HKFRS Practice Statement 2
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Hong Kong Financial Reporting Standards Practice Statement 2

Making Materiality Judgements

Hong Kong Institute of
Certified Public Accountants
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HKFRS Practice Statement 2 *Making Materiality Judgements* (Practice Statement) is set out in paragraphs 1–89 and the Appendix. This Practice Statement should be read in the context of its objective and Basis for Conclusions, as well as in the context of the *Preface to HKFRS Standards*, the *Conceptual Framework for Financial Reporting* and HKFRS Standards.

Introduction

IN1 The objective of general purpose financial statements is to provide financial information about a reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. The entity identifies the information necessary to meet that objective by making appropriate materiality judgements.

IN2 The aim of this HKFRS Practice Statement 2 *Making Materiality Judgements* (Practice Statement) is to provide reporting entities with guidance on making materiality judgements when preparing general purpose financial statements in accordance with HKFRS Standards. While some of the guidance in this Practice Statement may be useful to entities applying *HKFRS for Private Entities*, the Practice Statement is not intended for those entities.

IN3 The need for materiality judgements is pervasive in the preparation of financial statements. An entity makes materiality judgements when making decisions about recognition and measurement as well as presentation and disclosure. Requirements in HKFRS Standards only need to be applied if their effect is material to the complete set of financial statements.

IN4 This Practice Statement:

(a) provides an overview of the general characteristics of materiality.

(b) presents a four-step process an entity may follow in making materiality judgements when preparing its financial statements (materiality process). The description of the materiality process provides an overview of the role materiality plays in the preparation of financial statements, with a focus on the factors the entity should consider when making materiality judgements.

(c) provides guidance on how to make materiality judgements in specific circumstances, namely, how to make materiality judgements about prior-period information, errors and covenants, and in the context of interim reporting.

IN5 Whether information is material is a matter of judgement and depends on the facts involved and the circumstances of a specific entity. This Practice Statement illustrates the types of factors that the entity should consider when judging whether information is material.

IN6 A Practice Statement is non-mandatory guidance developed by the Hong Kong Institute of Certified Public Accountants (HKICPA). It is not a Standard. Therefore, its application is not required to state compliance with HKFRS Standards.

IN7 This Practice Statement includes examples illustrating how an entity might apply some of the guidance in the Practice Statement based on the limited facts presented. The analysis in each example is not intended to represent the only manner in which the guidance could be applied.

HKFRS Practice Statement 2
Making Materiality Judgements

Objective

1 This HKFRS Practice Statement 2 *Making Materiality Judgements* (Practice Statement) provides reporting entities with non-mandatory guidance on making materiality judgements when preparing general purpose financial statements in accordance with HKFRS Standards.

2 The guidance may also help other parties involved in financial reporting to understand how an entity makes materiality judgements when preparing such financial statements.

Scope

3 The Practice Statement is applicable when preparing financial statements in accordance with HKFRS Standards. It is not intended for entities applying *HKFRS for Private Entities*.

4 The Practice Statement provides non-mandatory guidance; therefore, its application is not required to state compliance with HKFRS Standards.

General characteristics of materiality

Definition of material

5 The *Conceptual Framework for Financial Reporting* (*Conceptual Framework*) provides the following definition of material information (paragraph 7 of HKAS 1 *Presentation of Financial Statements* provides a similar definition[1]):

> Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports, which provide financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report.[2]

6 When making materiality judgements, an entity needs to take into account how information could reasonably be expected to influence the primary users of its financial statements—its primary users—when they make decisions[3] on the basis of those statements (see paragraphs 13–23).[4]

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

1 See paragraph 7 of HKAS 1 *Presentation of Financial Statements*.
2 Paragraph 2.11 of the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*).
3 Throughout this Practice Statement, the term 'decisions' refers to decisions about providing resources to the entity, unless specifically indicated otherwise.
4 See paragraph 7 of HKAS 1.
5 See paragraph 1.2 of the *Conceptual Framework*.

Materiality judgements are pervasive

8 The need for materiality judgements is pervasive in the preparation of financial statements. An entity makes materiality judgements when making decisions about recognition, measurement, presentation and disclosure. Requirements in HKFRS Standards only need to be applied if their effect is material to the complete set of financial statements,[6] which includes the primary financial statements[7] and the notes. However, it is inappropriate for the entity to make, or leave uncorrected, immaterial departures from HKFRS Standards to achieve a particular presentation of its financial position, financial performance or cash flows.[8]

Recognition and measurement

9 HKFRS Standards set out reporting requirements that the Hong Kong Institute of Certified Public Accountants (HKICPA) has concluded will lead to financial statements that provide information about the financial position, financial performance and cash flows of an entity that is useful to the primary users of those statements. The entity is only required to apply recognition and measurement requirements when the effect of applying them is material.

Example A—materiality judgements on the application of accounting policies

Background

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

Application

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

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

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

Presentation and disclosure

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

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

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

[8] See paragraph 8 of HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

[9] See paragraphs 17(c) and 31 of HKAS 1.

Example B—materiality judgements on disclosures specified by HKFRS Standards
Background An entity presents property, plant and equipment (PP&E) as a separate line item in its statement of financial position. **Application** HKAS 16 *Property, Plant and Equipment* sets out specific disclosure requirements for PP&E, including the disclosure of the amount of contractual commitments for the acquisition of PP&E (paragraph 74(c) of HKAS 16). When preparing its financial statements, the entity assesses whether disclosures specified in HKAS 16 are material information. Even if PP&E is presented as a separate line item in the statement of financial position, not all disclosures specified in HKAS 16 will automatically be required. In the absence of any qualitative considerations (see paragraphs 46–51), if the amount of contractual commitments for the acquisition of PP&E is not material, the entity is not required to disclose this information.

Example C—materiality judgements that lead to the disclosure of information in addition to the specific disclosure requirements in HKFRS Standards
Background An entity has its main operations in a country that, as part of an international agreement, is committed to introducing regulations to reduce the use of carbon-based energy. The regulations had not yet been enacted in the national legislation of that country at the end of the reporting period. The entity owns a coal-fired power station in that country. During the reporting period, the entity recorded an impairment loss on its coal-fired power station, reducing the carrying amount of the power station to its recoverable amount. No goodwill or intangible assets with an indefinite useful life were included in the cash-generating unit. **Application** Paragraph 132 of HKAS 36 *Impairment of Assets* does not require an entity to disclose the assumptions used to determine the recoverable amount of a tangible asset, unless goodwill or intangible assets with an indefinite useful life are included in the carrying amount of the cash-generating unit. Nevertheless, the entity has concluded that the assumptions about the likelihood of national enactment of regulations to reduce the use of carbon-based energy, as well as about the enactment plan, it considered in measuring the recoverable amount of its coal-fired power station could reasonably be expected to influence decisions primary users make on the basis of the entity's financial statements. Hence, information about those assumptions is necessary for primary users to understand the impact of the impairment on the entity's financial position, financial performance and cash flows. Therefore, even though not specifically required by HKAS 36, the entity concludes that its assumptions about the likelihood of national enactment of regulations to reduce the use of carbon-based energy, as well as about the enactment plan, constitute material information and discloses those assumptions in its financial statements.

Judgement

11 When assessing whether information is material to the financial statements, an entity applies judgement to decide whether the information could reasonably be expected to influence decisions that primary users make on the basis of those financial statements. When applying such judgement, the entity considers both its specific circumstances and how the information provided in the financial statements responds to the information needs of primary users.

12 Because an entity's circumstances change over time, materiality judgements are reassessed at each reporting date in the light of those changed circumstances.

Primary users and their information needs

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

14 Because primary users include potential investors, lenders and other creditors, it would be inappropriate for an entity to narrow the information provided in its financial statements by focusing only on the information needs of existing investors, lenders and other creditors.

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

Background

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

Application

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

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

Decisions made by primary users

16 An entity needs to consider what type of decisions its primary users make on the basis of the financial statements and, consequently, what information they need to make those decisions.

17 The primary users of an entity's financial statements make decisions about providing resources to the entity. Those decisions involve: buying, selling or holding equity and debt instruments, providing or settling loans and other forms of credit, and exercising rights while holding investments (such as the right to vote on or otherwise influence management's actions that affect the use of the entity's economic resources).[13] Such decisions depend on the returns that primary users expect from an investment in those instruments.

10 See paragraph 1.5 of the *Conceptual Framework*.
11 See paragraphs 1.9 and 1.10 of the *Conceptual Framework*.
12 See paragraph 2.36 of the *Conceptual Framework*.
13 See paragraph 1.2 of the *Conceptual Framework*.

18 The expectations existing and potential investors, lenders and other creditors have about returns, in turn, depend on their assessment of the amount, timing and uncertainty of the future net cash inflows to an entity,[14] together with their assessment of management's stewardship of the entity's resources.

19 Consequently, an entity's primary users need information about:

(a) the resources of the entity (assets), claims against the entity (liabilities and equity) and changes in those resources and claims (income and expenses); and

(b) how efficiently and effectively the entity's management and governing board have discharged their responsibility to use the entity's resources.[15]

20 Financial information can make a difference in decisions if it has predictive value, confirmatory value or both.[16] When making materiality judgements, an entity needs to assess whether information could reasonably be expected to influence primary users' decisions, rather than assessing whether that information alone could reasonably be expected to change their decisions.

Meeting primary users' information needs

21 The objective of financial statements is to provide primary users with financial information that is useful to them in making decisions about providing resources to an entity. However, general purpose financial statements do not, and cannot, provide all the information that primary users need.[17] Therefore, the entity aims to meet the common information needs of its primary users. It does not aim to address specialised information needs—information needs that are unique to particular users.

Example E—primary users' unique or individual information requests

Background

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

Application

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

22 To meet the common information needs of its primary users, an entity first separately identifies the information needs that are shared by users within one of the three categories of primary users defined in the *Conceptual Framework*—for example investors (existing and potential)—then repeats the assessment for the two remaining categories—namely lenders (existing and potential) and other creditors (existing and potential). The total of the information needs identified is the set of common information needs the entity aims to meet.

