

**88Meeting:** International Public Sector Accounting  
Standards Board

**Meeting Location:** Virtual Meeting

**Meeting Date:** June 15–18 and 22, 2021

## Agenda Item 8

For:

- ☐ Approval  
☒ Discussion  
☐ Information

### CONCEPTUAL FRAMEWORK–LIMITED SCOPE UPDATE (CF-LSU) – NEXT STAGE

<b>Project summary</b>	The project objective is to update the Conceptual Framework for a limited number of issues based on the criteria of urgency, consequences, feasibility, and prevalence, with an emphasis on the first three of these criteria.	
<b>Board Sponsor</b>	Ian Carruthers, IPSASB Chair	
<b>Meeting objectives</b>	<b>Topic</b>	<b>Agenda Item</b>
<b>Project management</b>	<a href="#">Conceptual Framework–Limited Scope Update (CF-LSU)–Next Stage: Project Roadmap</a>	<a href="#">8.1.1</a>
	<a href="#">Instructions up to Previous Meeting</a>	<a href="#">8.1.2</a>
	<a href="#">Decisions up to Previous Meeting</a>	<a href="#">8.1.3</a>
<b>Decisions required at this meeting</b>	<a href="#">Service Potential</a>	<a href="#">8.2.1</a>
	<a href="#">Prudence</a>	<a href="#">8.2.2</a>
	<a href="#">Materiality: Scope of Update</a>	<a href="#">8.2.3</a>

**CONCEPTUAL FRAMEWORK–LIMITED SCOPE UPDATE (CF-LSU) –  
NEXT STAGE: PROJECT ROADMAP**

Meeting	Completed Actions or Discussions / Planned Actions or Discussions:
<b>Conceptual Framework–Limited-Scope Update</b>	
March 2020	1. Approve Limited Scope Update of Conceptual Framework Project Brief
June 2020	1. Discussion of Issues
September 2020	1. Discussion of Issues 2. Review [draft] Exposure Draft 76, <i>Conceptual Framework Update: Chapter 7, Measurement</i>
October 2020	1. Discussion of Issues
December 2020	1. Approve Exposure Draft 76
February 2021	1. Finalize remaining instructions
March 2021	1. Discussion of Issues
June 2021	1. Discussion of Issues
September 2021	1. Discussion of Issues 2. Review [draft] Exposure Draft <i>Conceptual Framework Update: Chapter 3, Qualitative Characteristics and Chapter 5, Elements</i>
December 2021	1. Approve Exposure Draft 81

**INSTRUCTIONS UP TO PREVIOUS MEETING**

Meeting	Instruction	Actioned
<b>Conceptual Framework–Limited-Scope Update</b>		
February 2021	1. All instructions provided up until February are reflected in the <a href="#">ED 76, Conceptual Framework Chapter 7, Measurement: Update</a>	1. All instructions provided up until February are reflected in the <a href="#">ED 76, Conceptual Framework Chapter 7, Measurement: Update</a>
March 2021	N/A	N/A

## DECISIONS UP TO PREVIOUS MEETING

Meeting	Decision	BC Reference
<b>Conceptual Framework–Limited-Scope Update–First Stage</b>		
February 2021	1. All decisions provided up until February are reflected in the <a href="#">ED 76, Conceptual Framework Chapter 7, Measurement: Update.</a>	1. All decisions provided up until February are reflected in the <a href="#">ED 76, Conceptual Framework Chapter 7, Measurement: Update.</a>
March 2021	1. Group the topics in the next stage of the Limited Scope Update according to whether then relate to Chapters 3 and 5 of the Conceptual Framework.	1. Topics grouped in accordance with March <a href="#">Agenda Paper 8.2.1</a> . BC paragraph to be presented to IPSASB in September 2021.
	2. Consider service potential in addition to the issues originally identified in the <a href="#">project brief</a> approved in March 2020.	2. <a href="#">Agenda Item 8.2.1</a> . considers service potential. BC paragraphs to be included in draft ED 81 and presented to IPSASB in September 2021.
	3. Further work on capital maintenance and concepts of capital should be taken forward separately on a longer timeframe.	3. BC paragraph(s) to be included in draft ED 81 and presented to IPSASB in September 2021.

