

31 MAY 2024

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Judging Materiality: Time to Revisit Given Disclosure Requirements of Major New Standards

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Following the release in June 2023 of IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures*, the International Sustainability Standards Board (ISSB) has recently provided stakeholders with a list of ongoing and completed jurisdictional consultations at national and supra-national level on sustainability-related disclosures.

Those jurisdictions listed as having closed or scheduled to complete their consultation by 30 April 2024 on the use of S1 and S2 in their jurisdiction include Malaysia, Australia, Hong Kong, Pakistan and Singapore.

Paragraph 17 of IFRS S1 requires an entity to disclose “**material** information about the sustainability-related risks and opportunities that could reasonably be expected to affect the entity’s prospects” whilst Paragraph 18 stipulates information to be **material** “if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users of general purpose financial reports make on the basis of those reports, which include financial statements and sustainability-related financial disclosures and which provide information about a specific reporting entity”. A similar definition on materiality is prescribed in IAS 1 paragraph 7.

Although the outcome of the consultations is still being determined in most of the jurisdictions, it appears reasonable to conclude that the provisions of IFRS S1, which include paragraphs 17 and 18, will have been a relevant consideration in finalising respective jurisdictional sustainability-related disclosures requirements.

IFRS 18 Presentation and Disclosure in Financial Statements¹

IFRS 18 is a recently released new Accounting Standard (issued in April 2024) which will supersede IAS 1 *Presentation of Financial Statements*, effective for annual reporting periods beginning on or after 1 January 2027.

The new Standard aims to “improve how information is communicated in financial statements, with a focus on information in the statement of profit or loss”. IFRS 18 responds to investors’ concerns about the comparability and transparency of companies financial reporting.

This includes presenting income and expenses in five categories: operating, investing, financing, income taxes and discontinued operations. While retaining the materiality principle from IAS 1, IFRS 18 introduces the concept of a *useful structured summary* to assist companies in determining what material information to present in the primary financial statements versus what to disclose in the notes to the financial statements. This concept emphasises the need for companies to understand the differences in the roles of the primary financial statements and the notes and hence the varying degrees of information to be provided, guided by the aggregation and disaggregation principles.

IFRS 18 also requires other disclosures, including how each MPM is calculated, what the MPM communicates about the entity’s financial performance, and any changes made to the MPMs in the year.

¹ For an overview of IFRS 18 and what’s changing from IAS 1, a technical article will be published on the MASB website in due course to provide you with an overview of the new requirements and how companies might be affected by them.

Definition of material together with guidance

In 2017 and 2018 the International Accounting Standards Board (IASB) clarified the definition of **material** and published guidance and a series of case studies to make it easier for companies to make **materiality judgements**. The initiatives included:

- issuing IFRS Practice Statement 2 *Making Materiality Judgements* which suggested that adopting a 4-step approach as follows may be of assistance:

Step 1 **Identify** information that has the potential to be material

Step 2 **Assess** whether the information identified in Step 1 is, in fact material

Step 3 **Organise** the information within the draft financial statements in a way that communicates the information clearly and concisely to primary users

Step 4 **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

- amending the definition of material effective 1 January 2020 from

“omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements”

to

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

- publishing the document “Better Communication in Financial Reporting” incorporating a number of case studies

Effectiveness of IASB guidance

In April 2022, the IASB sought to partner with a small number of national standard-setters to gather enough information to assess the effect of these initiatives on investors, companies, auditors and regulators.

In the light of the need to exercise judgement on materiality in the application of IFRS Accounting Standards, and their potential wide-ranging impact on financial reporting, it is timely to consider the recent publication (February 2024) by the IFRS Foundation of a summary of evidence gathered by its national standards-setter partners on the effects of guidance on materiality judgements in IFRS Accounting Standards and other materials. For further details, please refer to the summary on IFRS Foundation's website at this link: <https://www.ifrs.org/news-and-events/news/2024/02/ifrs-foundation-publishes-summary-of-national-accounting-standard-setters-research/>

The national standard-setter partners were from Australia, Malaysia, Botswana, China and New Zealand.

In the case of Malaysia, the research, conducted jointly with the Australian Accounting Standards Board (AASB), was based on feedback from 15 preparers and 20 auditors in Malaysia, and indicated that IFRS Practice Statement 2 had been of assistance and was working as intended.

However, a similar survey of auditors across Oceania, Asia and South America drawn mainly from Big 4 firms identified a need for education campaigns to increase awareness and application of IFRS Practice Statement 2 among auditors.

A similar need was identified in research undertaken by the other partners.

Botswana and China concentrated on preparers and noted the important role of auditors when making materiality judgements and the attention given by preparers to meeting local regulatory requirements rather than the guidance provided by the IASB.

In the case of New Zealand less reliance was placed on IFRS Practice Statement 2 due to a practice statement not being perceived as being of equal importance to mandatory IFRS Accounting Standards.

Time to review what is material to your company

In order for Directors to ascertain well in advance the impact which IFRS S1, IFRS S2, IFRS 18 and other IFRS Accounting Standards may have on their company's financial reporting disclosures in the next few years, it may be helpful to now revisit the 4-step approach adopted in IFRS Practice Statement 2 in the context of these Standards to determine and confirm that your company's current general purpose reports present all the information which could be reasonably be expected to influence the decisions primary users make on your company.
