cash flows changes
2. Changes resulting from getting or losing control of subsidiaries or other businesses.
3. The impact of changes in foreign exchange rates.
4. Fair values changes

5. Other changes.

According to the IASB, liabilities resulting from financing activities are defined as liabilities "for which cash flows were, or future cash flows will be, classified in the cash flows statement as cash flows from financing activities". Furthermore, it emphasizes that the novel requirements for disclosure also pertain to alterations in financial assets provided that they satisfy the same definition.

The amendments stipulate that reconciliation between the opening and closing balances for liabilities resulting from financing activities in the financial position statement is one method to satisfy the novel disclosure requirement.

Ultimately, the modifications stipulate that alterations in liabilities resulting from financing activities ought to be disclosed separately from alterations in other liabilities and assets.

The Disclosure Initiative (Amendments to IAS 7) becomes mandatory for yearly periods starting on or after 1 January 2017. (IFRS, January 2016)

4.2.4 Disclosure Initiative – Principles of Disclosure:

Principles of Disclosure Project is one of the two research projects that are included in the disclosure initiative. (Deloitte, IASB News, 2017)

Developing new disclosure principles in IFRS Standards or clarifying existing ones in order to address identified disclosure problems is the primary objective of this project and to: (IASB, Discussion paper, 2017)

(a) Assist organizations in applying superior **materiality** judgement and communicating information in a more effective way.

(b) Enhance the efficacy of disclosures for the financial statements` primary users.

(c) Help the Board in enhancing the Standards` disclosure requirements.

The IASB published a discussion paper (DP) in March 2017 outlining potential approaches for addressing disclosure problems, such as insufficient relevant information, excessive irrelevant information and ineffective communication of the provided information. (IASB, Discussion paper, 2017)

The Input received for the DP indicated that the most effective approach to addressing the disclosure problem is to enhance the development and drafting of disclosure requirements in IFRS. As a result, the Board made the decision to give priority to its Targeted Standards-level Review of Disclosures project. (IFRS, Project Summary, March 2019)
The Board additionally discussed other research results pertaining to:

- Accounting policy disclosures (In an effort to assist organizations in applying **materiality judgements** to accounting policy disclosure, the Board opted to introduce to its agenda a project involving the development of guidance and examples.
- Technology`s implications for financial reporting.
- The primary financial statements project`s usage of performance metrics in financial statements.

According to the Board decision, the remaining topics in the DP will not be pursed at this time. So, the Principles of Disclosure research project comes to an end with this Project Summary. (IFRS, Project Summary, March 2019)

IASB released in March 2019 a project summary titled "Disclosure Initiative -Principles of Disclosure". This summary provides an overview of the research project on principles of disclosure, including the work conducted and the conclusions drawn. (IFRS, Project Summary, March 2019).

4.2.5 Disclosure Initiative – Accounting Policies:

As part of the IASB's comprehensive disclosure initiative, this project aims to assist stakeholders in enhancing accounting policy disclosures for the financial statements` primary users. (IFRS, ED, 2019)

The accounting policies project was added to the Board's agenda on July 18, 2018. Its purpose is to assist entities in applying materiality judgments to accounting policy disclosure through the development of guidance and examples.

In response to comments on **Disclosure Initiative—Principles of Disclosure** DP, that recommended the need for guidance to aid organizations in determining which accounting policies to disclose, the Board introduced this project.

It was made clear that the **application of materiality** is crucial in determining which accounting policies to disclose.

But instead of mentioning materiality, IAS 1 Presentation of Financial Statements says that "[a]n entity shall disclose its significant accounting policies" without giving the term "significant" any specific definition from the Board. (Deloitte, IASB News, 2021)

Consequently, the Board made the decision to amend IAS 1 by requiring organizations to disclose their **material** accounting policies instead of their **significant** accounting policies. In order to endorse this amendment, the Board has additionally formulated guidelines and examples to elucidate and illustrate how the "four-step materiality process" outlined in IFRS PS2 Making Materiality Judgements might be applied to disclosures made in accounting policies. (Deloitte, IASB News, 2021)

ED Disclosure of Accounting Policies (Proposed amendments to IAS 1 and IFRS PS 2) was issued in July 2019.

The proposed amendments are based on the Definition of Material, which was issued in October 2018 and introduce modifications to IAS 1 and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.(IFRS, ED, 2019) The IASB published Disclosure of Accounting Policies (Proposed amendments to IAS 1 and IFRS PS 2) in February 2021.

Disclosure of Accounting Policies (Amendments to IAS 1 and IFRS PS2) makes the subsequent modifications to IAS 1: (IFRS in Focus, February 2021)

1- An organization is currently required to disclose its **material** accounting policy information rather than its **significant** accounting policies.
2- A number of paragraphs are appended to elucidate how an organization can determine **material** accounting policy information as well as to provide examples of when accounting policy information is probably to be **material**.
3- The modifications elucidate that accounting policy information might be considered **material** due to its nature, even though the associated amounts are immaterial.
4- The modifications provide clarification that accounting policy information is considered **material** if it is necessary for users of an organization's financial statements to comprehend other material information in those financial statements.
5- The modifications elucidate that if an organization discloses **immaterial** accounting policy information, it shall not obscure **material** accounting policy information.

Furthermore, IFRS PS 2 has been modified by introducing guidelines and examples to clarify and illustrate how the 'four-step materiality process' is applied to accounting policy information to bolster the amendments to IAS 1. (IFRS in Focus, February 2021)

The modifications take effect for yearly periods starting on or after 1 January 2023.