[14] See paragraph 1.3 of the *Conceptual Framework*.
[15] See paragraph 1.4 of the *Conceptual Framework*.
[16] See paragraph 2.7 of the *Conceptual Framework*.
[17] See paragraph 1.6 of the *Conceptual Framework*.

23 In other words, the assessment of common information needs does not require identifying information needs shared across all existing and potential investors, lenders and other creditors. Some of the identified information needs will be common to all three categories, but others may be specific to only one or two of those categories. If an entity were to focus only on those information needs that are common to all categories of primary users, it might exclude information that meets the needs of only one category.

Impact of publicly available information

24 The primary users of financial statements generally consider information from sources other than just the financial statements. For example, they might also consider other sections of the annual report, information about the industry an entity operates in, its competitors and the state of the economy, the entity's press releases as well as other documents the entity has published.

25 However, the financial statements are required to be a comprehensive document that provides information about the financial position, financial performance and cash flows of an entity that is useful to primary users in making decisions about providing resources to the entity. Consequently, the entity assesses whether information is material to the financial statements, regardless of whether such information is also publicly available from another source.

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

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

Background

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

Application

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

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

Interaction with local laws and regulations

27 An entity's financial statements must comply with the requirements in HKFRS Standards, including requirements related to materiality (materiality requirements), for the entity to state its compliance with those Standards. Hence, an entity that wishes to state compliance with HKFRS Standards cannot provide less information than the information required by the Standards, even if local laws and regulations permit otherwise.

28 Nevertheless, local laws and regulations may specify requirements that affect what information is provided in the financial statements. In such circumstances, providing information to meet local legal or regulatory requirements is permitted by HKFRS Standards, even if that information is not material according to the materiality requirements in the Standards. However, such information must not obscure information that is material according to HKFRS Standards.[18]

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

Background

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

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

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

Application

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

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

Background

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

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

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

Application

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

[18] See paragraph 30A of HKAS 1 and paragraph BC30F of the Basis for Conclusions on HKAS 1.

Making materiality judgements

Overview of the materiality process

29 An entity may find it helpful to follow a systematic process in making materiality judgements when preparing its financial statements. The four-step process described in the following paragraphs is an example of such a process. This description provides an overview of the role materiality plays in the preparation of financial statements, with a focus on the factors the entity should consider when making materiality judgements. In this Practice Statement, this four-step process is called the 'materiality process'.

30 The materiality process describes how an entity could assess whether information is material for the purposes of presentation and disclosure, as well as for recognition and measurement. The process illustrates one possible way to make materiality judgements, but it incorporates the materiality requirements an entity must apply to state compliance with HKFRS Standards. The materiality process considers potential omission and potential misstatement of information, as well as unnecessary inclusion of immaterial information and whether immaterial information obscures material information. In all cases, the entity needs to focus on how the information could reasonably be expected to influence decisions of the primary users of its financial statements.

31 Judgement is involved in assessing materiality when preparing financial statements. The materiality process is designed as a practice guide to help an entity apply judgement in an efficient and effective way.

32 The materiality process is not intended to describe the assessment of materiality for local legal and regulatory purposes. An entity refers to its local requirements to assess whether it is compliant with local laws and regulations.

A four-step materiality process

33 The steps identified as a possible approach to the assessment of materiality in the preparation of the financial statements are, in summary:

(a) Step 1—identify. Identify information that has the potential to be material.

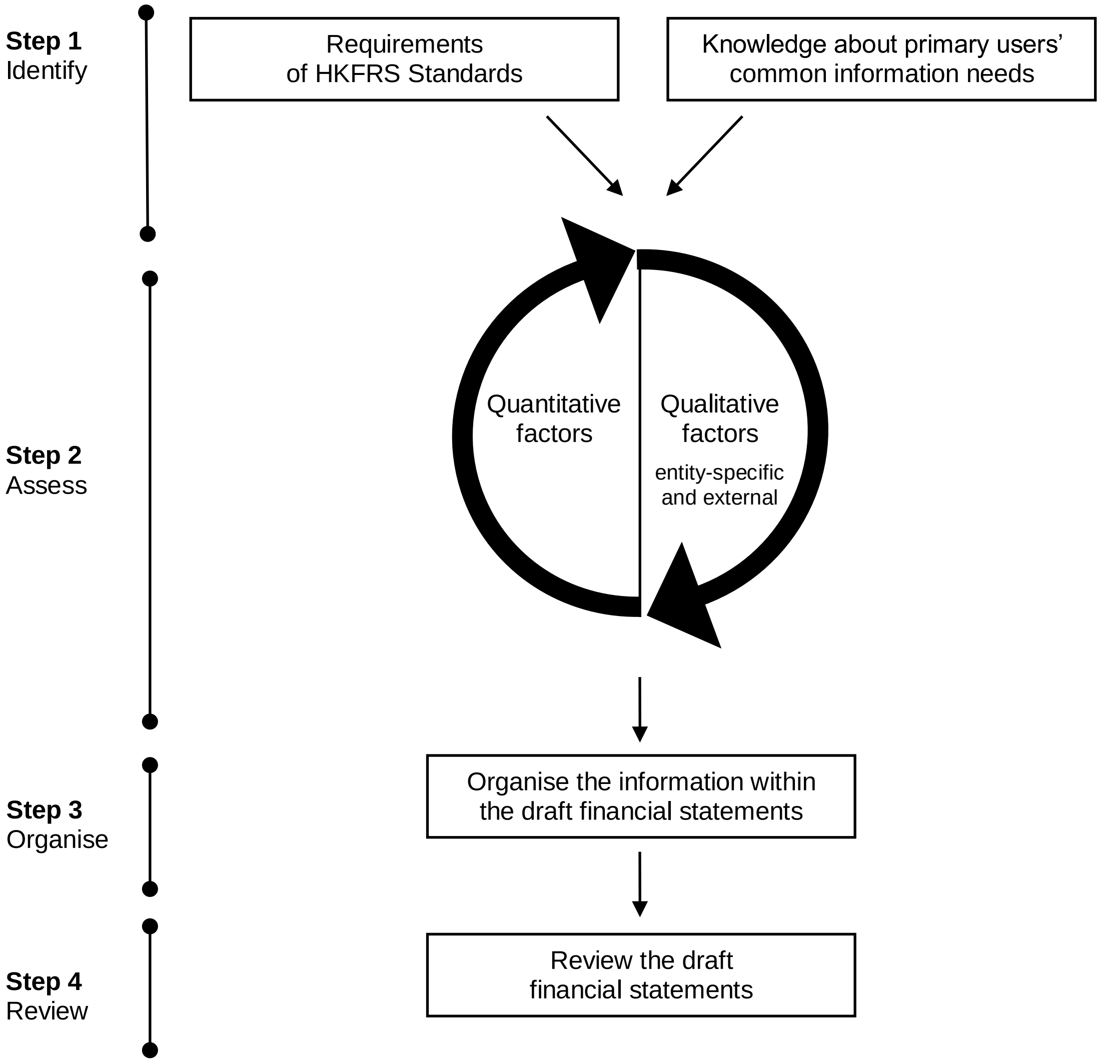
(b) Step 2—assess. Assess whether the information identified in Step 1 is, in fact, material.

(c) Step 3—organise. Organise the information within the draft financial statements in a way that communicates the information clearly and concisely to primary users.

(d) Step 4—review. Review the draft financial statements to determine whether all material information has been identified and materiality considered from a wide perspective and in aggregate, on the basis of the complete set of financial statements.

34 When preparing its financial statements, an entity may rely on materiality assessments from prior periods, provided that it reconsiders them in the light of any change in circumstances and of any new or updated information.

Diagram—the four-step materiality process



Step 1—identify

35 An entity identifies information about its transactions, other events and conditions that primary users might need to understand to make decisions about providing resources to the entity.

36 In identifying this information, an entity considers, as a starting point, the requirements of the HKFRS Standards applicable to its transactions, other events and conditions. This is the starting point because, when developing a Standard, the HKICPA identifies the information it expects will meet the needs of a broad range of primary users for a wide variety of entities in a range of circumstances.[19]

37 When the HKICPA develops a Standard, it also considers the balance between the benefits of providing information and the costs of complying with the requirements in that Standard. However, the cost of applying the requirements in the Standards is not a factor for an entity to consider when making materiality judgements—the entity should not consider the cost of complying with requirements in HKFRS Standards, unless there is explicit permission in the Standards.

[19] See paragraph 1.8 of the *Conceptual Framework*.

38 An entity also considers its primary users' common information needs (as explained in paragraphs 21–23) to identify any information—in addition to that specified in HKFRS Standards—necessary to enable primary users to understand the impact of the entity's transactions, other events and conditions on the entity's financial position, financial performance and cash flows (see paragraph 10). Existing and potential investors, lenders and other creditors need information about the resources of the entity (assets), claims against the entity (liabilities and equity) and changes in those resources and claims (income and expenses), and information that will help them assess how efficiently and effectively the entity's management and governing board have discharged their responsibility to use the entity's resources.[20]

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

Step 2—assess

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

41 An entity might conclude that an item of information is material for various reasons. Those reasons include the item's nature or magnitude, or a combination of both, judged in relation to the particular circumstances of the entity.[21] Therefore, making materiality judgements involves both quantitative and qualitative considerations. It would not be appropriate for the entity to rely on purely numerical guidelines or to apply a uniform quantitative threshold for materiality (see paragraphs 53–55).

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

(a) quantitative; and

(b) qualitative—either entity-specific or external.

