



Technical Advisory Group

Issue Paper

AGENDA ITEM: TAGFG05-04

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Implementation Guidance on Materiality

Summary	This paper provides TAG members with a draft of the Implementation Guidance for materiality. This draws on the provisions in Section 2 <i>Concepts and pervasive principles</i> and the IASB's Practice Statement 2 <i>Making materiality judgements</i> .
Purpose/Objective of the paper	The purpose of this paper is to seek TAG members' advice on the scope of the draft Implementation Guidance on materiality and how this relates to other INPAG sections.
Other supporting items	NA
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Actions for this meeting	Comment on: <ul style="list-style-type: none">The content and approach to the new Implementation Guidance on materiality to be included in Section 2.

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Implementation Guidance on Materiality

1. Introduction

- 1.1 Materiality has been raised in the majority of responses to the Exposure Drafts, with respondents seeking further guidance on the application of materiality to INPAG Sections. Materiality is a pervasive concept and as a result the Secretariat proposed in previous TAG meetings that general non-authoritative guidance, similar to the IASB's Practice Note 2 *Making Materiality Judgements*, be included in the Implementation Guidance. The Secretariat proposed that this general guidance could be supported by section specific guidance where necessary. TAG members supported this approach.
- 1.2 This paper sets out the approach to the development of the Implementation Guidance on the general application of materiality to be included in Section 2 *Concepts and pervasive principles*.

2. Background

- 2.1 TAG Members will be aware that responses to the Exposure Drafts have sometimes led to questions over the application of materiality to the various proposals and issues on which comments were sought. It is a regular issue where accounts preparers are seeking guidance.
- 2.2 Issues relating to low value inventory items and in response to the fund accounting proposals have been raised by respondents to EDs 2 and 3. These responses in particular have highlighted the need for additional guidance on materiality. Both topics have also raised questions about whether a threshold should be set. Recently respondents to SMCs on fundraising have also suggested that there should be a threshold set when considering if there is a need to split fundraising costs from other costs where a single activity is for more than one purpose.
- 2.3 International Standards generally do not set quantitative thresholds and TAG members have agreed that introducing a threshold would be problematic. TAG members' advice has been to apply materiality.
- 2.4 Materiality is a pervasive issue for all international standards. In principle the Secretariat is of the view that materiality guidance should not be repeated for each of the INPAG sections. Consequently, the Secretariat proposed that additional Implementation Guidance is included in Section 2, drawing on the IASB's Practice Note 2. This was supported through discussions at the September and December 2024 TAG meetings.
- 2.5 In addition to the general guidance, the Secretariat will consider whether specific materiality guidance is needed for each section, though this will be on an exceptional

basis. The Secretariat will also consider illustrative examples to demonstrate the application of materiality in the context of each section (again on an exceptional basis so that accounts preparers understand that materiality is a pervasive concept). The Secretariat will also consider TAG's recent discussions on the use of illustrations to ensure only those necessary to illustrate specific principles and concepts are included.

- 2.6 Appendix A includes a draft of the new paragraphs to be inserted into the Section 2 Implementation Guidance. This includes paragraphs (shaded) that were considered by TAG at its September meeting. Two paragraphs (IG2.5 and IG2.6) have been deleted in the light of the new guidance.

3. Approach to the Implementation Guidance on materiality

- 3.1 The development of the guidance on materiality has been inspired by IFRS Practice Statement 2, which provides non-mandatory guidance on the application of materiality when using IFRS standards. The new material in Section 2 Implementation Guidance reflects the overall context of the Implementation Guidance to Section 2 and as the concept of materiality will be applied to NPO circumstances. The previous relatively brief guidance on materiality has therefore been replaced with more detailed Implementation Guidance, albeit the Secretariat has also been mindful of the need to ensure that it is concise and understandable.
- 3.2 The IASB's Practice Note 2 is focused on encouraging a greater understanding of the role of materiality in applying IFRS and of how judgement should be exercised to assess materiality in preparing financial statements. The Practice Note, which is relatively long, has been used to inform the guidance that has been drafted.
- 3.3 The additional material on materiality includes guidance covering the following issues:
- The assessment of primary users' information requirements, including the importance of the need to consider both existing and potential users.
 - That materiality is pervasive to the application of INPAG across general purpose financial reports, ie that it applies to recognition, measurement, presentation and disclosure.
 - That materiality factors are both quantitative and qualitative, including a discussion of how those factors might apply.
 - The impact of materiality on presentation and disclosure, and
 - How materiality interacts with regulatory requirements.
- 3.4 Illustrations and examples have been included. Again, the Secretariat is mindful of the recent and previous discussions at TAG on the use of illustrative examples and has ensured that these are only used where they can assist with the understanding of the principles and concepts.



