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**International
Accounting Standards
Board**

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IASB Meeting: 20 July 2005, London

Project: Conceptual Framework - Qualitative Characteristics 4: Definitions of understandability and materiality (Agenda Paper 7B)

INTRODUCTION

1. This paper considers two follow-up items from June — definitions of understandability and of materiality.

UNDERSTANDABILITY

2. In June, the Boards requested that the proposed definition of understandability, “the quality of information that enables users to perceive its significance,”¹ be refined. During the June meetings, staff suggested that the phrase “perceive its significance” be replaced with “identify the economic phenomena that it purports to represent or the meaning of the message trying to be shown”.
3. [Not included in Observer Notes]
4. In summary, we recommend that understandability be described as follows in the proposed converged framework:

¹ See FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*, Glossary of Terms.

Definitions of understandability and materiality

“*Understandability* is the quality of information that enables users to comprehend its meaning. Financial statement users are expected to have a reasonable knowledge of business and economic activities and accounting, and a willingness to study the information with reasonable diligence. Understandability is enhanced when information is aggregated, classified, characterized, and presented in a clear and concise manner. Relevant information should not be excluded because it is too complex or difficult for certain users to understand.”

MATERIALITY

5. Based on the IASB and FASB definitions of materiality² and the improvements agreed to by the Boards in the June meetings, we recommend the following definition of materiality, based on terminology from the IASB Framework and CON 2, as appropriate:

“Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the nature and amount of the item judged in the particular circumstances of its omission or misstatement. Given the pervasive nature of materiality, it is difficult to consider the concept except as it relates to the qualitative characteristics of relevance and faithful representation. Thus, materiality is a screen or filter used to determine whether information is sufficiently significant to influence the decisions of users in the context of the entity, rather than as a qualitative characteristic of decision useful financial information.”

The Australian, Canadian, New Zealand and UK frameworks describe materiality in a similar manner.³

² IASB Framework definition of materiality is “Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements” (paragraph 30). CON 2 Glossary definition of materiality is “The magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.” Additional guidance supporting the definition in CON 2 is “Materiality is not a primary characteristic of the same kind. In fact, the pervasive nature of materiality makes it difficult to consider the concept except as it relates to the other qualitative characteristics, especially relevance and reliability.” (paragraph 124)

³ The Japanese Discussion Paper, “Qualitative Characteristics of Accounting Information,” notes that materiality is not included – it is considered self-evident, overlapping with other characteristics, or doubtful about its significance.