2.4.3.6 Disclosure Initiative – Targeted Standards-level Review of Disclosures:

This Research project is part of the IASB's comprehensive disclosure initiative, which was introduced by the board in response to comments received on the **Disclosure Initiative—Principles of Disclosure** DP. (Deloitte, IASB News, March 2021)

Using a four-step approach, the Board chose to pursue a project: (IFRS in focus, March 2021)

- **Step 1:** Develop draft guidelines for the Board to utilize when developing and drafting disclosure sections.
- **Step 2:** Select two standards on which to apply the draft guidelines.
- **Step 3:** Test the draft guidelines by applying them to those standards.
- **Step 4:** Prepare an ED of modifications to those standards.

The IASB released in March 2021 an ED titled "**Disclosure Requirements in IFRS Standards—a Pilot Approach".** The ED proposes a novel approach for developing and drafting requirements for disclosure in future IFRS Standards. Additionally, it introduced novel requirements for disclosure for IFRS 13 Fair Value Measurement and IAS 19 Employee Benefits. (IFRs, News, 2021)

The novel approach is formulated as draft guidelines for the Board`s employment in developing requirements for disclosure in individual Standards. The Board`s objectives in implementing this guidance is to: (IFRS, Exposure draft, March 2021)

- Improve investor engagement to guarantee the Board fully comprehends the information needs of investors and effectively elucidate those needs in the Standards.

- Give the purpose of disclosure requirements greater prominence, requiring firms to **exercise materiality judgement** and furnish information to satisfy the described needs of investor.
- Minimize requirements to disclose specific items of information, and instead to assist entities to concentrate on disclosing only **material information**.

The Board is looking for feedback from stakeholder regarding whether the proposed novel approach to formulating requirements for disclosure as well as proposed modifications to IFRS 13 and IAS 19 would assist entities and others enhance the usefulness of information disclosed. (IFRs, News, 2021)

During its meeting on October 2022, the IASB made the decision to halt any additional efforts on the disclosure requirements outlined in IFRS 13 and IAS 19. The issuance of the Project Summary by the IASB is scheduled for March 2023.

IASB concluded its project on Disclosure Initiative—Targeted Standards-level Review of Disclosures in March 2023 and released Guidance for the development and drafting of requirements for disclosure in IFRS Accounting Standards.

The purpose of this Guidance is to assist the IASB in formulating IFRS Accounting Standards that facilitate companies in making better judgements regarding the **materiality** of information and its disclosure, hence enhancing the usefulness of information provided to investors. The Guidance outlines a methodology that entails:

1) Initiating early engagements with users to comprehend their information requirements.
2) Establishing requirements for disclosure concurrently with requirements for recognition and measurement.
3) Take into account the digital reporting ramifications of novel requirements for disclosure.

4) Employing broad and particular disclosure aims for describing and explaining information requirements of users.
5) Promoting particular disclosure aims by mandating organizations to disclose items of information that in the majority of instances, would fulfill these aims.

The IASB plans to utilize these Guidelines while establishing and drafting requirements for disclosure in IFRS Accounting Standards.

The IASB has chosen to discontinue any additional efforts on the disclosure requirements outlined in IFRS 13, Fair Value Measurement, and IAS 19, Employee Benefits.

5. Conclusions and Future Research:

5.1 Conclusions:

Regulatory bodies and accounting bodies, including the FASB, AAA, AICPA, SEC and IASB, have been exerting efforts to incorporate the notion of materiality into their standards and regulations. This practice aids in ensuring that financial statements only contain information that is material for users to comprehend the financial position, performance, and cash flows of the organization.

In order to tackle the difficulties and ramifications of materiality, accounting and regulatory bodies are engaged in various initiatives and projects. Theses encompass the establishing frameworks and guidelines for the application of materiality in various contexts, Encouraging the harmonization of materiality standards and practices across various jurisdictions and sectors, such as the IASB and the FASB`s alignment regarding the definition and disclosure of materiality, the Issuance of IFRS PS 2 “Making Materiality Judgements”, offer guidelines and illustrative examples for making materiality judgements in various contexts and scenarios. As well as modifying the definition of material in IAS 1

Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

Moreover, in collaboration with the International Sustainability Standards Board (ISSB), establishing a framework for implementing materiality to sustainability reporting, to facilitate the integration of financial and non-financial information.

In general, accounting and regulatory bodies are currently taking the materiality notion into account when setting standards, regulations, and guidelines to guarantee that financial information is relevant, reliable, and valuable for the purpose of making decisions.

5.2 Future Research:

In relation to this topic, the researcher proposes the subsequent areas for future research:

1- Conduct additional research on exploring the relationship between materiality and FRQ across distinct countries, cultures, and institutional settings, as well as how they influence the decision-making of diverse stakeholders.

2- Conduct additional research on to analyze the impact of varying definitions, approaches, and thresholds of materiality on the quality of audit and assurance standards.

3- Conduct additional research on Investigating the opportunities and difficulties associated with the application of materiality to non-financial information including integrated reporting, sustainability reporting, corporate social responsibility.

4- Perform further research on the development of novel methods for measuring and disclosing materiality judgments and estimates, including sensitivity analysis, key audit matters, and materiality matrices, and how they improve the transparency and reliability of financial reporting.

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