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| Interpretation IFRIC \_\_\_\_\_\_\_\_\_\_ DRAFT  Application the Concept of Materiality In Accounting Procedures And Preparation Of Financial Statements  References:  -*Conceptual Framework for Financial Reporting (the Framework)*  - IAS 1 “Presentation of Financial Statements”  - *IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”*  *- IFRS for Small and Medium-sized Entities (SMEs)*  Source information   1. *The Framework* recognizes significance as a qualitative characteristic of financial statement and gives next definition of significant information: Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. Applying the concept of materiality, according to *The Framework*, presume disclosure in financial statements only information, that could influence the economic decisions that users make on the basis of the financial statements, and exclusion of information that has no influence on such decisions. Thereby, the main objective of applying the concept of materiality is identification and disclosure of useful (relevant) information to users using criterion - materiality threshold. 2. To select materiality threshold, according to *The Framework,* both quantitative and qualitative aspects are applied, involving reference to material such quantitatively immaterial information (both financial and nonfinancial), which could influence the decisions of financial statements users in view of its nature and function. 3. IAS 1 “*Presentation of Financial Statements*” and IAS 8 “*Accounting Policies, Changes in Accounting Estimates and Errors*” state: Material 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. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor. 4. IAS 1 “*Presentation of Financial Statements*” states: An entity need not provide a specific disclosure required by an IFRS if the information is not material.   5 IAS 8 “*Accounting Policies, Changes in Accounting Estimates and Errors*” states: the accounting policies in IFRSs need not be applied when the effect of applying them is immaterial. However, it is inappropriate to make, or leave uncorrected, immaterial departures from IFRSs to achieve a particular presentation of an entity's financial position, financial performance or cash flows.  6 According to IAS 8 “*Accounting Policies, Changes in Accounting Estimates and Errors*”, applying the concept of materiality allow to provide disclosure in the financial statemente of short set of key indicators determining a financial position, results of operations, cash flows and changes in equity, as well as information about all inherent risks of an entity. In addition, applying the concept of materiality involves certain degree of accuracy of the information presented in the financial statements (for example, due to rounding procedures).  7 Most standards issued International Accounting Standard Board contain certain decisions, somehow related to application the concept of materiality.  8 This Interpretation provides responces, related to certain elements the concept of materiality in accounting procedures and financial reporting.  Scope  9 This Interpretation applies to the implementation of certain elements the concept of materiality, selecting and applying of certain accounting policies and disclosure of information related to the concept of materiality.  Issues  10 This interpretation response on the following issues:  (a) how to select the form of accounting and financial reporting;  (b) how does the choice of method and level of rounding for the purposes of accounting and financial reporting influense usefulness of financial statements;  (c) what is the procedure for recognition the objects immaterial, to which specific IFRS requirements aren't applied;  (d) how to apply certain materiality thresholds, provided by IFRS requirements;  (e) how to provide accomplishment of aggregating/desaggregating procedures in order to prepare full-fledged financial statements;  (f) what information is material by nature;  (g) what errors are material, that require correction in financial statements;  (h) what elements of accounting policy, related to applying the concept of materiality shall be disclosed;  (j) what kind of nonfinancial information should be disclosed togeher with the financial statements; and  (к) how to ensure control review of procedures applied before financial statements preparing.  Consensus  **Selecting a form of accounting and financial reporting**  11 *Interrelation with the concept of materiality*: separate accounting procedures, as well as the form and content of financial statements for SMEs and micro-business entities have a significant difference. As a rule, the financial statements of SMEs and micro-business entities are significantly aggregated.  12 The IFRS for SMEs is intended for use by small and medium-sized entities (SMEs). Small and medium-sized entities are entities that:  (a) do not have public accountability, and  (b) publish general purpose financial statements for external users.  Micro-business entities are entities that match the above criteria for SMEs, as well as additional criteria established by national legislation.  .  13 Selection of a form of accounting and financial reporting includes the following steps:  (a) verification of entity’s compliance with criteria established by the IFRS for SMEs;  (b) assessing the possibility of applying the IFRS for SMEs in accordance with national legislation;  (c) consideration of the implications of applying accounting and financial reporting provided IFRS for SMEs (the area of professional judgment);  (d) selecting of accounting and financial reporting.  14 Financial statements, prepared in accordance with IFRS for SMEs should include a reference to it. If the entity that have public accountability use IFRS for SMEs, its financial statement shouldn’t contain any references to compliance with IFRS for SMEs, even if national laws or regulations permit or require that entities use IFRS f or SMEs.  **Influence of the method and level of rounding on the usefulness of financial statements**  15 *Interrelation the concept of materiality:* financial reporting indicators can be presented not absolutely precisely, thus the essential information shouldn't be omitted.  16 According to IAS 1 par. 53, financial statements become more understandable by presenting information in thousands or millions of units of the presentation currency. This is acceptable as long as the entity discloses the level of rounding and does not omit material information.  