

STAFF PAPER

April 2016

[REG/ADD] IASB Meeting]

Project	Materiality
Paper topic	Feedback Summary on Exposure Draft: <i>IFRS Practice Statement Application of Materiality to Financial Statements</i>
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Purpose of this paper

1. This paper summarises the main feedback received from the comment letters in response to the Exposure Draft of the *IFRS Practice Statement: Application of Materiality to Financial Statements* (the ED).
2. The ED was published on the 28 October 2015 with a 120-day comment period which ended on 26 February 2016.
3. This paper does not ask the Board any specific questions. The staff will provide more detailed feedback and recommendations to the IASB (Board) at its meeting in May.

Structure of this Paper

4. The Agenda Paper is set out as follows:
 - (a) Summary of the feedback;
 - (b) Summary of the outreach carried out; and
 - (c) Overall feedback and key issues raised by the respondents to the ED.

Summary of feedback

5. As of 6 April 2016, the Board has received 96 comment letters. Appendix A provides a summary of the letters received by type of respondent and geographical region. In addition, during the comment period, staff conducted 12 outreach meetings with preparers, standard setters, auditors and users.

Summary of outreach

6. Although the ED's objective was to 'assist management in applying the concept of materiality to general purpose financial statements', we were conscious that the ED would also have an impact on all entities involved in financial reporting. Therefore, we met with preparers, standard setters, auditors and users. We also presented to the Global Preparers Forum (GPF), and Capital Markets Advisory Committee (CMAC).
7. We were aware that the ED could be useful to preparers from smaller entities that, usually, do not have the capacity to become involved in our outreach processes. Therefore we asked national standard setters through the World Standard Setters network to use their local connections to make small-entity preparers aware of the opportunity to comment available to them. This led to a couple of face-to-face conversations and more targeted responses specifically related to smaller entities in some of the national-standard setters' comment letters. Their comments were generally in line with other feedback we received, although said they are more likely to seek their auditors' advice when making materiality judgements.
8. Staff also held a webinar to coincide with the publication of the ED, which attracted 594 registrants. The staff discussed the thinking behind the ED, its content, and responded to participants' specific questions.
9. The feedback received from these outreach activities is consistent with the comments made by other respondents to the ED, summarised in this paper.

Overall feedback and key issues raised by respondents to the ED

10. There was widespread support for the Board to undertake a project to help preparers apply materiality when preparing their general purpose financial statements. We received similar feedback to what we had previously heard from the Disclosure Forum¹ and during the consultation process for the recent IAS 1 amendments: materiality is viewed as the key to improving the quality of disclosures and the readability of the financial statements. The majority of respondents see the Materiality project as an essential aspect of the Disclosure Initiative.
11. In addition, the majority of respondents commented that it will be a useful tool when discussing materiality with their auditors, a key objective of the ED. There was also widespread praise for the document's potential as an educational document. The hope was expressed that the publication of this document would prompt greater discussion, and emphasis, on the role that materiality plays in preparing financial statements, and embolden preparers to examine their materiality judgements, thus improving financial statements.
12. In general, the feedback did not contest the technical content of the ED. Instead the comments focused on the presentation of the information and on ways to optimise the usefulness of the Practice Statement.

Question 1

13. Question 1 emphasised that a Practice Statement is not a Standard. The Board's reasoning for issuing guidance on applying the concept of materiality in the form of a non-mandatory Practice Statement was set out in the Basis of Conclusion of the ED. Respondents were asked whether:
 - (a) the guidance should be issued as non-mandatory guidance, and why;
 - (b) a Practice Statement is the appropriate form for non-mandatory guidance on applying the concept of materiality, and why. Respondents were also asked

¹ The IASB hosted a public Discussion Forum on Financial Reporting Disclosure to foster dialogue between users of financial statements, preparers, standard-setters, auditors and regulators. The objective of this forum was for these and other interested parties to get a clearer picture of the 'disclosure problem' and its causes

to proposed alternative methods of guidance, if they thought it was more suitable.

Summary Feedback

14. The majority of respondents were in favour of a non-mandatory Practice Statement. They acknowledged that materiality is already part of IFRS Standards through IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. They recognised that the Practice Statement is not a new requirement but an expansion on the principles in the Standards aimed at guiding preparers when making materiality judgements. Some respondents noted that it is regrettable that the Board is not in a position to make the guidance mandatory, but given the international application of IFRS Standards this may not be possible. They considered the Practice Statement to be a good compromise.
15. Those who are not in favour of a Practice Statement noted the ‘undetermined’ status of the Practice Statement. They are concerned that a Practice Statement’s non-mandatory status would make it difficult for management to rely on it in discussions with auditors and regulators, and, in particular, before the courts.
16. Considering that materiality is already a requirement in IFRS Standards, some suggested that there is a need for educational material rather than a Practice Statement. However, many of those who favoured the Practice Statement highlighted full due process (which does not apply to educational materials²) as one of their main reasons for support.
17. Others were of the view that the guidance should be mandatory. They argued that it would allow for less bias in the application of the concept. It would also provide management with a stronger footing in discussions with auditors and regulators and clearer requirements when materiality is the focus of litigation.
18. A number of other suggestions were put forward. These include the attaching of implementation guidance to IAS 1, developing guidance based on existing illustrative examples, and issuing guidance as part of the Principles of Disclosure project.

