Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

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45. Sitzung IFRS-FA am 07.01.2016
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Dear Hans,

IASB Exposure Draft ED/2015/8 *IFRS Practice Statement: Application of Materiality to Financial Statements*

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the IASB Exposure Draft ED/2015/8 *IFRS Practice Statement: Application of Materiality to Financial Statements* (herein referred to as 'ED'). We appreciate the opportunity to comment on the ED.

Generally, we consider that the concept of materiality is already clearly and consistently understood as an entity-specific aspect of relevance by our constituents who have a reasonable accounting knowledge of IFRS. Therefore, we think for those preparers the benefits of the proposed guidance are limited. Nonetheless, we consider some potential benefits of the proposed guidance that we address in our response on the individual questions in the appendix to this letter.

Importantly, we think additional guidance on materiality, as a pervasive concept to the preparation of financial statements, should not be published as non-mandatory guidance. The concept of materiality is mandatory for preparing financial statements and, therefore, any guidance about the application of the mandatory concept should be an integral part of IFRS. We do not see the basis for introducing an exemption to the existing approach of placing application guidance as integral part of IFRS. Furthermore, we are concerned that an entity could declare compliance with IFRS even if the entity would choose an approach that is clearly characterised as not appropriate or inadequate in the ED.

In addition, we think the IASB should wait for the feedback of the upcoming Discussion Paper for its Principles of Disclosure project before finalising the guidance on the application of materiality to the financial statements. It is our understanding that the Discussion Paper would include proposals and discussion that would significantly affect the proposed guidance in the ED. Similarly, it should be considered that some parts of the proposed guidance appear to go beyond current IFRS. For example, the proposed description in the ED of the different roles of primary financial statements and the notes might require corresponding amendments to current IFRS.

If you would like to discuss our comments further, please do not hesitate to contact Holger Obst or me.

Yours sincerely,

Andreas Barckow
President

Appendix – Answers to the questions of the exposure draft

Question 1 — Form of the guidance

A Practice Statement is not a Standard. The IASB's reasoning for issuing guidance on applying the concept of materiality in the financial statements in the form of a non-mandatory Practice Statement is set out in paragraphs BC10–BC15.

a) Do you think that the guidance should be issued as non-mandatory guidance? Why or why not?

b) Do you think that a Practice Statement is the appropriate form for non-mandatory guidance on applying the concept of materiality? Why or why not? If not, what alternative(s) do you propose and why?

Response to question 1(a):

We think application guidance published by the IASB on concepts and requirements underlying the preparation of IFRS financial statements have a binding character. Therefore, we do not support non-mandatory guidance on the application of materiality, as the concept of materiality is anchored in IAS 1 and IAS 8 as a pervasive concept for preparing financial statements in accordance with IFRS.

Especially, we question whether an entity could declare compliance with IFRS if it neglects the proposed materiality guidance. For example, in paragraph 58 of the ED the IASB states that it would not be appropriate to omit information about the entity that is specifically required by IFRSs from the financial statements solely because it had previously been included in a press release or other publicly available document. Similarly, paragraph 27 of the ED states that an example of an inadequate […] disclosure would be if an entity simply quotes the requirements in IFRSs without tailoring the description of its accounting policy to explain how it has been applied by the entity. We think preparers cannot ignore such application guidance that reflects the IASB's understanding of a fair presentation and formed the basis of developing disclosure requirements in particular IFRSs.

In addition, we highlight the fact that, currently, the IASB does not make a distinction between mandatory and non-mandatory guidance. Current IFRSs have the distinction whether guidance is an integral part of a Standard or not. Thus, it is not clear to us if the distinction between mandatory and non-mandatory guidance has a similar meaning of being an integral part of a Standard, ie mandatory, or not, ie non-mandatory guidance. In our view, the IASB should not change practice and should continue to locate application guidance and examples of application of IFRS requirements as an integral part of a Standard, ie as a mandatory part of IFRS.