17 Rounding apply as to accounting procedures and financial reporting. In the accounting procedures rounding is applied both value indicators and physical characteristics. For the purpose of financial reporting it could made a decision about the level of rounding - in thousands or millions of units of the presentation currency. In some cases financial statements may be prepared in units of the presentation currency (without rounding in thousands or millions).  18 In decision-making related to the choice level of rounding should consider the following aspects:  (a) whether the national laws provide possibility to select the level of rounding;  (b) whether specific requirements of the Exchange exist regarding selection the level of rounding financial statements figures;  (c) what level of rounding could be most optimal from financial statements users perspective;  (d) whether the significant information could be omitted as a result of applying the chosen level of rounding;  (e) whether there will be a necessity to disclose in the notes to the financial statements certain essential information that won't be included in the financial statements forms as a result of applying the chosen level of rounding;  (f) whether the impact of cumulative effect associated with applying of rounding is considered.  19 When choosing a method of rounding should be considered that the most commonly used rounding to the nearest integer, with the number of decimal rounded to the N-th sign in the N +1 depending on the sign:  - if N +1 sign< 5, then N-th sign remains, and N +1 and all subsequent reset;  - if N +1 sign≥ 5, then N-th sign increase by unit, and N +1 and all subsequent reset.  For the purposes of financial reporting the following modified methods of rounding to the nearest number could be applied:  (a) banker's rounding, when rounding occurs to the nearest even, that allows to eliminate a regular rounding error in the summation of a considerable quantity of numbers;  (b) when rounding occurs in smaller or larger side in random order, but with equal probability (often used in statistics);  (c) alternating rounding, when rounding occurs in smaller or larger side of the turn;  These rounding modifications apply if the (N +1)-th symbol is equal 5 and allow to reduce potentially negative impact of a cumulative effect.  In selecting the level of rounding in financial statements should be considered the following:  (a) requerements of concistency presentation in financial statements;  (b) the more figures are presented in the financial statements the more significant is potential negative impact of cumulative effect.  **Procedure for recognition of objects immaterial, to which IFRS requirements do not apply**   1. *Interrelation with the concept of materiality:* IFRS requirements need not be applied to certain immaterial accounting objects and therefore information about them will not be true and accurate, but owing to its insignificance, it will not influence the decisions of financial statements users. 2. IFRS explicitly provide possibility not apply their requirements regarding immaterial items (Section ‘Scope and authority of International Financial Reporting Standards’, Preface to International Financial Reporting Standards; par.8 IFRS (IAS)8) and prescribe that accounting 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 IFRSs to achieve a particular presentation of an entity’s financial position, financial performance or cash flows. 3. To make a decision related to recognition of accounting object immaterial, which would not apply IFRS requirements, consider the following aspects:   (a) permission in IFRSs do not apply of their requirements to immaterial accounting objects does not preclude the possibility of applying these requirements to immaterial objects;  (b) the use of standard requirements to immaterial objects is justified in some cases, both in terms of the concept of materiality, as well as in terms of cost-benefit ratio;  (c) for difficult in terms of accounting immaterial objects possible partial applying of IFRS requirements, in that cases should refuse of statement about compliance with standards’ requirements concerning such objects;  (d) in decision making about referring of particular accounting objects to material/immaterial, it is necessary to consider both their size, and character in certain circumstances;  (e) the possible impact of a cumulative effect should be considered, that leads to the items, initially considered as immaterial, accumulate and reach a material value.  **Application of separate materiality thresholds provided by IFRS** **requirments**   1. *Interrelation with the concept of materiality:* application of materiality thresholds allow to specify borderline between material and immaterial information. 2. Certain IFRS provides application of materiality thresholds for the purposes of accounting and disclosures in financial statements. Application of materiality thresholds is a matter of professional judgment. 3. To make a decision related to applying of materiality thresholds should consider experience and best practice as well as the following aspects:   (a) in selecting materiality thresholds the relevant guidelines adopted by local jurisdiction should not be ignored as they are usually based on the best practices. However, these guidelines should serve as a basis for professional judgment, rather than categorical requirements.  (b) requirements of national laws related to applying of materiality thresholds;  (c) requirements of particular IFRS related to applying of materiality thresholds;  (d) definitions, acceptance criteria and measurement concepts of assets, liabilities, revenues and expenditures, provided by the Framework;  (e) developments and guidelines of accounting borders (IASB, FASB, at alias)  (f) best practice of companies operating in the same industry to the extent it does not contradict the abovestated requirements.   1. Selection of materiality thresholds relevant to individual objects of accounting and financial statements items, based on professional judgment taking into consideration referred to above requirements, should be determined by the accounting policy of the entity, that requires consistent application. For better understanding of general approach to materiality thresholds by the financial statements users, key elements of accounting policy applied should be reflected in the notes to financial statements.   **Performing of aggregating procedures for the purpose of financial reporting**   1. *Interrelation with the concept of materiality:* procedures of aggregating provide brief disclosures of information, if there is no requirement of expanded presentation. Applying of disaggregation provide detailed disclosure of aggregated information to more complete understanding of it. 2. Procedures of aggregation and disaggregation are critical in terms of materiality concept and are determined by IFRS (IAS)1 in the form of requirement to present separately each material class of similar items, and items of a dissimilar nature or function unless they are immaterial. 3. Fundamental for the pupposes of aggregation is: if a line item is not individually material, it is aggregated with other items either in those statements or in the notes. An item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes. 4. Procedures of aggregation include possibility:   (a) aggregate in financial statements items of a similar nature or function, that recorded separately, in single item;  (b) add immaterial items to material items;  (c) consolidate several immaterial items in single item.   1. Procedures of disaggregation arise from necessity to disclose in the notes information presented aggregated in financial statements. Main purpose of aggregation is to disclose certain components of the items that was aggregated in financial statements both at the level of sub-account and at the level of item for the purpose of better disclosure (due to requirements of IAS1, setting out that an item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes.) 2. Professional judgment is used to perform procedures of aggregation or disaggregation, that relates to deciding about:   (a) differentiation material and immaterial items;  (b) acceptability of adding immaterial items to material items or combining them into single item;  (c) the necessity to disclose in the notes to financial statements information about the individual components of aggregated items   1. In decision-making relate to aggregation/disaggregation procedures should be considered:   (a) item’s nature or function;  (b) necessity in testing of items from the point of both qualitative and quantitative aspects;  (c) acceptability of including “other” items in financial statements, given the fact, that presence the word “other” in the title of item itself at a certain level of perception enable to refer that item to the category of immaterial;  (d) necessity to identify material item to which adding immaterial items is possible;  (e) importance of selecting the information to be disaggregated in the notes to the financial statements, considering the need for elimination effect of “littering” information;  (f) necessity to apply materiality thresholds.  **Identification of information relevant to material in nature (qualitative aspect)**   1. *Interrelation with the concept of materiality:* certain quantitatively insignificant but qualitatively essential information could considerable influence the decisions of financial statements users. 2. Disclosure of quantitative immaterial but qualitatively significant information, not reflected in financial statements, is usually achieved by including that information in the notes to financial statements. The need for disclosure of such information is defined by its influence on decisions of the financial statements users. In decision-making to disclose certain quantitatively immaterial information, accountant uses a professional judgment to determine the extent of the potential impact such information on decisions of the financial statements users. 3. Identification of information that is essential for decision-making cannot be a subject of exclusively quantitative estimation, because the magnitude and nature of the information can be decisive. The information, that could be material even at its insignificant size, include:   (a) information that supplement material information and comtribute its more complete understanding;  (b) information relates to penalties, financial, administrative sanctions;  (c) information relates to management’s payments;  (d) information relates to new markets entry (must be disclosured, for example, even insignificant gains);  (е) information relates to new segments;  (f) information relates to value of pleged assets,  (g) information relates to financial impact events after the balance date.   1. In many cases, there is a necessity to disclose information that is not financial, but is directly related to financial and supplement it to a more complete understanding. This information may include (not exclusively):   (a) the fact of providing assets as collateral (provision)  (b) information about events after the balance date;  (c) information relates to litigations;  (d) information about human resources dinamics.  **Material Errors Correction**   1. *Interrelation with the concept of materiality:* in identifying the errors it is necessary to make a decision on their materiality *–* extent of influence on financial statements reliability. 2. Procedure for correcting errors in the financial statements specified in IAS 8, which determines that financial statements do not comply with IFRSs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity’s financial position, financial performance or cash flows. Implementation of the concept of materiality for the purpose of correcting errors consists in determining of materiality of such errors, their impact on the reliability of financial statements, and assessing of their cumulative effect. 3. To determine materiality of errors professional judgment is applied. It requires to receive an answers to the following, whether:   (a) the error is quantitatively material;  (b) the error is made intentionally to achieve a particular presentation of an entity’s financial position, financial performance or cash flows;  (c) what is the effect of uncorrected misstatements due to prior period errors on the current information disclosure and the decisions of financial statements users;  (d) the error influence on comparability and consistency.   1. Since materiality of error is determined, decision is made about relate disclosures in the notes in accordance with the procedure prescribed by IAS8.   **Disclosure accounting policies elements, related to the concept of materiality**   1. *Interrelation with the concept of materiality:* for a complete understanding of individual elements of accounting policy by the users of financial statements in relation to the concept of materiality, these elements should be disclosed in the notes to the financial statements, thereby avoiding varied understanding of the subjective approach to selecting of accounting policy made on the basis of professional judgment. 