43 The output of Step 2 is a preliminary set of material information. For presentation and disclosure, this involves decisions about what information an entity needs to provide in its financial statements, and in how much detail[22] (including identifying appropriate levels of aggregation an entity provides in the financial statements). For recognition and measurement, the output of Step 2 involves the identification of information that, if not recognised or otherwise misstated, could reasonably be expected to influence primary users' decisions.

Quantitative factors

44 An entity ordinarily assesses whether information is quantitatively material by considering the size of the impact of the transaction, other event or condition against measures of the entity's financial position, financial performance and cash flows. The entity makes this assessment by considering not only the size of the impact it recognises in its primary financial statements but also any unrecognised items that could ultimately affect primary users' overall perception of the entity's financial position, financial performance and cash flows (eg contingent liabilities or contingent assets). The entity needs to assess whether the impact is of such a size that information about the transaction, other event or condition could reasonably be expected to influence its primary users' decisions about providing resources to the entity.

45 Identifying the measures against which an entity makes this quantitative assessment is a matter of judgement. That judgement depends on which measures are of great interest to the primary users of the entity's financial statements. Examples include measures of the entity's revenues, the entity's profitability, financial position ratios and cash flow measures.

[20] See paragraph 1.4 of the *Conceptual Framework*.

[21] See paragraph 7 of HKAS 1.

[22] See paragraph 29 of HKAS 1.

Qualitative factors

46 For the purposes of this Practice Statement, qualitative factors are characteristics of an entity's transactions, other events or conditions, or of their context, that, if present, make information more likely to influence the decisions of the primary users of the entity's financial statements. The mere presence of a qualitative factor will not necessarily make the information material, but is likely to increase primary users' interest in that information.

47 In making materiality judgements, an entity considers both entity-specific and external qualitative factors. These factors are described separately in the following paragraphs. However, in practice, the entity may need to consider them together.

48 An entity-specific qualitative factor is a characteristic of the entity's transaction, other event or condition. Examples of such factors include, but are not limited to:

(a) involvement of a related party of the entity;

(b) uncommon, or non-standard, features of a transaction or other event or condition; or

(c) unexpected variation or unexpected changes in trends. In some circumstances, the entity might consider a quantitatively immaterial amount as material because of the unexpected variation compared to the prior-period amount provided in its financial statements.

49 The relevance of information to the primary users of an entity's financial statements can also be affected by the context in which the entity operates. An external qualitative factor is a characteristic of the context in which the entity's transaction, other event or condition occur that, if present, makes information more likely to influence the primary users' decisions. Characteristics of the entity's context that might represent external qualitative factors include, but are not limited to, the entity's geographical location, its industry sector, or the state of the economy or economies in which the entity operates.

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

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

Interaction of qualitative and quantitative factors

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

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

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

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

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

Background

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

Application

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

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

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

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

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

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

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

Background

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

Application

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

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

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

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

Example K—influence of external qualitative factors on materiality judgements

Background

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

Application

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

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

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

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

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

Step 3—organise

56 Classifying, characterising and presenting information clearly and concisely makes it understandable.[23] An entity exercises judgement when deciding how to communicate information clearly and concisely. For example, the entity is more likely to clearly and concisely communicate the material information identified in Step 2 by organising it to:

(a) emphasise material matters;

(b) tailor information to the entity's own circumstances;

(c) describe the entity's transactions, other events and conditions as simply and directly as possible without omitting material information and without unnecessarily increasing the length of the financial statements;

(d) highlight relationships between different pieces of information;

(e) provide information in a format that is appropriate for its type, eg tabular or narrative;

(f) provide information in a way that maximises, to the extent possible, comparability among entities and across reporting periods;

(g) avoid or minimise duplication of information in different parts of the financial statements; and

(h) ensure material information is not obscured by immaterial information.

57 Financial statements are less understandable for primary users if information is organised in an unclear manner. Similarly, financial statements are less understandable if an entity aggregates material items that have different natures or functions, or if material information is obscured,[24] for example, by an excessive amount of immaterial information.

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

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

Step 4—review

60 An entity needs to assess whether information is material both individually and in combination with other information[25] in the context of its financial statements as a whole. Even if information is judged not to be material on its own, it might be material when considered in combination with other information in the complete set of financial statements.

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

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

(a) all relevant relationships between different items of information have been identified. Identifying new relationships between information might lead to that information being identified as material for the first time.

(b) items of information that are individually immaterial, when considered together, could nevertheless reasonably be expected to influence primary users' decisions.

[23] See paragraph 2.34 of the *Conceptual Framework*.
[24] See paragraph 30A of HKAS 1.
[25] See paragraph 7 of HKAS 1.

(c) the information in the financial statements is communicated in an effective and understandable way, and organised to avoid obscuring material information.

(d) the financial statements provide a fair presentation of the entity's financial position, financial performance and cash flows.[26]

63 The review may lead to:

(a) additional information being provided in the financial statements;

(b) greater disaggregation of information that had already been identified as material;

(c) information that had already been identified as immaterial being removed from the financial statements to avoid obscuring material information; or

(d) information being reorganised within the financial statements.

64 The review in Step 4 may also lead an entity to question the assessment performed in Step 2 and decide to re-perform that assessment. As a result of re-performing its assessment in Step 2, the entity might conclude that information previously identified as material is, in fact, immaterial, and remove it from the financial statements.

65 The output of Step 4 is the final financial statements.

Specific topics

Prior-period information

66 An entity makes materiality judgements on the complete set of financial statements, including prior-period[27] information provided in the financial statements.

67 HKFRS Standards require an entity to present information in respect of the preceding period for all amounts reported in the current-period financial statements.[28] Furthermore, the Standards require the entity to provide prior-period information for narrative and descriptive information if it is relevant to understanding the current-period financial statements.[29] Finally, the Standards require the entity to present, as a minimum, two statements of financial position, two statements of profit or loss and other comprehensive income, two statements of profit or loss (if presented separately), two statements of cash flows, two statements of changes in equity, and related notes.[30] These requirements are the minimum comparative information identified by the Standards.[31]

68 Assessing whether prior-period information is material to the current-period financial statements might lead an entity to:

(a) provide more prior-period information than was provided in the prior-period financial statements (see paragraph 70); or

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

[26] See paragraph 15 of HKAS 1.

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

[28] Except when HKFRS Standards permit or require otherwise. See paragraph 38 of HKAS 1.

[29] See paragraph 38 of HKAS 1.

[30] See paragraph 38A of HKAS 1.

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

69 An entity also needs to consider any local laws or regulations, in respect of the prior-period information to be provided in financial statements, when making decisions on what prior-period information to provide in the current-period financial statements. Those local laws or regulations might require the entity to provide in the financial statements prior-period information in addition to the minimum comparative information required by the Standards. The Standards permit the inclusion of such additional information, but require that it is prepared in accordance with the Standards[32] and does not obscure material information.[33] However, an entity that wishes to state compliance with HKFRS Standards cannot provide less information than required by the Standards, even if local laws and regulations permit otherwise.

Prior-period information not previously provided

70 An entity must provide prior-period information needed to understand the current-period financial statements,[34] regardless of whether that information was provided in the prior-period financial statements—this requirement is not conditional on whether the prior-period information was provided in the prior-period financial statements. Consequently, the inclusion of prior-period information not previously included would be required if this is necessary for the primary users to understand the current-period financial statements.

Example L—prior-period information not previously provided

Background

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

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

Application

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

Summarising prior-period information

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

32 See paragraph 38C of HKAS 1.
33 See paragraph 30A of HKAS 1 and paragraph BC30F of the Basis for Conclusions on HKAS 1.
34 See paragraph 38 of HKAS 1.

Example M—summarising prior-period information

Background

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

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

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

Application

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

Errors

72 Errors are omissions from and/or misstatements in an entity's financial statements arising from a failure to use, or misuse of, reliable information that is available, or could reasonably be expected to be obtained.[35] Material errors are errors that individually or collectively could reasonably be expected to influence decisions that primary users make on the basis of those financial statements. Errors may affect narrative descriptions disclosed in the notes as well as amounts reported in the primary financial statements or in the notes.

73 An entity must correct all material errors, as well as any immaterial errors made intentionally to achieve a particular presentation of its financial position, financial performance or cash flows, to ensure compliance with HKFRS Standards.[36] The entity should refer to HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for guidance on how to correct an error.

74 Immaterial errors, if not made intentionally to achieve a particular presentation, do not need to be corrected to ensure compliance with HKFRS Standards. However, correcting all errors (including those that are not material) in the preparation of the financial statements lowers the risk that immaterial errors will accumulate over reporting periods and become material.

75 An entity assesses whether an error is material by applying the same considerations as outlined in the description of the materiality process. Making materiality judgements about errors involves both quantitative and qualitative considerations. The entity identifies information that, if misstated or omitted, could reasonably be expected to influence primary users' decisions (as described in Step 1 and Step 2 of the materiality process). The entity also considers whether any identified errors are material on a collective basis (as described in Step 4 of the materiality process).

[35] See paragraph 5 of HKAS 8 (derived from the definition of prior-period errors).
[36] See paragraph 41 of HKAS 8.

76 If an error is judged not to be material on its own, it might be regarded as material when considered in combination with other information. However, in general, if an error is individually assessed as material to an entity's financial statements, the existence of other errors that affect the entity's financial position, financial performance or cash flows in the opposite way, does not make the error immaterial, nor does it eliminate the need to correct the error.

Example N—individual and collective assessment of errors

Background

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

(a) an expense accrual of CU100[a] that should not have been recognised. The accrual affected the line item 'cost of services'.

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

Application

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

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

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

Cumulative errors

77 An entity may, over a number of reporting periods, accumulate errors that were immaterial, both in individual prior periods and cumulatively over all prior periods. Uncorrected errors that have accumulated over more than one period are sometimes called 'cumulative errors'.