## Description of Service Potential

### Question

1. Does the IPSASB agree that:
  - (a) The concept of service potential should be retained in the IPSASB Conceptual Framework (the PSASB Framework)?
  - (b) The description of service potential in paragraph 5.8 of the IPSASB Framework should be amended to replace references to 'capacity to provide services that contribute to achieving the entity's objectives' with 'ability to provide services that contribute to achieving the entity's objectives.' (staff underlining for emphasis)?

### Recommendations

2. Board Sponsor and Staff recommend that:
  - (a) The concept of service potential should be retained in the IPSASB Framework.
  - (b) The description of service potential in paragraph 5.8 of the IPSASB Framework should be amended to replace the reference to 'capacity' with 'ability'.

### Background

3. 'Service potential' was not identified as a key issue in the project brief approved at the March 2020 meeting. Key Issue #7 is a review of the definitions of an asset and a liability in the IPSASB Framework in the light of the finalized definitions of 'an asset' and 'a liability' in the International Accounting Standards Board's Conceptual Framework, which post-dated the approval of the IPSASB Framework in 2014. Key Issue #7 is also considering the experience of applying the definition of a liability in the Revenue project (see Agenda Item 6.2.4).
4. Service potential is not referred to directly in the definition of an asset in the IPSASB Framework. It is however indirectly encompassed in the definition of an asset by the inclusion of 'resource' in that definition. Service potential is in the definition of 'assets' in IPSAS 1, *Presentation of Financial Statements*.
5. Reservations about the current description of service potential in Chapter 5, *Elements*, of the Conceptual Framework arose during the development of the definition of, and commentary on, current operational value. Service potential was also an issue in finalizing [ED 75, Leases](#).<sup>1</sup>
6. It was therefore proposed during the December 2020 meeting that this issue should be considered in the next stage of the Limited Scope Update. Members confirmed this approach at the March 2021 meeting.

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<sup>1</sup> In the context of identification of a lease see AG 10 and BC46-48 in ED 75. Specific Matter for Comment 3 asks for views on the IPSASB's decision to include both economic benefits and service potential in the Application Guidance of ED 75

## Analysis

### *Conceptual references to service potential*

7. The current definition of an asset in the IPSASB Framework is:  
*A resource presently controlled by the entity as a result of a past event.*
8. As indicated in paragraph 2 service potential is indirectly included in the definition of an asset through the description of a resource. A resource is described as:  
*An item with service potential or the ability to generate economic benefits.*
9. Service potential is described in paragraph 5.8 of Chapter 5 as:  
*The capacity to provide services that contribute to achieving the entity's objectives. Service potential enables an entity to achieve its objectives without necessarily generating net cash flows.*(staff underlining for emphasis).
10. In addition, the Preface to the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*, identifies 'The Nature and Purpose of Assets and Liabilities' as a characteristic of the public sector that the IPSASB considered in the development of the Framework. In this context there is an up-front statement that the primary reason why public sector entities hold property, plant and equipment and other assets is for their service potential rather than their ability to generate cash flows.

### *Standards-level references to service potential*

11. As indicated in paragraph 4 service potential is pervasive to IPSASB's standards-level literature because of its inclusion in the definition of assets in IPSAS 1:  
*Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.*
12. Service potential is not defined in IPSAS 1 or elsewhere at standards level, but guidance explains that:  
*Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity's objectives, but which do not directly generate net cash inflows, are often described as embodying service potential.*

### *Way forward*

13. Because it is embedded in IPSASB's literature at both conceptual and standards levels, the Board Sponsor and Staff do not think it desirable or practical to delete the term 'service potential' from the IPSASB's literature.
14. Acknowledging that there have been standards-level issues with its operationalization, at a high level the term conveys the important principle that a resource does not have to generate cash flows in order to meet the definition of an asset. Service potential therefore reflects the primary objective of

service delivery, rather than cash generation, that characterizes the entities for which the IPSASB is developing standards.<sup>2</sup>

15. Board Sponsor and Staff think that the problem is with the word 'capacity' in the description of 'service potential' in the IPSASB Framework. The word has led to confusion with surplus capacity in developing the proposed definition and guidance on current operational value and with the use of the term 'highest and best use' in a non-cash-generating context.