² The development of educational material does not take place in public meetings and is not subjected to the public scrutiny that is given to the development of IFRSs. The due process steps needed vary depending on the type of educational initiative.

Question 2

19. Question 2 dealt with the use of examples throughout the ED. Respondents were asked whether:
- (a) the examples in the [draft] Practice Statement were helpful; and
 - (b) any additional practical examples should be included, and if so, which scenarios should the examples address.

Summary Feedback

20. The majority of respondents favoured using examples as part of the guidance. However, a large majority of respondents were critical of how the examples are currently written in the ED. They note that the examples, generally, illustrate a conceptual idea that is being discussed, and failed to describe the thought process leading to materiality judgements or illustrate the practical issues involved in making those judgements.
21. Respondents would like to see more detailed, practical examples. There is a need to illustrate the thought process that management should be applying. Respondents think that this will make the Practice Statement more useful to preparers in practice. Several commented that illustrating common considerations may improve preparers' understanding of the materiality concept, and would develop the guidance's educational function.
22. Respondents also suggested that the examples are currently too simplistic and would benefit from more detail; demonstrating different aspects of the judgement simultaneously. A few respondents suggested this could be achieved by producing a 'decision-tree'.
23. We received widespread feedback to our request for specific examples. This view was often combined with an acknowledgement that it is difficult for the Board to provide examples in the context of the Practice Statement that do not appear to be interpretations of the IFRS Standards.
24. Some respondents did not think examples were a useful addition to the guidance. This opinion was often given by respondents who thought that materiality guidance should take the form of mandatory guidance within IFRS Standards.

Question 3

25. Question 3 outlined the logic behind structure of the proposed Practice Statement and asked respondents whether:
- (a) any additional content should be included in the Practice Statement, if so, which content, and why;
 - (b) the guidance will be understandable by, and helpful to, preparers of financial statements who have a reasonable level of business/accounting knowledge and IFRS—respondents were also asked to identify unclear or unhelpful information;
 - (c) the respondents disagreed with any paragraphs or sections, and, if so, why;
 - (d) any paragraphs or sections are unnecessary, and, if so, why;
 - (e) any aspects of the guidance will conflict with any legal requirements related to materiality within their jurisdiction.

Summary Feedback

26. As mentioned in paragraph 12, most respondents were in general agreement with the technical content of the ED. Some commented that the bringing together of guidance from different parts of IFRS Standards brought clarity to the concept of materiality.
27. There were, however, some questions raised about whether, in some places, the guidance was an interpretation of IFRS Standards. A small minority of respondents said that the omissions and misstatements section of the ED (paragraph 67–79) was an interpretation of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. In particular, they expressed concerns about the guidance given on prior period errors. A more detailed discussion of their concerns will be presented at the Board meeting in May.
28. Some respondents also commented on the inclusion of a discussion on the needs of the primary users (paragraphs 13–23, ED). They were generally complimentary of the discussion, but they questioned whether guidance on materiality was the most appropriate place for this discussion. Further analysis of the feedback received on this issue will also be presented at the Board meeting in May.

Question 4

29. Question 4 asked whether respondents approved of the timing of the Materiality project in relation to the Principles of Disclosure project.
30. The Board decided at its March 2015 meeting to issue the Practice Statement before the finalisation of its Principles of Disclosure project. The Board has tentatively decided to include a discussion on the definition of materiality, and whether there is a need to change or clarify that definition within IFRS Standards, in the Discussion Paper for its Principles of Disclosure project, expected to be published in mid-2016. Nevertheless, in order to address the need for guidance on the application of materiality, the Board thinks it is useful to develop the Practice Statement now. At their March 2015 discussion the Board did not envisage that the discussion about the definition of materiality or any other topics in its *Principles of Disclosure* project will significantly alter the content of the Practice Statement. Nevertheless, the Board agreed to consider whether any consequential amendments to the Practice Statement are necessary following the completion of the Principles of Disclosure project.

Summary Feedback

31. The majority of respondents agree with the Board's reasoning and are supportive of the guidance on materiality to be published before the Principles of Disclosure project is complete. Most respondents have agreed with them on the basis that the Board is not planning to significantly change the definition of materiality in the Principles of Disclosure project. The commentators say the guidance will be beneficial, particularly before the Principles of Disclosure project is complete.
32. A minority of respondents, however, do not agree with the Board's proposal to proceed with guidance on materiality. They are reluctant to implement guidance now when there is a possibility of the definition changing within the next few years. In response to such concerns, we plan to bring a more detailed discussion to the May Board meeting regarding the timing of this project and its interaction with the Principles of Disclosure project and the Conceptual Framework project.

Appendix A—Comment letter demographic information