78 Materiality judgements about cumulative errors in prior-period financial statements that an entity made at the time those statements were authorised for issue need not be revisited in subsequent periods unless the entity failed to use, or misused, information that:

(a) was available when financial statements for those periods were authorised for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation of those financial statements.[37]

79 To assess whether a cumulative error has become material to the current-period financial statements, an entity considers whether, in the current period:

(a) the entity's circumstances have changed, leading to a different materiality assessment for the current period; or

(b) further accumulation of a current-period error onto the cumulative error has occurred.

37 See paragraph 5 of HKAS 8.

80 An entity must correct cumulative errors if they have become material to the current-period financial statements.

Example O—current-period assessment of cumulative errors

Background

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

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

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

Application

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

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

Information about covenants

81 An entity assesses the materiality of information about the existence and terms of a loan agreement clause (covenant), or of a covenant breach, to decide whether to provide information related to the covenant in the financial statements. This assessment is made in the same way as for other information, that is, by considering whether that information could reasonably be expected to influence decisions that its primary users make on the basis of the entity's financial statements (see 'A four-step materiality process', from paragraph 33).

82 In particular, when a covenant exists, an entity considers both:

(a) the consequences of a breach occurring, that is, the impact a covenant breach would have on the entity's financial position, financial performance and cash flows. If those consequences would affect the entity's financial position, financial performance or cash flows in a way that could reasonably be expected to influence primary users' decisions, then the information about the existence of the covenant and its terms is likely to be material. Conversely, if the consequences of a covenant breach would not affect the entity's financial position, financial performance or cash flows in such a way, then disclosures about the covenant might not be needed.

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

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

Example P—assessing whether information about covenants is material

Background

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

Application

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

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

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

The entity also considered the likelihood of a breach occurring.

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

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

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

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

Materiality judgements for interim reporting

84 An entity makes materiality judgements in preparing both annual financial statements and interim financial reports prepared in accordance with HKAS 34 *Interim Financial Reporting*. In either case, the entity could apply the materiality process described in paragraphs 29–65. For its interim financial report, the entity considers the same materiality factors as in its annual assessment. However, it takes into consideration that the time period and the purpose of an interim financial report differ from those of the annual financial statements.

85 In making materiality judgements on its interim financial report, an entity focuses on the period covered by that report, that is:

(a) it assesses whether information in the interim financial report is material in relation to the interim period financial data, not annual data.[38]

(b) it applies the materiality factors on the basis of both the current interim period data and also, whenever there is more than one interim period (eg in the case of quarterly reporting), the data for the current financial year to date.[39]

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

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

Background

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

Application

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

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

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

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

[38] See paragraphs 23 and 25 of HKAS 34 *Interim Financial Reporting*.

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

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

Background

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

Application

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

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

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

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

87 In assessing materiality, an entity also considers the purpose of interim financial reports, which differs from the purpose of annual financial statements. An interim financial report is intended to provide an update on the latest complete set of annual financial statements.[40] Information that is material to the interim period, but was already provided in the latest annual financial statements, does not need to be reproduced in the interim financial report, unless something new occurs or an update is needed.[41]

Interim reporting estimates

88 When an entity concludes that information about estimation uncertainty is material, the entity needs to disclose that information. Measurements included in interim financial reports often rely more on estimates than measurements included in the annual financial statements.[42] That fact does not, in itself, make the estimated measurements material. Nevertheless, relying on estimates for interim financial data to a greater extent than for annual financial data might result in more disclosures about such uncertainties being material, and thus being provided in the interim financial report, compared with the annual financial statements.

Application date

89 This Practice Statement does not change any requirements in HKFRS Standards or introduce any new requirements. An entity that chooses to apply the guidance in the Practice Statement is permitted to apply it to financial statements prepared from 22 March 2021.

40 See paragraph 6 of HKAS 34.
41 See paragraphs 15–15A of HKAS 34.
42 See paragraph 41 of HKAS 34.

Appendix
References to the *Conceptual Framework for Financial Reporting* and HKFRS Standards

Extracts from the *Conceptual Framework for Financial Reporting*

Paragraph 1.2

Referred to in paragraphs 7 and 17 of the Practice Statement

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity. Those decisions involve decisions about:

(a) buying, selling or holding equity and debt instruments;

(b) providing or settling loans and other forms of credit; or

(c) exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.

Paragraph 1.3

Referred to in paragraph 18 of the Practice Statement

The decisions described in paragraph 1.2 depend on the returns that existing and potential investors, lenders and other creditors expect, for example, dividends, principal and interest payments or market price increases. Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity and on their assessment of management's stewardship of the entity's economic resources. Existing and potential investors, lenders and other creditors need information to help them make those assessments.

Paragraph 1.4

Referred to in paragraphs 19 and 38 of the Practice Statement

To make the assessments described in paragraph 1.3, existing and potential investors, lenders and other creditors need information about:

(a) the economic resources of the entity, claims against the entity and changes in those resources and claims (see paragraphs 1.12–1.21); and

(b) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's economic resources (see paragraphs 1.22–1.23).

Paragraph 1.5

Referred to in paragraph 13 of the Practice Statement

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

Paragraph 1.6

Referred to in paragraph 21 of the Practice Statement

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

Paragraph 1.8

Referred to in paragraph 36 of the Practice Statement

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

Paragraph 1.9

Referred to in paragraph 13 of the Practice Statement

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

Paragraph 1.10

Referred to in paragraph 13 of the Practice Statement

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

Paragraph 2.7

Referred to in paragraph 20 of the Practice Statement

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

Paragraph 2.11

Referred to in paragraph 5 of the Practice Statement

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports (see paragraph 1.5) make on the basis of those reports, which provide financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the HKICPA cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

Paragraph 2.34

Referred to in paragraph 56 of the Practice Statement

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

Paragraph 2.36

Referred to in paragraph 15 of the Practice Statement

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

Extracts from HKAS 1 *Presentation of Financial Statements*

Paragraph 7

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

> ***Material*:**
>
> **Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements which provide financial information about a specific reporting entity.**
>
> Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.

Paragraph 7

Referred to in paragraph 6 of the Practice Statement

> Assessing whether information could reasonably be expected to influence decisions made by the primary users of a specific reporting entity's general purpose financial statements requires an entity to consider the characteristics of those users while also considering the entity's own circumstances. […] At times, even well informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

Paragraph 15

Referred to in paragraph 62 of the Practice Statement

> **Financial statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity. True and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*). The application of HKFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a true and fair view.**

Paragraph 17

Referred to in paragraph 10 of the Practice Statement

> In virtually all circumstances, an entity achieves a true and fair view by compliance with applicable HKFRSs. A true and fair view also requires an entity:
>
> (a) to select and apply accounting policies in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. HKAS 8 sets out a hierarchy of authoritative guidance that management considers in the absence of an HKFRS that specifically applies to an item.
>
> (b) to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
>
> (c) to provide additional disclosures when compliance with the specific requirements in HKFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Paragraph 29

Referred to in paragraph 43 of the Practice Statement

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

Paragraph 30A

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

When applying this and other HKFRSs an entity shall decide, taking into consideration all relevant facts and circumstances, how it aggregates information in the financial statements, which include the notes. An entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions.

Paragraph 31

Referred to in paragraph 10 of the Practice Statement

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

Paragraph 38

Referred to in paragraphs 67 and 70 of the Practice Statement

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

Paragraph 38A

Referred to in paragraph 67 of the Practice Statement

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

Paragraph 38C

Referred to in paragraph 69 of the Practice Statement

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

Paragraph BC30F of the Basis for Conclusions

Referred to in paragraphs 28 and 69 of the Practice Statement

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

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

Paragraph 5

Referred to in paragraphs 72 and 78 of the Practice Statement

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

(a) **was available when financial statements for those periods were authorised for issue; and**

(b) **could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.**

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

Paragraph 8

Referred to in paragraph 8 of the Practice Statement

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

Paragraph 41

Referred to in paragraph 73 of the Practice Statement

Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with HKFRSs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are authorised for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs 42–47).

Extracts from HKAS 34 *Interim Financial Reporting*

Paragraph 6

Referred to in paragraph 87 of the Practice Statement

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

Paragraph 15

Referred to in paragraph 87 of the Practice Statement

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

Paragraph 15A

Referred to in paragraph 87 of the Practice Statement

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

Paragraph 20

Referred to in paragraph 85 of the Practice Statement

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

(a) **statement of financial position as of the end of the current interim period and a comparative statement of financial position as of the end of the immediately preceding financial year.**

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

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

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

Paragraph 23

Referred to in paragraph 85 of the Practice Statement

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

Paragraph 25

Referred to in paragraph 85 of the Practice Statement

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

Paragraph 41

Referred to in paragraph 88 of the Practice Statement

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

Appendix
Amendments to Disclosure of Accounting Policies

The following sets out amendments required for this Practice Statement resulting from amendments to HKAS 1 that are not yet effective. Once the amendments to HKAS 1 effective, the amendments set out below will be incorporated into the text of this Practice Statement and this appendix will be deleted.

Paragraphs 88A–88G and their heading, and Examples S and T, are added. Paragraphs 117, 117A, 117B, 117C, 117D and 117E of HKAS 1 are added to the Appendix. For ease of reading new text is not underlined.

Specific topics

...