16. Board Sponsor and Staff think that this confusion can be removed by replacing the word 'capacity' with 'ability', so that paragraph 5.8 reads:

Service potential is the ~~capacity~~ ability to provide services that contribute to achieving the entity's objectives. Service potential enables an entity to achieve its objectives without necessarily generating net cash inflows.

17. This modification will also align the description of service potential with the reference to economic benefits in the description of 'a resource':

A resource is an item with service potential or the ability to generate economic benefits (staff underlining).

### Decision Required

18. Does the IPSASB agree with the Board Sponsor and Staff recommendations at paragraph 2?

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<sup>2</sup> See the *The Applicability of IPSASs* and the revised *Preface to International Public Sector Accounting Standards*, issued in April 2016.

## **Prudence**

### **Questions**

1. Does the IPSASB agree that:
  - (a) Prudence should not be adopted as a qualitative characteristic (QC) of financial reporting in its own right in the IPSASB Conceptual Framework (the IPSASB Framework)?
  - (b) The IPSASB Framework should be amended to include a reference to prudence as a reinforcement of neutrality in the context of faithful representation.
  - (c) Additional paragraphs explaining neutrality should be added to Chapter 3, *Qualitative Characteristics*.

### **Recommendations**

2. Board Member Sponsor and Staff recommend that:
  - (a) Prudence should not be adopted as a separate QC in Chapter 3, *Qualitative Characteristics*.
  - (b) Chapter 3 should be amended to include a reference to prudence as a reinforcement of neutrality in the context of faithful representation.
  - (c) The draft paragraphs in paragraph 19 should be included in a revised proposed Chapter 3 in ED 81, *Update of the Conceptual Framework Update: Chapter 3, Qualitative Characteristics and Chapter 5, Elements*.

### **Background**

3. Chapter 3 deals with both QCs and constraints on information in general purpose financial reports.<sup>3</sup> In the context of general purpose financial reporting prudence is the exercise of caution when making judgments under conditions of uncertainty. Prudence is not included as a QC in the IPSASB Framework approved in September 2014 and there is no reference to prudence as supporting other QCs in the core text of Chapter 3, *Qualitative Characteristics*.
4. Key Issue #9 in the project brief approved in March 2020 identifies prudence as an issue to be addressed in the Conceptual Framework Limited Scope Update. The project brief noted that the International Accounting Standards Board's (IASB) 2018 Conceptual Framework (IASB Framework) does discuss prudence in the core text but does not include prudence as a separate QC. The project brief also noted that the role of prudence has been emphasized by certain members of the European Public Sector Accounting Standards (EPSAS) Working Group.

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<sup>3</sup> It is therefore broader in scope than the equivalent chapter in the International Accounting Standards Board's 2018 Conceptual Framework



## Analysis

### *Approach to prudence in IASB Conceptual Framework: 2010 Framework*

5. The IASB's 2010<sup>4</sup> Chapter, *The Objective of Financial Reporting and the Qualitative Characteristics*, did not include prudence (or conservatism) in its discussion of faithful representation. While acknowledging the views of those who advocated the inclusion of conservatism, prudence or both the IASB concluded that 'including either would be inconsistent with neutrality.' The IASB also expressed a view that 'understating assets or overstating liabilities in one period frequently leads to overstating financial performance in later periods—a result that cannot be described as prudent or neutral'.<sup>5</sup>