Question 1: What are TAG members' views on the proposed guidance? Are TAG members content that it addresses the general application of materiality?

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Appendix A – Section 2 Implementation Guidance (materiality)

Primary users of general purpose financial reports

Are donors and other funders primary users of financial statements?

IG2.1 Paragraph G2.6 confirms that donors (and other funders) are acting as primary users when they do not have rights to demand information tailored to meet their particular information needs. However, donors' (and other funders') needs are complex because in some instances they may only have access to generally available information and in other instances they may be able to require information to be tailored to meet their particular needs, (special purpose financial reports). These special purpose financial reports are outside the scope of INPAG. However, INPAG Practice Guide 1 Supplementary Statements offers a standard format for an optional supplementary statement that can meet the financial accountability needs of providers of grant funding.

What information might resource providers and the public that depend on the goods and services provided by NPOs or on the activities that they carry out need?

IG2.2 Paragraphs G2.14 – G2.15 set out that general purpose financial reports will provide information on the financial position, financial performance and cash flows. The financial statements will provide information about the effects of transactions and other events that change a reporting NPO's economic resources and claims.

IG2.3 Resource providers and the public that depend on the goods and services provided by the NPO or on the activities that they carry out need financial and non-financial information to support accountability and decision making in the following areas:

- The performance of the NPO during the period. This will include information on how an NPO meets its purposes (including financial and service objectives). It will include information to assess whether the NPO has used resources in a way which maximises economy, efficiency, and effectiveness in the delivery of its activities. Information in the Statement of Income and Expenses and Statement of Changes in Net Assets will inform assessments of how an NPO has met its financial objectives and whether it has acquired its resources economically.
- The liquidity (ie resources available to meet current obligations) and solvency (ie resources to meet future obligations). The Statement of Cash Flows and associated notes will contain the relevant information.
- The sustainability of the NPO's activities over the long term the demonstration of the achievement of its objectives. An NPO will need to provide users with information on its levels of funds and reserves. It will need to be able to demonstrate that it will be able to access long term funding sources and that these resources can meet current and future costs related to future activity.
- The ability of the NPO to comply with the specifications set by government regulatory or other similar bodies that the NPO must meet in providing services and raising resources. The general purpose financial report will be able to provide information to support this.

Qualitative characteristics of financial and non-financial information

How will the qualitative characteristics of financial and non-financial information impact on general purpose financial reports?

IG2.4 Applying the qualitative characteristics of financial and non-financial information may appear difficult for NPOs that have access to limited technical accounting resources. However, NPOs will generally not need to separately consider the qualitative characteristics. This is because the guidance in other INPAG

Sections describe the accounting treatment that must be followed and how the NPO recognises, measures, presents and discloses the transactions. The qualitative characteristics of financial and non-financial information have been used to develop the requirements for each of these Sections. The qualitative characteristics can be used to support the application of each INPAG Section particularly where a transaction has characteristics that do not appear to fit with those defined within each Section. However, use of these qualitative characteristics by NPOs is not expected to be generally necessary.

~~IG2.5 — Ensuring accounting systems and processes are in place that are well designed and operating effectively will assist in enabling NPOs to gather and process the financial and non-financial information needed to apply the qualitative characteristics to transactions and economic events and comply with the relevant requirements of INPAG.~~

~~IG2.6 — From a reporting perspective, the needs of users should guide how NPOs present and disclose financial and non-financial information. Materiality and whether users require the information for accountability and decision-making purposes is a key consideration. NPOs also need to ensure that where they report material information, they also consider users' abilities to understand the information provided. Certain transactions and economic events necessarily require complex accounting treatments. For users to understand these, it may be necessary to provide additional explanatory disclosures. NPOs may also need to provide additional disclosures to enable users to understand material unrecognised assets and liabilities or longer-term trends.~~

How might an NPO make decisions about materiality in general purpose financial reports?