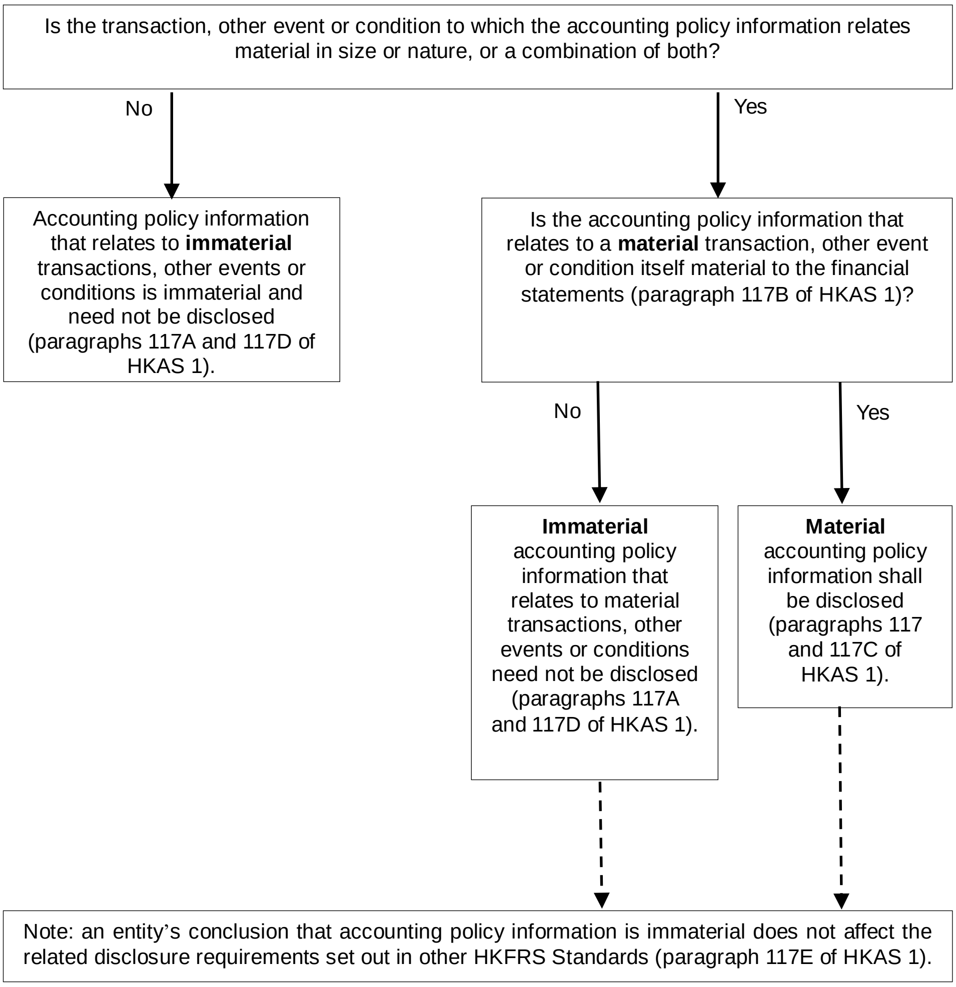
Information about accounting policies

88A Paragraph 117 of HKAS 1 requires an entity to disclose material accounting policy information.

88B Accounting policy information relating to immaterial transactions, other events or conditions is immaterial and need not be disclosed. Accounting policy information may nevertheless be material because of the nature of the related transactions, other events or conditions, even if the amounts are immaterial. An entity is required to disclose accounting policy information relating to material transactions, other events or conditions if that information is material to the financial statements.

88C In assessing whether accounting policy information is material to its financial statements, an entity considers whether users of the entity's financial statements would need that information to understand other material information in the financial statements. An entity makes this assessment in the same way it assesses other information: by considering qualitative and quantitative factors, as described in paragraphs 44–55. Diagram 2 illustrates how an entity assesses whether accounting policy information is material and, therefore, shall be disclosed.

Diagram 2—determining whether accounting policy information is material



88D Paragraph 117B of HKAS 1 includes examples of circumstances in which an entity is likely to consider accounting policy information to be material to its financial statements. The list is not exhaustive, but provides guidance on when an entity would normally consider accounting policy information to be material.

88E Paragraph 117C of HKAS 1 describes the type of material accounting policy information that users of financial statements find most useful. Users generally find information about the characteristics of an entity's transactions, other events or conditions—entity-specific information—more useful than disclosures that only include standardised information, or information that duplicates or summarises the requirements of the HKFRS Standards. Entity-specific accounting policy information is particularly useful when that information relates to an area for which an entity has exercised judgement—for example, when an entity applies an HKFRS Standard differently from similar entities in the same industry.

88F Although entity-specific accounting policy information is generally more useful, material accounting policy information could sometimes include information that is standardised, or that duplicates or summarises the requirements of the HKFRS Standards. Such information may be material if, for example:

(a) users of the entity's financial statements need that information to understand other material information provided in the financial statements. Such a scenario might arise when an entity applying HKFRS 9 *Financial Instruments* has no choice regarding the classification of its financial instruments. In such scenarios, users of that entity's financial statements may only be able to understand how the entity has accounted for its material financial instruments if users also understand how the entity has applied the requirements of HKFRS 9 to its financial instruments.

(b) an entity reports in a jurisdiction in which entities also report applying local accounting standards.

(c) the accounting required by the HKFRS Standards is complex, and users of financial statements need to understand the required accounting. Such a scenario might arise when an entity accounts for a material class of transactions, other events or conditions by applying more than one HKFRS Standard.

88G Paragraph 117D of HKAS 1 states that if an entity discloses immaterial accounting policy information, such information shall not obscure material information. Paragraphs 56–59 provide guidance about how to communicate information clearly and concisely in the financial statements.

Example S—making materiality judgements and focusing on entity-specific information while avoiding standardised (boilerplate) accounting policy information

Background

An entity operates within the telecommunications industry. It has entered into contracts with retail customers to deliver mobile phone handsets and data services. In a typical contract, the entity provides a customer with a handset and data services over three years. The entity applies HKFRS 15 *Revenue from Contracts with Customers* and recognises revenue when, or as, the entity satisfies its performance obligations in line with the terms of the contract.

The entity has identified two performance obligations and related considerations:

(a) the handset—the customer makes monthly payments for the handset over three years; and

(b) data—the customer pays a fixed monthly charge to use a specified monthly amount of data over three years.

For the handset, the entity concludes that it should recognise revenue when it satisfies the performance obligation (when it provides the handset to the customer). For the provision of data, the entity concludes that it should recognise revenue as it satisfies the performance obligation (as the entity provides data services to the customer over the three-year life of the contract).

The entity notes that, in accounting for revenue it has made judgements about:

(a) the allocation of the transaction price to the performance obligations; and

(b) the timing of satisfaction of the performance obligations.

The entity has concluded that revenue generated from these contracts is material to the reporting period.

Application

The entity notes that for contracts of this type it applies separate accounting policies for two sources of revenue, namely revenue from:

(a) the sale of handsets; and

(b) the provision of data services.

Having identified revenue from contracts of this type as material to the financial statements, the entity assesses whether accounting policy information for revenue from these contracts is, in fact, material.

The entity evaluates the effect of disclosing the accounting policy information by considering the presence of qualitative factors. The entity noted that its revenue recognition accounting policies:

(a) were unchanged during the reporting period;

(b) were not chosen from accounting policy options available in the HKFRS Standards;

(c) were not developed in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in the absence of an HKFRS Standard that specifically applies; and

(d) are not so complex that primary users will be unable to understand the related revenue transactions without standardised descriptions of the requirements of HKFRS 15.

However, some of the entity's revenue recognition accounting policies relate to an area for which the entity has made significant judgements in applying its accounting policies—for example, in deciding how to allocate the transaction price to the performance obligations, and the timing of revenue recognition.

The entity considers that, in addition to disclosing the information required by paragraphs 123–126 of HKFRS 15 about the significant judgements made in applying HKFRS 15, primary users of its financial statements are likely to need to understand related accounting policy information. Consequently, the entity concludes that such accounting policy information could reasonably be expected to influence the decisions of the primary users of its financial statements. For example, understanding:

(a) how the entity allocates the transaction price to its performance obligations is likely to help users understand how each component of the transaction contributes to the entity's revenue and cash flows; and

(b) that some revenue is recognised at a point in time and some is recognised over time is likely to help users understand how reported cash flows relate to revenue.

The entity also notes that the judgements it made are specific to the entity. Consequently, material accounting policy information would include information about how the entity has applied the requirements of HKFRS 15 to its specific circumstances.

The entity, therefore, assesses that accounting policy information about revenue recognition is material and should be disclosed. Such disclosure would include information about how the entity allocates the transaction price to its performance obligations and when the entity recognises revenue.

Example T—making materiality judgements on accounting policy information that only duplicates requirements in the HKFRS Standards

Background

Property, plant and equipment are material to an entity's financial statements.

The entity has no intangible assets or goodwill and has not recognised an impairment loss on its property, plant or equipment in either the current or comparative reporting periods.

In previous reporting periods, the entity disclosed accounting policy information relating to impairment of non-current assets which duplicates the requirements of HKAS 36 *Impairment of Assets* and provides no entity-specific information. The entity disclosed that:

> The carrying amounts of the group's intangible assets and its property, plant and equipment are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. For goodwill and intangibles with an indefinite useful life, the recoverable amount is estimated at least annually.
>
> An impairment loss is recognised in the statement of profit or loss whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.
>
> The recoverable amount of assets is the greater of their fair value less costs to sell and their value in use. In measuring value in use, estimated future cash flows are discounted to present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.
>
> Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to that cash-generating unit and then to reduce the carrying amount of the other assets in the unit on a pro rata basis.
>
> An impairment loss in respect of goodwill is not subsequently reversed. For other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount, but only to the extent that the new carrying amount does not exceed the carrying amount that would have been determined, net of depreciation and amortisation, if no impairment loss had been recognised.

Application

Having identified assets subject to impairment testing as being material to the financial statements, the entity assesses whether the accounting policy information for impairment is, in fact, material.

As part of its assessment, the entity considers that an impairment or a reversal of an impairment had not occurred in the current or comparative reporting periods. Consequently, accounting policy information about how the entity recognises and allocates impairment losses is unlikely to be material to its primary users. Similarly, because the entity has no intangible assets or goodwill, information about its accounting policy for impairments of intangible assets and goodwill is unlikely to provide its primary users with material information.