### *Current approach to prudence in IPSASB Conceptual Framework*

6. While not an alignment project the IPSASB drew on the IASB's 2010 chapter, *Qualitative Characteristics*, in the development of its own Framework. The IPSASB did not think that there was a public sector reason for including prudence or for discussing prudence in the core text. Some respondents to the 2010 Conceptual Framework Exposure Draft, *Role and Authority, Objectives, Qualitative Characteristics and the Reporting Entity*, expressed concern that prudence was not identified as a QC and felt that its importance was insufficiently recognized or explained.
7. The IPSASB therefore further deliberated prudence and concluded that 'prudence is reflected in the explanation of neutrality as a component of faithful representation .....(and) therefore.... prudence is not identified as a separate QC because its intent and influence in identifying information that is included in GPFRs is already embedded in the notion of faithful representation.'<sup>6</sup> Neutrality is described as 'the absence of bias'. This is further explained as meaning that the selection and presentation of financial and non-financial information is not made with the intention of attaining a particular predetermined result.'<sup>7</sup> In applying the Framework since 2014 the IPSASB has not identified a case for including prudence as a QC.

### *Approach to prudence in IASB Conceptual Framework: Revised Approach in 2018 Framework*

8. Following representations from constituents, in particular from Europe, and considerable discussion, the IASB revised its approach to prudence in the 2018 Framework. The IASB did not include prudence as a QC, but, in the context of faithful representation, explained that 'neutrality is supported by the exercise of prudence' and that 'prudence is the exercise of caution when making judgments

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<sup>4</sup> The IASB revised two chapters of its Conceptual Framework in 2010: *Objective of General-Purpose Financial Reporting and Qualitative Characteristics of Useful Financial Information*

<sup>5</sup> See paragraphs BC2.34 & 2.35 of the 2018 IASB Framework. Paragraph BC 2.36 addresses the Board's conclusion on the view that neutrality is impossible to achieve.

<sup>6</sup> See paragraph BC3.7 of the IPSASB Framework.

<sup>7</sup> See paragraphs 3.13 and 3.14 of the IPSASB Framework.

under conditions of uncertainty.’ The IASB characterized the approach adopted in the 2018 Framework as ‘cautious prudence’.<sup>8</sup>

9. The IASB Framework continues by asserting that the exercise of prudence does not lead to overstatements or understatements of assets, liabilities, income, or expense. Furthermore, the exercise of prudence does not imply the need for asymmetry, although particular standards may contain asymmetric requirements.<sup>9</sup> An example of such asymmetry is the different thresholds for recognizing and disclosing contingent liabilities and contingent assets in IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. These requirements and guidance are mirrored in IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.<sup>10</sup>
10. The Basis for Conclusions explains that the IASB noted that different stakeholders have different interpretations of prudence and that this had led to confusion, which perhaps had exacerbated the diversity in use of the term. The IASB concluded that ‘it would reduce the confusion by reintroducing the term with a clear explanation that caution works both ways, so that assets and liabilities are neither overstated nor understated.

*Prudence in the draft Conceptual Framework of the EPSAS Project*

11. Prudence has been a much-discussed issue in the development of a Conceptual Framework in the EPSAS project led by Eurostat. The draft EPSAS Framework is largely based on the IPSASB’s 2014 Framework. The draft EPSAS Framework makes a pragmatic compromise, including prudence as a QC and presenting it in the context of faithful representation/reliability. The current description is:

*Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or revenue are not overstated while liabilities or expenses are not understated.*

12. While the IASB Framework and the draft EPSAS Framework differ in their approach to prudence as a QC in its own right, both approaches reflect cautious prudence.

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<sup>8</sup> Cautious prudence’ contrasts with ‘asymmetric prudence’ under which (a) the threshold for recognizing income and assets is higher than for expenses and liabilities and (b) measurement bases are selected that recognize losses at an earlier stage than gains. Some supporters of asymmetric prudence also cite it as a reason for their use of historical cost rather than current value measurement bases, in particular fair value. For a discussion of asymmetric prudence see B. Adam, J. Heiling and T. Meglitsch, *The Principle of Prudence in Public Sector Accounting-A Comparative Analysis of Cautious and Asymmetrical Prudence Based on IPSAS and German Standards of Governmental Accrual Accounting in the Context of EPSAS: Public Money and Management* (London), 2021. This is available from staff on request.