- IG2.5 NPOs need to assess the needs of their primary users. This assessment guides how NPOs report financial information and what information is important to their primary users. It is therefore fundamental when considering materiality.
- IG2.6 When making materiality judgements, an NPO needs to consider the impact information could reasonably be expected to have on existing and potential primary users of its general purpose financial reports. Those primary users are:
- resource providers;
 - the public that depends on the goods and services provided by NPOs; and
 - those acting as representatives of the interests of resource providers and the public that depend on the goods and services provided by NPOs.
- These are users who cannot require NPOs to provide information directly to them and must rely on general purpose financial statements for much of the financial information they need. In addition to those primary users, other parties, such as the NPO's management, regulators and other members of the public, (ie those that are not dependent on the goods and services provided by the NPO) may be interested in financial information about the NPO and may find the financial statements useful. However, the financial statements are not primarily directed at these other parties.
- IG2.7 When assessing whether information is material to the financial statements and narrative report, an NPO applies judgement to decide whether the information could reasonably be expected to influence decisions that primary users make based on those financial statements. When applying such judgements, the NPO considers both its specific circumstances and what the information provided in the financial statements contributes to the decision making needs of primary users.
- IG2.8 The application of materiality is vital to support accountability and decision making. The definition of materiality at paragraph G2.22 focuses on information being material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make based on those reports.



- IG2.9 Judgements made on materiality are pervasive to general purpose financial reports. This means that all decisions (judgements) on information to be included in NPO general purpose financial reports, including recognition, measurement, presentation and disclosure, will be subject to materiality considerations. This includes what information can be aggregated or shown separately. Consequently, INPAG requirements only need to be met if their effect is material to the complete set of financial statements (including prior period information) and the narrative report.
- IG2.10 The information needs of primary users are discussed in paragraph IG2.2 and IG2.3 above. When making materiality judgements NPOs need to ensure that the needs of both existing and potential users are met. For example, where an NPO provides medical services using both donated and non-donated assets (including hospitals and outreach centres to be able to serve the various local communities) it needs to consider the common information needs of its primary users. The NPO considers that the current users of the financial statements are the funders providing the donated assets. However, to decide what might be material information and to make the relevant materiality judgements the NPO must consider not only the current users of the financial statements, but also potential users. These potential users include:
- donors or funders that might contribute resources in the future;
 - service users or other members of the community that rely on the medical services provided by the NPO; and
 - individual members of a local government body that act on behalf those in receipt of the medical services.
- IG2.11 An NPO is only required to apply INPAG recognition and measurement requirements when the effect of applying them is material. An NPO might conclude that an item of information is material for various reasons. Those reasons include the item's nature (qualitative factors) or size (quantitative factors), or a combination of both, judged in relation to its circumstances. The NPO's assessment is thus both quantitative and qualitative.
- IG2.12 For example, Section 17, *Property, plant and equipment* requires that an NPO recognise an item of property, plant and equipment when it meets the criteria in paragraph G17.4. To implement this requirement an NPO decides to set a threshold for when expenses on property, plant and equipment are capitalised, so that only amounts above the threshold are capitalised. The NPO develops the accounting policy such that in not capitalising its expenses on property, plant and equipment there will not be a material effect on the current financial statements or on future financial statements. In reaching this judgement the NPO determines which information about the amounts not capitalised and their potential depreciation are below the threshold that could be reasonably expected to influence decisions made by the primary users of the NPO's financial statements.
- IG2.13 Materiality can also affect how information is presented and disclosed. For example, an NPO might carry its property, plant and equipment at historical cost in the Statement of Financial Position. However, it may have a single investment property that it cannot reliably measure at fair value, and which is therefore measured at historical cost less accumulated depreciation and impairment. Paragraph G4.2 requires investment properties held at historical cost less accumulated depreciation to be presented as a separate line item in the statement of financial position.
- IG2.14 However, if the NPO determines that the carrying value of the single investment property is not material it might decide to present it in the property, plant and equipment line item by aggregating it within the total property, plant and equipment in the Statement of Financial Position. The NPO may also take the decision to report the item as a separate column in the reconciliation of the property, plant and equipment note showing separately aggregations of items of property, plant and equipment and the investment property in the notes to the financial statements.
- IG2.15 The examples of the application of materiality in IG2.13 and IG2.14 above assumes that there are no qualitative factors and is therefore based on an assessment of quantitative materiality only.

What factors should an NPO consider to assess whether information is material?

IG2.16 Paragraph G3.17 requires that an NPO assess whether information, either individually or in combination with other information, is material in the context of its financial statements when these are taken as a whole. This means that while information may not be judged to be material on its own, it might be material when it is considered in combination with other information in the complete set of financial statements.