However, the entity's impairment accounting policy relates to an area for which the entity is required to make significant judgements or assumptions, as described in paragraphs 122 and 125 of HKAS 1. Given the entity's specific circumstances, it concludes that information about its significant judgements and assumptions related to its impairment assessments could reasonably be expected to influence the decisions of the primary users of the entity's financial statements. The entity notes that its disclosures about significant judgements and assumptions already include information about the significant judgements and assumptions used in its impairment assessments.

The entity decides that the primary users of its financial statements would be unlikely to need to understand the recognition and measurement requirements of HKAS 36 to understand related information in the financial statements.

Consequently, the entity concludes that disclosing a summary of the requirements in HKAS 36 in a separate accounting policy for impairment would not provide information that could reasonably be expected to influence decisions made by the primary users of its financial statements. Instead, the entity discloses material accounting policy information related to the significant judgements and assumptions the entity has applied in its impairment assessments elsewhere in the financial statements.

Although the entity assesses some accounting policy information for impairments of assets as immaterial, the entity still assesses whether other disclosure requirements of HKAS 36 provide material information that should be disclosed.

...

Appendix
References to the *Conceptual Framework for Financial Reporting* and HKFRS Standards

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Extracts from HKAS 1 *Presentation of Financial Statements*

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Paragraph 117

Referred to in paragraphs 88A and 88C of the Practice Statement

An entity shall disclose material accounting policy information (see paragraph 7). Accounting policy information is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements.

Paragraph 117A

Referred to in paragraph 88C of the Practice Statement

Accounting policy information that relates to immaterial transactions, other events or conditions is immaterial and need not be disclosed. Accounting policy information may nevertheless be material because of the nature of the related transactions, other events or conditions, even if the amounts are immaterial. However, not all accounting policy information relating to material transactions, other events or conditions is itself material.

Paragraph 117B

Referred to in paragraphs 88C and 88D of the Practice Statement

Accounting policy information is expected to be material if users of an entity's financial statements would need it to understand other material information in the financial statements. For example, an entity is likely to consider accounting policy information material to its financial statements if that information relates to material transactions, other events or conditions and:

(a) the entity changed its accounting policy during the reporting period and this change resulted in a material change to the information in the financial statements;

(b) the entity chose the accounting policy from one or more options permitted by HKFRSs—such a situation could arise if the entity chose to measure investment property at historical cost rather than fair value;

(c) the accounting policy was developed in accordance with HKAS 8 in the absence of a HKFRS that specifically applies;

(d) the accounting policy relates to an area for which an entity is required to make significant judgements or assumptions in applying an accounting policy, and the entity discloses those judgements or assumptions in accordance with paragraphs 122 and 125; or

(e) the accounting required for them is complex and users of the entity's financial statements would otherwise not understand those material transactions, other events or conditions—such a situation could arise if an entity applies more than one HKFRS to a class of material transactions.

Paragraph 117C

Referred to in paragraphs 88C and 88E of the Practice Statement

Accounting policy information that focuses on how an entity has applied the requirements of the HKFRSs to its own circumstances provides entity-specific information that is more useful to users of financial statements than standardised information, or information that only duplicates or summarises the requirements of the HKFRSs.

Paragraph 117D

Referred to in paragraphs 88C and 88G of the Practice Statement

If an entity discloses immaterial accounting policy information, such information shall not obscure material accounting policy information.

Paragraph 117E

Referred to in paragraph 88C of the Practice Statement

An entity's conclusion that accounting policy information is immaterial does not affect the related disclosure requirements set out in other HKFRSs.

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BASIS FOR CONCLUSIONS ON IFRS Practice Statement 2 *Making Materiality Judgements*

HKFRS Practice Statement 2 is based on IFRS Practice Statement 2 *Making Materiality Judgements* (Practice Statement). In approving HKFRS Practice Statement 2, the Financial Reporting Standards Committee of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on the Practice Statement. Accordingly, there are no significant differences between HKFRS Practice Statement 2 and the Practice Statement. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of the Practice Statement referred to below generally correspond with those in HKFRS Practice Statement 2.

This Basis for Conclusions accompanies, but is not part of, the IFRS Practice Statement 2 Making Materiality Judgements (Practice Statement). It summarises the considerations of the International Accounting Standards Board (Board) when developing the Practice Statement. Individual Board members gave greater weight to some factors than to others.

Background

BC1 The Board was informed at the Discussion Forum on Financial Reporting Disclosure in January 2013, through feedback on the 2014 Exposure Draft of proposed amendments to IAS 1 *Presentation of Financial Statements* and from other sources, that entities experience difficulties making materiality judgements when preparing financial statements. Some entities are unsure how to make materiality judgements and tend to use disclosure requirements in IFRS Standards as if they were items on a checklist, rather than using judgement when deciding what information to provide in financial statements. Some stakeholders stated that these difficulties and practices contribute to a disclosure problem—namely, entities provide too much irrelevant information and not enough relevant information in their financial statements.

BC2 Some stakeholders suggested that one of the factors contributing to these difficulties was the lack of guidance on materiality in IFRS Standards, particularly on how entities 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. The aim of the Board is to promote a behavioural change in the way entities prepare their financial statements, encouraging a greater exercise of judgement when determining what information to include or not to include in those statements.

BC3 In October 2015, the Board published the Exposure Draft IFRS Practice Statement *Application of Materiality to Financial Statements* (Practice Statement ED). The Board developed the Practice Statement ED after considering the input obtained from outreach and consultations with the IFRS Advisory Council; the Accounting Standards Advisory Forum (ASAF); the World Standard-Setters; the Global Preparers Forum (GPF); the Capital Markets Advisory Committee (CMAC); representatives of the International Auditing 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.[1]

BC4 The Board received 95 comment letters in response to the Practice Statement ED. The Board also conducted outreach on the proposals in the Practice Statement ED, including consultation with the ASAF, the CMAC and the GPF. Responses to the Practice Statement ED indicated widespread support for the Board to issue practical guidance on making materiality judgements in the preparation of financial statements. The Board considered the input it received on the Practice Statement ED when developing this Practice Statement.

1 The IFRS Advisory Council, the Accounting Standards Advisory Forum (ASAF), the Global Preparers Forum (GPF) and the Capital Markets Advisory Committee (CMAC) are the Board's advisory bodies. The World Standard-Setters is a meeting of accounting standard-setters organised by the Board.

Form of the guidance

BC5 The Practice Statement sets out non-mandatory guidance with the aim of assisting entities in making materiality judgements when preparing general purpose financial statements. Entities applying IFRS Standards are not required to comply with the Practice Statement to state compliance with those Standards. Nevertheless, the Board expects the Practice Statement to help promote a greater understanding of the role of materiality in applying IFRS Standards and of how judgement should be exercised to assess materiality in preparing financial statements. The Board expects that better understanding of the role of materiality will ultimately make financial statements more useful and easier to understand.

BC6 The Board decided to provide guidance on how to make materiality judgements in the form of a non-mandatory Practice Statement because:

(a) issuing mandatory requirements in a Standard could risk appearing prescriptive, which could undermine the emphasis on entities applying their judgement in the assessment of materiality; and

(b) issuing guidance as a separate non-mandatory document, rather than as non-mandatory implementation guidance supporting a specific Standard, such as IAS 1, would help to emphasise that the concept of materiality is pervasive throughout IFRS Standards.

BC7 Moreover, the Board was told that adding mandatory requirements in a Standard could risk creating conflicts with local legal or regulatory frameworks. Nevertheless, the Board observed that even though some jurisdictions might have legal or regulatory requirements that interact with IFRS materiality requirements, this should not result in a conflict with the guidance in the Practice Statement, provided that those local requirements do not prevent an entity from applying the requirements in IFRS Standards. No respondents to the Practice Statement ED and no participants in the outreach organised by the Board reported such a circumstance.

BC8 Furthermore, this Practice Statement does not change any requirements in IFRS Standards or introduce any new requirements. The Board decided that non-mandatory status was more appropriate.

BC9 Finally, the Board issued a Practice Statement rather than asking the IFRS Foundation staff to develop educational material because a Practice Statement is subject to full due process, including public consultation, and is more accessible than educational material.

BC10 Responses to the Practice Statement ED indicated widespread agreement with the considerations that led the Board to include its guidance in a non-mandatory Practice Statement.

Scope

BC11 The objective of this Practice Statement is to provide entities with guidance on making materiality judgements when preparing general purpose financial statements in accordance with IFRS Standards. The Board discussed whether to broaden the audience of the Practice Statement by also addressing it to other parties involved in financial reporting, but concluded that the Practice Statement should only be addressed to those involved in the preparation of the financial statements. The Board noted, however, that the Practice Statement is also likely to help other parties, such as auditors, users of financial statements, regulators and enforcers, understand the approach an entity follows in making materiality judgements when preparing its financial statements.

BC12 The Board discussed whether the Practice Statement should also be addressed to entities applying the *IFRS for SMEs®* Standard. However, 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 need of users of the financial statements of such entities. The *IFRS for SMEs* Standard does not refer to the concept of primary users as included in the *Conceptual Framework for Financial Reporting (Conceptual Framework)* and does not include recent changes to full IFRS Standards (eg that an entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information). Therefore, the Board decided that the Practice Statement is not intended for entities applying the *IFRS for SMEs* Standard. 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.

BC13 Materiality is a general concept widely used for financial reporting and other purposes. For example, auditors usually assess materiality when making judgements about the nature, timing and extent of the work to be done to express an opinion as to whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. Some respondents to the Practice Statement ED noted that preparers and auditors of financial statements assess materiality using a comparable approach—they both focus on information that could reasonably be expected to influence decisions of the users of an entity's financial statements. The Board discussed whether to include in the Practice Statement a 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 the preparation of financial statements is beyond the scope of this Practice Statement. Moreover, referring to different applications of the concept of materiality might cause confusion.