<sup>9</sup> Paragraphs 2.15 & 2.16 of the 2018 IASB Framework.

<sup>10</sup> Whereas contingent liabilities are disclosed unless the possibility of an outflow of resources embodying economic benefits or service potential is remote. Contingent assets are disclosed where an inflow of economic benefits or service potential is probable.

## Options

13. Board Sponsor and Staff have identified three options for updating the IPSASB's Framework:

- (a) Retain the current position in the 2014 Framework; or
- (b) Clarify the approach along the lines of the 2018 IASB Framework; or
- (c) Adopt prudence as an additional QC.

### *Retain current position*

14. Retention of the current position would continue to neither include prudence as a QC nor discuss prudence in the core text of Chapter 3. The existing explanation in the Basis for Conclusions would be complemented by a reference to prudence having been further considered in the Limited Scope Update project, but no change having ensued. The rationale for not amending the current position is that there is already an adequate discussion of measurement uncertainty in Chapter 6, *Recognition*. Stating that prudence is the exercise of caution when making judgments under conditions of uncertainty and that the exercise of prudence does not lead to overstatements or understatements of assets, liabilities, income, or expense are superfluous.

### *Clarify approach along lines in 2018 IASB Conceptual Framework*

15. The rationale for adopting the same approach as the IASB, or a similar approach, is that, while not creating an additional QC, it would clarify the role of prudence and provide guidance on its interpretation. It would also respond to the concerns of some constituents that the existing coverage of prudence is inadequate.

### *Adopt prudence as an additional QC*

16. The rationale for adopting prudence as a QC is that it acts as a counterweight against management optimism and helps the standard setter set rigorous standards that reduce the risk of management bias. Adopting prudence as a QC would align the IPSASB Framework with the draft EPSAS Framework. However, adopting prudence could have unforeseen consequences, for example stimulating further debates on different interpretations. Furthermore, the final version of the EPSAS Framework, if kept in its current form, would still diverge from the IPSASB Framework, even if prudence were to be adopted as an additional QC. Adopting prudence as an additional QC in the IPSASB Framework would also differ from IASB's approach.

## The Way Forward

17. In the view of the Board Sponsor and Staff, the case for including prudence as a QC (option (c) is unconvincing. Prudence is insufficiently distinct from faithful representation to justify inclusion as an additional QC. Practical application of the IPSASB Framework has not identified that the non-inclusion of prudence as a QC is problematic.
18. There is certainly a case for retaining the current approach (option (a) on the grounds that an allusion to, and discussion of prudence, adds little to the notion of neutrality, which itself conveys the notion of a lack of bias. However, clarifying that prudence entails caution in assessing uncertainty in the measurement of all elements would be beneficial and would respond to those who view the absence of references to prudence as a risk. It would also state firmly that caution should be applied consistently rather than focusing disproportionately on assets and revenue. Therefore, Board Sponsor and Staff advocate option (b).

19. Board Sponsor and Staff therefore support the insertion of two new paragraphs in Chapter 3 based on those in the 2018 IASB Framework after paragraph 3.14.

3.14A Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgments under conditions of uncertainty. The exercise of prudence means that assets and revenue are not overstated and liabilities and expense are not understated. Equally, the exercise of prudence does not allow for the understatement of assets or revenue or the overstatement of liabilities or expense. Such misstatements can lead to the overstatement or understatement of revenue or expense in future reporting periods.

3.14B The exercise of prudence does not imply a need for asymmetry; for example, a systematic need for more persuasive evidence to support the recognition of assets or revenue than the recognition of liabilities or expense. Particular standards may contain asymmetric requirements if this is a consequence of decisions intended to select the most relevant information that faithfully represents what it purports to represent.

**Decision Required**

20. Does the IPSASB agree with the Board Sponsor and Staff recommendations in paragraph 2?

## **Materiality: Scope of Update**

### **Question**

1. Does the IPSASB agree that:
  - (a) The revision of the subsection on materiality in Chapter 3, *Qualitative Characteristics*, should be amended to include the minor amendments to the IASB Conceptual Framework (the IASB Framework) in 2018?
  - (b) The Basis for Conclusions should include a discussion of regularity?