Quantitative assessment

IG2.17 An NPO will normally assess whether financial information is quantitatively material by considering the size of the impact of the transaction, other event or condition. This can be considered against measures of its financial position (eg net assets), financial performance (eg income, expenses and/or surplus or deficit) and/or cash flows.

IG2.18 The assessment includes not only the size of the impact of a transaction that is recognised in the primary financial statements but also takes account of any items that have not been recognised (eg contingent liabilities or contingent assets) that could ultimately affect primary users' overall perception of the NPO's financial position, financial performance and cash flows. The NPO needs to determine if 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 the NPO. This includes the current and future provision of resources to it. The NPO's assessment might, for example, be a decision about when to recognise an item of income or expense in the financial statements (timing) or for example, whether an item is so material that it should be presented on the face of the Statement of Income and Expenses rather than included in relevant disclosures.

IG2.19 Identifying what measures to use for the quantitative assessment is a matter of judgement. Measures may be a specified amount (threshold amount), a rate (percentage) relative to specified amounts (for example for subheadings) in the primary financial statements or some other level. These measures are often used as a tool in making materiality judgements. The measure selected will need to be the one that is most appropriate for the transaction, event or condition.

IG2.20 Frequently, an assessment about materiality is made with reference to the overall level of income. However, as income received by NPOs can fluctuate between years, it may be, for example, more appropriate to use expenses as a reference point. Judgements about materiality depend on which measures are of significant interest to the primary users of the NPO's financial statements. Other example measures might be:

- overall revenues for grants and donations;
- total expenses;
- the NPO's financial surplus or deficit;
- total funds in net assets;
- total non-current assets;
- financial position ratios; and
- cash flow measures.

Qualitative assessment

IG2.21 Materiality assessments also require analysis of NPO specific and external qualitative factors. Qualitative factors related to an NPO's transactions, other events or conditions include, but are not limited to:

- Local and national interest, including political or community interest, in a transaction, event or condition.

- Receipt of a donation from an individual or organisation with conflicting objectives to those of the NPO.
- Related party involvement in an NPO.
- Uncommon or non-standard features in an NPO's operations.
- Unexpected variations or unexpected changes in trends.

IG2.22 An NPO could identify an item of information as material based on one or more of these qualitative materiality factors. Generally, the more factors that apply to an item, or the more significant those factors are, the more likely it is that the item is material. These factors may need therefore need to be considered individually or as a combination of factors.

IG2.23 External qualitative factors relate to the context in which an NPO operates. This might be related to transactions, events or conditions that if present are more likely to influence primary users' decisions. They might include, but are not limited to, the economic or regulatory environment, an NPO's location, the sector an NPO operates in, regulatory issues or the particular concern that many NPOs and their primary users have for environmental issues.

IG2.24 The presence of qualitative factors generally lowers the thresholds for the quantitative assessment. The more significant the qualitative factors, the lower those quantitative thresholds will be.

How might materiality judgements affect presentation of information in general purpose financial reports?

IG.25 An NPO will need to use materiality judgements to determine what information is presented in the financial statements and how it is presented in a clear and understandable way. This might be to:

- aggregate or disaggregate information;
- emphasise material matters or items of information;
- describe transactions as simply as possible without omitting material information or adding to the length of the general purpose financial report;
- provide information in a way that maximises, to the extent possible, comparability among NPOs and across reporting periods
- highlight relationships with different pieces of information across the general purpose financial report;
- present information appropriately for primary users, for example, in a narrative or tabular format;
- avoid or minimise duplication in different parts of the general purpose financial report.

IG2.26 In making decisions about presentation, an NPO will need to consider the overall perspective of its financial position, financial performance and cash flows, along with its non-financial information. It also needs to consider the relationships between different items of information and aggregations of information which might lead to an item being assessed as material. NPOs must also consider whether the NPO's financial position, financial performance and cash flows, along with its non-financial information, are presented in a fair and understandable way to avoid obscuring material information.

How will materiality interact with regulatory requirements?

IG2.27 For an NPO to confirm compliance with INPAG it must comply with the requirements of all sections including those related to materiality. An NPO cannot provide less information than required by INPAG and confirm compliance even if local laws and regulations permit otherwise. Conversely local laws and regulations may specify requirements which will require information to be provided even if this is not material. This might, for example, include remuneration disclosures. In such cases providing information to meet these requirements is permitted by INPAG though NPOs should ensure that it avoids obscuring material information in the financial statements.