2. To realize the concept of materiality inaccounting procedures management shall select and consistently apply accounting policies, relating to:   (а) selection of accounting form and financial statements;  (b) selection of method and level of rounding for accounting procedures and preparation of financial statements;  (c) determination of the order of recognition accounting units are immaterial, that IFRSs need not be applied;  (d) compliance with particular legal requirements and accounting standards, relates to materiality;  (e) using of aggregation and disaggregation;  (f) identification of quantitatively immaterial and supplement nonfinancial information that could influence the economic decisions of users;  (g) disclosure of material nonfinancial (ecological, social and managerial) information;  (h) material errors identification, classification and correction.   1. Entity shall disclosure specific elements of accounting policies, relate to the concept of materiality, such as:   (а) method and level of rounding in financial statement figures;  (b) order of recognition accounting units are immaterial, that IFRSs need not be applied;  (c) materiality threshold, relevant to particular accounting units and financial statement items.   1. Results of separate elements the concept of materiality application are:   (а) disclosure of aggregated material information in the financial statements, and disaggregated material information in the notes;  (b) disclosure in the notes to the financial statements quantitatively immaterial and supplement nonfinancial information that could influence the economic decisions of users;  (c) disclosure of material nonfinancial information;  (d) disclosure related to correction of material errors.  **Disclosure Nonfinancial Information With Financial Statements [[1]](#footnote-2)**  *Interrelation with the concept of materiality:* significant nonfinancial (environmental, social, managerial) information along with information in financial statements allow fully and comprehensively assess various aspects of the entity’s operations, identify inherent risks and therefore make the most informed economic decisions.   1. Possibility to disclose non-financial information is provided IAS 1. The modern entity represents not only system generating cash flow, but also an entity that undertakes a social responsibility beyond the requirements of current legislation. This means that an entity assume responsibility for influence of its activities to contracting parties, employees, shareholders, local communities and other stakeholders of the public sphere (the so-called concept of corporate social responsibility). Voluntary commitments accepted ​​by the entity, imply additional measures to improve the quality of life for employees and their families, as well as local community and society as a whole and certainly affect the entity’s financial position. 2. The concept of sustainable development emerged as a result of combining the three basic perspectives: economic, social and environmental, and identifies the process where exploitation of natural resources, the direction of investments, orientation of technological development, personal development and institutional changes are consistent with each other and strengthen the current and future potential to meet human needs and aspirations. 3. The results of all activities of the company within the concept of sustainable development should be taken into account and disclosed to make possible decision-making. 4. Traditional accounting models are not able to assess the environmental efficiency of the entity and its impact on financial performance. However, it is obvious that users of financial information are also interested in obtaining non-financial information, covering entity’s environmental, social activity and structure of its corporate governance. 5. Applying the concept of materiality to disclosure of non-financial information should be structured and sequential process, understandable to users of the information, herewith the matter of recognition particular information material to be disclosed in the financial statements, relates to the scope of professional judgment. 6. Accounting policy of the entity regarding disclosure of non-financial information should define a procedure of identifying the relevant information to be disclosed in general format of the integrated reporting.   **Performing Of Control Review Procedures Applied Before Financial Statements Preparation**   1. The purpose of reviewing the implementation of control - an assessment of all procedures that are applied within the concept of materiality prior to the preparation of financial statements to exclude effect of a critical accumulation. 2. Before preparation of financial statements management shall perform a retrospective review of all decisions and procedures related to the concept of materiality to detect and prevent adverse impact of cumulative effect (the effect of a critical accumulation). The main objective of this review is to assess whether the procedures applied within the scope of materiality concept allow to prepare full-fledged unambiguous, useful information that could influence the economic decisions made by users on the basis of the financial statements, and whether any significant information has been omitted in financial statements.   Effective Date   1. Entity shall apply this Interpretation for annual periods beginning on or after 1 January 20\_\_. Earlier application is permitted. If an entity adopts this Interpretation for an earlier period, it shall disclose that fact.   Transition  IAS 8 specify how an entity should implement a change in accounting policy, resulting from initial application of an Interpretation. Entity does not need comply these requirements in the first-time adoption of this Interpretation. If an entity has used this exemption from the requirements, it shall apply the provisions of paragraphs 6-9 of the this Interpretation for the agreements in force at the beginning of the earliest period for which comparative data are presented according to IFRS based on the facts and circumstances existing at the beginning of the period. |

1. This section will be applied after the coming into force of the amendments to IFRS [↑](#footnote-ref-2)