### **Recommendations**

2. Board Sponsor and Staff recommend that:
  - (a) The revision of the subsection on materiality in Chapter 3, *Qualitative Characteristics* should include the amendments to the IASB Framework, which was consequential to standards-level amendments to IAS 1, *Presentation of Financial Statements*, and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, in 2019.
  - (b) The Basis for Conclusions should reflect a view that regularity is primarily a compliance requirement and that it is unnecessary to refer to regularity in the core text of Chapter 3. Paragraph 21 provides draft text.

### **Purpose of this Agenda Item**

3. The purpose of this agenda item is to address the scope of the Board's review of materiality, in particular whether the next stage of the Limited Scope Update should consider materiality in the context of 'regularity' as well as change introduced by the International Accounting Standards Board (IASB) in its Framework in 2018. The agenda item also considers materiality in the context of sustainability reporting and the consistency of the proposed amendments with the literature of the International Audit and Assurance Standards Board (IAASB). It also discusses briefly the guidance of the International Organization of Supreme Audit Institutions (INTOSAI).

### **Background and Analysis**

4. Key Issue #10 in the project brief approved in March 2020 is Materiality. The project brief indicated that the IPSASB would consider recent changes to the IASB Framework.
5. Chapter 3 of the IPSASB Conceptual Framework (IPSASB Framework) discusses qualitative characteristics (QCs) and constraints on information in general purpose financial reports (constraints). Chapter 3 is therefore broader in scope than the equivalent chapter in the IASB Framework, which relates specifically to the financial statements. This broader scope does not have a major impact. The IPSASB Framework identifies the same QCs as those in the IASB Framework but does not differentiate QCs as fundamental and enhancing<sup>11</sup>. Materiality is considered as an aspect of faithful representation rather than a constraint on financial reporting in its own right. The IPSASB Framework also explicitly acknowledges the balance between the QCs as a constraint.

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<sup>11</sup> In the IASB Framework relevance and faithful representation are classified as 'fundamental'; understandability, timeliness, comparability, and verifiability are classified as 'enhancing'

*Changes to IASB Conceptual Framework*

6. The IASB finalized its Framework in 2018. The core of the chapter on QCs was the version developed in 2010 in conjunction with the United States Financial Accounting Standards Board. Some material was added in the final 2018 version, notably on prudence<sup>12</sup>, but also on substance over form, measurement uncertainty, and the trade-off between relevance and measurement uncertainty.
7. The IASB's 2018 Improvements Project amended IAS 1, *Presentation of Financial Statements*, and IAS 8, *Accounting Policies, Changes Accounting Estimates and Errors*, to clarify the definition of material in order to resolve difficulties that entities experience in making materiality judgements when preparing financial statements and to align the definitions in both standards. The principal change to IAS 1 was an amendment to the definition of materiality with the following wording added:

Information is obscured if it is communicated in a way that would have a similar effect for primary users of financial statements to omitting or misstating that information. The following are examples of circumstances that may result in material information being obscured:

- (a) Information regarding a material item, transaction or other event is disclosed in the financial statements but the language used is vague or unclear;
  - (b) Information regarding a material item, transaction or other event is scattered throughout the financial statements;
  - (c) Dissimilar items, transactions or other events are inappropriately aggregated;
  - (d) Similar items, transactions or other events are inappropriately disaggregated; and
  - (e) The understandability of the financial statements is reduced as a result of material information being hidden by immaterial information to the extent that a primary user is unable to determine what information is material.
8. Because of these changes the IASB made minor, but significant, amendments to paragraph 2.11 of Framework Chapter 2, *Qualitative Characteristics of Useful Financial Information*, adding the word 'obscuring' and softening the threshold for determining that information is material (deleted text struck out and new text underlined):

Information is material if omitting, ~~or~~ 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.