General characteristics of materiality

Definition of material

BC14 The Board has discussed the definition of 'material' and whether to change or clarify that definition in its Principles of Disclosure project. In September 2017, on the basis of those discussions, the Board published the Exposure Draft *Definition of Material (Proposed amendments to IAS 1 and IAS 8)* (Definition of Material ED). The Definition of Material ED proposes refining the definition of material by incorporating the existing description of material information in paragraph 7 of IAS 1[2] and emphasising the need to ensure material information is not obscured, as described in paragraph 30A of IAS 1. IFRS Standards already include both concepts; consequently, the Practice Statement includes these notions. The Board considered whether to postpone issuing this Practice Statement until the completion of the Definition of Material project. However, the Board concluded that providing guidance on making materiality judgements as quickly as possible would be useful and responded to requests for guidance.

BC15 Moreover, the Board observed that, since the proposed amendments in the Definition of Material ED 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 this Practice Statement would not be affected by the proposed amendments, other than by the possible need to update the definition of material quoted in the document.

[2] '… the assessment needs to take into account how users […] could *reasonably* be expected to be influenced in making economic decisions' [emphasis added].

Materiality judgements are pervasive

BC16 The Board discussed whether to focus the guidance in the Practice Statement on IFRS presentation and disclosure requirements only, but concluded that the need for materiality judgements is pervasive in the preparation of financial statements, also encompassing recognition and measurement requirements. Consequently, the Board provided, throughout the Practice Statement, guidance on how to make materiality judgements in the context of recognition and measurement as well as of presentation and disclosure.

Primary users and their information needs

BC17 The Practice Statement explains that, when making its materiality assessments, an entity should consider the primary users of its financial statements—its primary users—as defined by the *Conceptual Framework*, that is, existing and potential investors, lenders and other creditors. 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 and expectations those users might have, could create a tension with the definition of general purpose financial statements, which focuses on the common information needs of a wide range of users. Consequently, the Practice Statement refers to the three categories of primary users identified in the *Conceptual Framework*—existing and potential investors, lenders and other creditors.

BC18 Furthermore, the Board decided to emphasise in the Practice Statement that the primary users of an entity's financial statements include potential investors, lenders and other creditors, as well as existing ones. The Board concluded this would address concerns some stakeholders expressed about an inappropriate focus on specific existing users; the Board decided to make clear that an entity cannot narrow the information provided in its financial statements by focusing only on its existing users' information needs.

BC19 An entity considers decisions its primary users make on the basis of the financial statements when deciding what information to include in those statements. Consequently, the Board decided the Practice Statement should describe primary users' decisions and related information needs as set out in the *Conceptual Framework*. Primary users' decisions depend on the returns they expect from the resources they provide to an entity. Expectations about returns, in turn, depend on primary users' assessment of the amount, timing and uncertainty of the future cash inflows to the entity, as well as on the assessment of management's stewardship of the entity's resources.

BC20 The Board further considered the *Conceptual Framework* when developing its guidance on the information needs of primary users an entity should consider when making materiality judgements. Providing all the information existing and potential investors, lenders and other creditors need is not the objective of general purpose financial statements. The Board clarified that an entity is not required to address information needs that respond to unique or individual information requests. An entity should aim to meet primary users' common information needs. In developing its guidance, the Board clarified that, to avoid losing information relevant to one category of primary users (among the three identified in the *Conceptual Framework*), the common information needs are not limited to the information needs simultaneously shared across all categories of primary users. An entity separately identifies the common information needs for each of the three categories, and meets the total of these needs.

Interaction with local laws and regulations

BC21 The Board discussed the interaction of materiality requirements in IFRS Standards with local laws and regulations in the light of stakeholders' comments relating to potential conflicts between the guidance in the Practice Statement ED and local legal or regulatory requirements. The Board noted that the Practice Statement provides guidance on making materiality judgements when preparing financial statements in accordance with IFRS Standards; it does not provide guidance on how to apply local legal or regulatory requirements.

BC22 Nevertheless, the Board acknowledged that local requirements might affect information provided in the financial statements. In these circumstances, an entity must comply with the materiality requirements in IFRS Standards, but the 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. A conflict would only occur if local laws or regulations prohibit the inclusion of information that is material for the purpose of IFRS Standards. No respondents to the Practice Statement ED and no participants in the outreach organised by the Board reported such a circumstance.

BC23 When information in addition to that required by IFRS Standards is provided in the financial statements, paragraph 30A of IAS 1 requires an entity to ensure that material information required by the Standards is not obscured. The Board observed that the appropriate organisation of information in the financial statements would allow an entity to meet that requirement.

Making materiality judgements

BC24 Respondents commenting on the Practice Statement ED welcomed the fact it gathered guidance on materiality from multiple IFRS Standards. However, some 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 (materiality process) in consultation with the ASAF, the CMAC and the GPF. The description of the materiality process illustrates the role materiality plays in the preparation of financial statements and clarifies how a materiality judgement is made. The materiality process also identifies the factors an entity should consider when making materiality judgements.

BC25 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 includes the materiality requirements an entity must apply to state compliance with IFRS Standards.

BC26 The Board considered whether to focus its guidance on the application of judgement or to illustrate the overall process of which materiality judgements are a part. However, as some respondents to the Practice Statement ED 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 various materiality decisions are connected with each other.

BC27 The Board included Step 1 (identify) to provide an entity with a clear starting point for its assessments. Stakeholders largely agreed that an entity should use the requirements in IFRS Standards to identify information that primary users might need to make decisions about providing resources to the entity. When using the requirements in IFRS Standards, an entity benefits from the assessment the Board makes when developing IFRS Standards—when developing a Standard the Board identifies information it expects will meet the needs of a broad range of primary users. The Board also considered that some information not specified in IFRS Standards might be necessary to enable primary users to understand the impact of an entity's transactions, other events and conditions on the entity's financial position, financial performance and cash flows. Therefore, the Board decided that the entity's knowledge about its primary users' common information needs should be an additional input to Step 1. On the basis of that knowledge, an entity should consider whether to include additional information not specified by IFRS Standards in its financial statements.

BC28 Step 2 (assess) describes factors an entity should consider in identifying whether an item of information is material. The Board concluded that the application of judgement in assessing whether information is material involves both quantitative and qualitative considerations. Respondents to the Practice Statement ED also agreed that, in making materiality judgements, an entity should consider both quantitative and qualitative factors. The Practice Statement includes some examples of materiality factors. However, the Board decided to describe a limited number of factors rather than provide an exhaustive list of considerations to be taken into account.

BC29 The Board decided to include some guidance in the materiality process on the way an entity should reflect its materiality judgements. Step 3 (organise) deals with the output of an entity's materiality judgements and provides guidance the entity might want to consider to make its financial statements easier to understand. The Board recommends that an entity considers the different roles of the primary financial statements and the notes in deciding whether to present an item of information separately in the primary financial statements, to aggregate it with other information and/or to disclose the information in the notes. However, the Board decided not to provide further guidance on those topics in the Practice Statement. A discussion of the roles of the different components of the financial statements, as well as of the implications of those roles, has been included in the *Principles of Disclosure* Discussion Paper, which the Board published in March 2017.

BC30 Step 4 (review) gives an entity the opportunity to 'step back', once it has prepared its draft financial statements, and consider the information from an aggregated perspective. The Board discussed whether this step duplicates the assessment performed in Step 2 and clarified that an entity makes its materiality judgements in Step 2, but then reviews these judgements once a draft of the financial statements is available. In Step 2, an entity based its assessment on the expected financial statements as a whole, while it was still preparing its draft. In Step 4, an entity checks its assessment against the actual draft financial statements—this review may lead the entity to revisit the assessment performed in Step 2, provide additional information in the financial statements, remove immaterial information or reorganise existing information.

Specific topics

Prior-period information

BC31 When discussing materiality judgements about prior-period information included in financial statements, the Board acknowledged some legal or regulatory requirements might set out the amount of prior-period information to include in the financial statements. However, the Board decided that providing guidance on making materiality judgements about prior-period information in the Practice Statement would be necessary to promote behavioural change consistently across all parts of the financial statements and to encourage entities to exercise greater judgement when determining what information to include or not to include in financial statements.

BC32 The Board developed the guidance in the Practice Statement in the light of the minimum comparative information required by IAS 1. However, the Board acknowledged that an entity needs to consider any legal or regulatory requirements when making materiality judgements about prior-period information. Consequently, the Board decided to explain that, in its current-period financial statements, an entity may summarise prior-period information, compared to the way it was included in prior-period financial statements, except when local laws or regulations demand otherwise. The Board also clarified that an entity that wishes to state compliance with IFRS Standards cannot provide less information than the information required by the Standards, even if local laws and regulations permit otherwise.

BC33 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 provided in accordance with those Standards and should not obscure material information. Some stakeholders asked whether providing prior-period information at the same level of detail as current-period information could be seen as obscuring material information in the current-period financial statements. The Board does not expect that such prior-period information would obscure current-period material information.

Errors

BC34 The Board discussed whether to include in the Practice Statement guidance to help entities determine whether an error is material. The Board noted that the assessment of whether an error could reasonably be expected to influence primary users' decisions is an integral part of the preparation of the financial statements, and therefore concluded that the Practice Statement should address this topic. The Board noted that the materiality factors an entity would apply to conclude whether an error is material are the same as those described in the materiality process. Consequently, there is no need to provide any specific additional guidance. In the 'Errors' section, the Practice Statement suggests that an entity refer to the considerations described in the materiality process.

BC35 Respondents to the Practice Statement ED asked the Board to also address the situation in which an entity faces 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'). The Board concluded it would be helpful to clarify that, in such circumstances:

(a) materiality judgements about cumulative errors that an entity made at the time the prior-period financial statements were authorised for issue need not be revisited in the current period, provided those judgements were reasonable at the time they were made and the entity considered information that was available, or was reasonably expected to be available, at that time; however

(b) an entity needs to assess whether cumulative errors have become material to the current-period financial statements.