9. The amendment of the definition of material has not yet been incorporated in IPSAS 1, *Presentation of Financial Statements*, or IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*. The IPSASB considered proposing these amendments in its 2019 Improvements Project, together with an amendment to the IPSASB Framework. The IPSASB decided not to propose isolated changes to the Framework in advance of the Limited Scope Update and considered it inappropriate to propose standards-level improvements before considering minor changes to the IPSASB Framework and the stakeholder response to such changes. The IASB made further amendments in February 2021 to IAS 1 and IFRS Practice Statement 2, *Making Materiality Judgements*, related to

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<sup>12</sup> See [Agenda Item 8.2.2](#).

the disclosure of “material accounting policy information” instead of “significant accounting policies” because IAS 1 does not define the term “significant”. Consistent with the approach to the revised definition of materiality the IPSASB has not yet proposed amending IPSAS 1 for this further change.

10. Staff and Board Sponsor consider that, while small, the reference to obscuring information is important. In particular it helps to reinforce the IPSASB’s discouragement of immaterial disclosures by setting up the conceptual underpinning for standards-level guidance that immaterial disclosures are not only unnecessary, but they also have the potential to impair the usefulness of the financial statements. The change also positions the IPSASB Framework to support development of a Materiality Practice Statement, which is a potential project in the IPSASB’s forthcoming Mid-Term Work Program Consultation.
11. Staff and Board Sponsor therefore propose that the first sentence of paragraph 3.32 of Chapter 3 of the Framework should be amended as follows:

Information is material if ~~its omission, or misstatement~~ omitting, misstating, ~~or obscuring~~ it could reasonably be expected to influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity’s GPFRs prepared for that reporting entity.

12. The Framework BC should be amended to note that the changes were derived from those made to the IASB Framework, and that the IPSASB considered them appropriate for the public sector. Changes to IPSAS 1 and IPSAS 3 should be proposed in the 2022 Improvements Project.<sup>13</sup> This timescale will allow the IPSASB to consider responses to the proposal to amend the Conceptual Framework before proposing standards-level changes. Suggested BC text is below:

BC3.XA In its 2018 Improvements Project the IASB amended IAS 1, *Presentation of Financial Statements*, and IAS 8, *Accounting Policies, Changes Accounting Estimates and Errors*, to clarify the definition of material in order to resolve difficulties that entities experience in making materiality judgements when preparing financial statements and to align the definitions in both standards. Because of these changes the IASB made minor, but significant, amendments to Chapter 2, *Qualitative Characteristics of Useful Financial Information*, of its Conceptual Framework, by complementing the guidance that information is material if omitting or misstating it could influence decision making with a reference to ‘obscuring’ information, and also by softening the threshold for determining that information is material.

BC3.XB The IPSASB considered both changes in the context of public sector general purpose financial reporting. The IPSASB concluded that the reference to ‘obscuring information’ is relevant to the public sector as, amongst other practices, it suggests that the inclusion of immaterial disclosures can have a negative impact on users, rather than just being unnecessary. This is a relevant consideration for both the general purpose financial statements and other general purpose financial reports. The IPSASB also concluded that modifying the wording on adversely influencing users by adding the words ‘reasonably expected to influence’ imposes a more realistic expectation on preparers’ assessments of materiality. The IPSASB therefore decided to adopt these changes in its Conceptual Framework.

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<sup>13</sup> There is also a project on the Presentation of Financial Statements proposed in the mid-term work program consultation.

*Materiality in Literature of International Audit and Assurance Standards Board (IAASB).*

13. Materiality is an important issue in the literature of the IAASB. ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards of Auditing*, defines 'misstatement'<sup>14</sup>. ISA 315, *Identifying and Assessing the Risks of Material Misstatement through An Understanding of the Entity and Its Environment*, revised in 2019, addresses identifying and assessing risks of material misstatements. Paragraph 2 of ISA 320, **Materiality in Planning and Performing an Audit**, refers to omissions in the context of misstatements.
14. Paragraph 13(d) of ISA 700, *Forming an Opinion and Reporting on Financial Statements*, explicitly identifies the inclusion of information that is not relevant or that obscures a proper understanding of the matters disclosed as factors that can undermine the overall presentation of the financial statements. Paragraph A5 of ISA 700 highlights the presentation of information in the financial statements in a clear and concise manner, the placement of significant disclosures and the cross-referencing of disclosures.
15. ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*, applies to information in the annual report outside the financial statements. The definition of 'misstatement of other information'<sup>15</sup> in ISA 720 refers to a misstatement of other information being 'otherwise misleading (because it omits or obscures information necessary for a proper understanding of a matter disclosed in the other information).' Therefore, a reference to 'obscuring' is consistent with IAASB literature.
16. IAASB staff have discussed the treatment of materiality with IASB staff. Both staff teams have concluded that the guidance in IASB and IAASB is consistent even if the wording is not always congruent.

*Materiality in Guidance of International Organisation of Supreme Audit Institutions (INTOSAI).*

17. INTOSAI has public sector specific guidance on ISAs, which includes considerable guidance on materiality. This is available from staff on request. INTOSAI has not yet addressed the changes to the IASB's definition of materiality. Staff will keep the INTOSAI Financial Audit and Accounting Subcommittee updated on IPSASB's conceptual and standards-level amendments related to materiality.

*Materiality and Sustainability Reporting*

18. Sustainability reporting is particularly topical at present as a component of corporate reporting and is increasingly accepted as highly relevant to the public sector.

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<sup>14</sup> A difference between the reported amount, classification, presentation or disclosure of a financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

<sup>15</sup> Other information is financial or non-financial information (other than the financial statements (and the auditor's report thereon) included in an entity's annual report.



19. Staff thinks that it is unclear whether sustainability reports are general purpose financial reports (GPFRs)<sup>16</sup> and therefore whether such reports are within scope of the IPSASB Framework. Nevertheless, the proposed modifications to paragraph 3.32 of the IPSASB Framework are fully relevant to sustainability reports. Obscuring information is potentially a risk in reporting on sustainability, particularly where information is communicated in vague or unclear language or key information is hidden by less important information. The revised paragraph therefore provides a sound underpinning for any work that IPSASB undertakes on sustainability reporting in the future.

*Regularity: Incurring Expenditure in Accordance with Governing Legislation and Regulations*

20. Regularity may be defined as 'compliance with the relevant framework of laws and regulations.' Regularity should be distinguished from 'propriety', which relates to standards of conduct and governance. In a number of jurisdictions public sector entities are required to report on whether expenditure has been incurred in accordance with governing legislation and regulations. This is often referred to as a regularity assertion or statement. Auditors may be required to express an opinion on such assertions/statements, separate to that on the financial statements. The materiality threshold for such assertions/statements may differ from that for the financial statements, and, further, there may be differential materiality thresholds, dependent on the nature and risk profile of transactions, balances, and disclosures.
21. The Board Sponsor and Staff are of the view that regularity is an important public sector issue in certain jurisdictions. However, they believe that these are compliance requirements rather than GPFRs, so the section of Chapter 3 on materiality should not include a discussion of how materiality relates to regularity assertions/statements. However, there should be a reference to the IPSASB's consideration of this issue in the BC. Suggested text is below:

BC3.YA In a number of jurisdictions public sector entities are required to report on whether expenditure has been incurred in accordance with governing legislation and regulations. In some jurisdictions such reports are referred to as a regularity assertion or statement. Auditors may be required to express an opinion on such statements, separate to that on the financial statements.

BC3.YB The IPSASB considered whether the Conceptual Framework should provide guidance on materiality considerations on regularity assertions/statements. The IPSASB concluded that such statements/assertions are not GPFRs. The assessment of materiality on such assertions/statements is primarily an audit issue.

**Decision Required**

22. Does the IPSASB agree with the Board Sponsor and Staff recommendations at paragraph 2?

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<sup>16</sup> Chapter 1 of the 2014 Conceptual Framework describes GPFRs as financial reports intended to meet the information needs of users who are unable to require the preparation of financial reports tailored to meet their specific information needs.