BC36 The Board decided to include a statement in the Practice Statement to remind an entity that a cumulative error must be corrected if it becomes material to the current-period financial statements. The Board discussed whether to provide further guidance on how to correct such an error, but concluded that the Practice Statement should focus on how to make materiality judgements, instead of dealing with the consequences of these judgements. IAS 8 contains the requirements on the correction of errors.

BC37 The Practice Statement ED 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. Respondents to the Practice Statement ED commented that the wording appears inconsistent with paragraph 41 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Paragraph 41 of IAS 8 does not characterise such errors as material, however, it requires the correction of all errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. The Board decided to align the wording in the Practice Statement with the wording of paragraph 41 of IAS 8.

Information about covenants

BC38 When discussing whether the existence of a covenant, or similar contractual terms, could influence materiality judgements, the Board identified two concerns:

(a) do any specific considerations apply in making materiality judgements on information about the existence and terms of a covenant, or a covenant breach?

(b) does the existence of a covenant influence materiality judgements about information other than about the existence of the covenant, or a covenant breach, included in the financial statements?

BC39 In respect of the first concern, the Board concluded that, in addition to the materiality factors described in the materiality process, materiality judgements are specifically influenced by the consequences of a breach occurring and the likelihood of that breach occurring. In particular, the Board clarified that, regardless of the significance of the consequences of a breach occurring, information about the covenant is not material if the likelihood of the breach occurring is remote. In providing this clarification, the Board applied the disclosure threshold set in paragraph 28 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* regarding the disclosure of contingent liabilities.

BC40 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 the financial statements. In other words, an entity is not required to reperform its materiality assessments the closer it gets to breaching a covenant. 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 guidance on the impact of covenants on materiality assessments.

Materiality judgements for interim reporting

BC41 The Board discussed whether to provide guidance on how to make materiality judgements when preparing an interim financial report. The Board concluded that, when preparing an interim financial report, an entity should consider 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. In particular, the Board noted that it would be helpful to explain how the different time period and purposes of an interim financial report, compared to the annual financial statements, affect materiality judgements, as well as to address some practical concerns raised by respondents to the Practice Statement ED.

Likely effects of this Practice Statement

BC42 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'. The Practice Statement is designed to provide guidance on how to make materiality judgements in the preparation of financial statements. The Practice Statement does not change any requirements in IFRS Standards or introduce any new requirements. With no changes in existing requirements and given that the application of the Practice Statement is not required to state compliance with IFRS Standards, the Board concluded that a separate effects analysis was not necessary.

BC43 The expected effects of the Practice Statement have been considered as part of the Board's discussions. The Board expects the Practice Statement will:

(a) enhance awareness of the role of materiality in helping to promote positive changes in behaviour (such as to discourage rigid adherence to checklists by an entity preparing financial statements);

(b) encourage an entity to exercise judgement to a greater extent when preparing financial statements, which should lead to a reduction in boilerplate disclosures and redundant information and provide a framework for assessing the need in the financial statements for information that is additional to disclosure requirements specified by IFRS Standards; and

(c) provide a useful reference point for discussions between an entity, its auditors and regulators on the assessment of materiality, which could help facilitate agreement.

BC44 The Board does not expect any significant costs associated with the application of the Practice Statement because it introduces no new requirements nor is the application of the Practice Statement mandatory. However, some implementation costs might be faced by an entity that has previously relied on a checklist approach when preparing its financial statements. The Board expects such an entity would apply more judgement when deciding what information to include in the financial statements, if it follows the guidance 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 required when entities apply judgement in preparing financial statements, rather than following a checklist. Conversely, an entity already applying appropriate judgement in the preparation of its financial statements would incur no additional implementation costs and could benefit from the issue of the Practice Statement in its interaction with auditors and other stakeholders.

BC45 The effects the Board expects from the Practice Statement were assessed against the comments received on the Practice Statement ED. Overall, respondents confirmed the Board's expectations and welcomed the proposal to issue the Practice Statement.

Interaction with the Board's other projects

BC46 The Board decided to issue this Practice Statement before the finalisation of the Principle of Disclosures project, for which a Discussion Paper was published in March 2017; the Definition of Material project, for which an Exposure Draft was published in September 2017; or the *Conceptual Framework* project—the revised *Conceptual Framework* is expected to be issued in 2018.[3] The Board considered whether to postpone issuing this Practice Statement until the completion of one or more of those projects; however, it concluded that it would be useful to provide guidance on making materiality judgements as quickly as possible, to respond to requests for guidance. Moreover, the Board concluded that the finalisation of these projects would be unlikely to affect the guidance in the Practice Statement.

3 In 2018 the Board issued a revised *Conceptual Framework*. References to the *Conceptual Framework* in this Practice Statement were updated to refer to the revised *Conceptual Framework*.

Appendix
Amendments to the Basis for Conclusions on Disclosure of Accounting Policies

This appendix contains amendments to the Basis for Conclusions on IFRS Practice Statement 2 resulting from amendments to IAS 1 that are not yet effective. Once the amendments to IAS 1 effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted.

Paragraphs BC41A–BC41F and their related heading are added. Dissenting opinion is added. For ease of reading new text is not underlined.

Specific topics

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Materiality judgements for accounting policy information (see paragraphs BC76H–BC76AB of IAS 1)

BC41A In February 2021 the Board amended IAS 1 to require an entity to disclose its material accounting policy information rather than its significant accounting policies.

BC41B To help entities to apply the amendments to IAS 1, the Board also amended IFRS Practice Statement 2 to illustrate how an entity can judge whether accounting policy information is material to its financial statements.

BC41C The Board added guidance and examples to IFRS Practice Statement 2 to help an entity apply the four-step materiality process to accounting policy information. The guidance and examples help an entity apply the amendments to IAS 1 by:

(a) confirming that in assessing whether accounting policy information is material, an entity considers both qualitative and quantitative factors (see paragraph 88C);

(b) linking materiality judgements to accounting policy disclosures using the four-step materiality process described in paragraph 33 (see paragraph 88C).

(c) emphasising the need to focus on useful information for users of financial statements (see paragraphs 88C–88E); and

(d) demonstrating how an entity can apply the four-step materiality process to address:

(i) standardised (boilerplate) information disclosed as part of material accounting policy information (see Example S); and

(ii) accounting policy information that only duplicates or summarises the requirements of IFRS Standards (see Example T).

BC41D Examples S and T are intended only to illustrate the application of the amendments to IAS 1 and the four-step materiality process to accounting policy information. They do not illustrate the application of the definition of material to all disclosure requirements of IFRS 15 *Revenue from Contracts with Customers* and IAS 36 *Impairment of Assets*. An entity is also required to comply with the other disclosure requirements of those IFRS Standards.

BC41E The Board concluded that accounting policy information that includes standardised information, or that duplicates or summarises some of the requirements of IFRS Standards, could sometimes be material. The Board added guidance about when such accounting policy information might be material to an entity's financial statements (see paragraph 88F).

BC41F The Board concluded that, as the amendments provide non-mandatory guidance on the application of the definition of material to accounting policy information, transition requirements and an effective date for these amendments are unnecessary.

Dissenting opinion

Dissent of Ms Françoise Flores from *Disclosure of Accounting Policies*

DO1 Ms Flores voted against the publication of *Disclosure of Accounting Policies*, which amends IAS 1 and IFRS Practice Statement 2. The reasons for her dissent are set out below.

DO2 Ms Flores agrees with those amendments to IAS 1 and IFRS Practice Statement 2 which aim to provide primary users of financial statements with all and only relevant accounting policy information. She also supports the Board's past and current efforts to clarify how the concept of materiality should be applied more generally. She agrees with all the amendments except paragraph 117B(e) of IAS 1 and paragraph 88F of IFRS Practice Statement 2.

DO3 In particular, Ms Flores disagrees with paragraph 117B(e) of IAS 1, which implies that accounting policy information that includes information that is standardised or duplicates the requirements of IFRS Standards could be material when the underlying accounting is complex; and that, therefore, such information is required to be included in the financial statements. Ms Flores believes that the notion of complexity is highly subjective and, therefore, does not constitute a robust basis for a requirement. Introducing such a subjective assessment could, in her view, undermine the overall aim of the amendments, which is to contribute to a better application of the concept of materiality to accounting policy disclosures and thereby help an entity reduce the disclosure of immaterial accounting policy information. Facing such subjective judgements, an entity may opt for 'being on the safe side', providing more information than is required. In her view, paragraph 117B(e) of IAS 1 is an unsatisfactory response to feedback from users of financial statements who said they find entity-specific accounting policy information to be more useful than information that is standardised or that duplicates or summarises the requirements of IFRS Standards.

DO4 A minority of respondents were concerned that the Board's proposals could be read as prohibiting the publication of any accounting policy information that is standardised, or that duplicates or summarises the requirements of IFRS Standards. Ms Flores believes that the appropriate response would have been to explain that such accounting policy information may, in some circumstances, be useful in providing context for entity-specific information. Such an approach would enhance the readability of entity-specific accounting policy information.

DO5 Furthermore, Ms Flores notes that paragraph 2.36 of the *Conceptual Framework of Financial Reporting*, paragraph 7 of IAS 1 and the guidance included in paragraphs 13–23 of IFRS Practice Statement 2 state that users of financial statements are expected to have a reasonable knowledge of business and economic activities, but may need to seek the aid of an adviser to cope with perceived complexity. In her view, investors are responsible for ensuring that their economic decisions are derived from a proper and knowledgeable understanding of an entity's financial statements, which includes understanding the requirements of IFRS Standards. IFRS Standards should be regarded as public knowledge in a financial reporting environment. No mere recitation of the words from the IFRS Standards can meet the definition of material without stretching that definition endlessly. In Ms Flores' view, improving users' understanding of the requirements in IFRS Standards should be achieved through education by the IFRS Foundation. Such an objective should not be achieved by amending the requirements of IFRS Standards.