Response to question 1(b):
Paragraph IN6 of the ED states that the application of the Practice Statement ***Application*** [emphasis added] *of Materiality to Financial Statements* is not required in order to state compliance with IFRS. We think the IASB should not issue guidance and further interpretation of mandatory IFRS concepts and principles with the impression of them being negligible for achieving compliance with IFRS. In this context we highlight that IFRS Practice Statements

As highlighted in the ED, the concept of materiality is pervasive to the preparation of financial statements. Therefore, guidance regarding the application of the pervasive concept should be an integral part of IFRS. This would be consistent with other application guidance developed for particular IFRS concepts and requirements. We do not think that application guidance for materiality should receive special treatment and form an exemption compared to other application guidance in IFRSs. In addition, IFRS Practice Statements are not considered to be subject to the endorsement process of IFRS in our jurisdiction. Therefore, this guidance as an IFRS Practice Statement could generally not become a binding document for preparers.

Furthermore, we think the IASB should evaluate whether it is possible to include identified useful guidance, based on the feedback from constituents, in existing IFRS guidance. We think the IASB should avoid redundancy in guidance and consider concerns from constituents that IFRS guidance becomes too voluminous.

Question 2 — Illustrative examples
Do you find the examples helpful in the [draft] Practice Statement? Do you think any additional practical examples should be included? If so, what scenarios should the examples address? Please be as specific as possible and explain why those example(s) would be helpful to entities.

We think examples are especially helpful if they provide additional information that is not already obvious from existing guidance in IAS 1 and IAS 8. For example, we think it is helpful if guidance provides clear statements whether a particular approach for applying materiality is inappropriate or inadequate. In this context, we consider some examples in the ED to be helpful. Nonetheless, we think many examples remain vague or more obvious and therefore without substantial help for preparers that have a reasonable knowledge of IFRS.

In our view, it could be helpful to provide examples that specifically address judgement about qualitative notes disclosure. Particularly, we think it would be helpful to provide guidance on the application of materiality regarding qualitative disclosure requirements for specific transactions or events that are not presented as separate line items in the primary financial statements. Most disclosure requirements in IFRSs for specific transactions or events seemed to have been developed implying that the specific transaction or event would be presented as separate line items in the primary financial statements and, therefore, justify the wide range of additional required disclosures. Therefore, question often arise to what extent, especially qualitative disclosures, could be omitted if the specific transaction or events is not depicted as separate line item in the primary financial statements. In this context, we understand that the upcoming Discussion Paper for the Principles of Disclosure project might provide additional helpful guidance based on the proposals of introducing a two-tiers disclosure approach for the notes.

[*t.b.d.*]

Question 3 — Content of the [draft] Practice Statement

The [draft] Practice Statement proposes guidance in three main areas:

(a) characteristics of materiality;

(b) how to apply the concept of materiality in practice when presenting and disclosing information in the financial statements; and

(c) how to assess whether omissions and misstatements of information are material to the financial statements.

It also contains a short section on applying materiality when applying recognition and measurement requirements.

Please comment on the following and provide any suggestions you have for improving the [draft] Practice Statement:

(d) Do you think that any additional content should be included in the Practice Statement? If so, what additional content should be included and why?

(e) Do you think the guidance will be understandable by, and helpful to, preparers of financial statements who have a reasonable level of business/accounting knowledge and IFRS? If not, which paragraphs/sections are unclear or unhelpful and why?

(f) Are there any paragraphs/sections with which you do not agree? If so, which paragraphs/sections are they and why?

(g) Do you think any paragraphs/sections are unnecessary? If so, which paragraphs/sections are they and why?

(h) Do you think any aspects of the guidance will conflict with any legal requirements related to materiality within your jurisdiction, or a jurisdiction in which you file financial statements?

Response to question 3(a) – (d):

[*t.b.d.*]

Response to question 3(e):

In our view, many parts of the proposed guidance repeat what is already included in current IFRSs. Many conclusion depicted in the ED are self-evident from current IFRSs for preparers that have a reasonable accounting knowledge of IFRSs. We think that the concept of materiality is already clearly and consistently understood as an entity-specific aspect of relevance by our constituents who have a reasonable accounting knowledge of IFRSs[1]. Thus, as addressed in our response to question 2, we think the guidance provides limited help for preparers of financial statements who have a reasonable level of business/accounting knowledge and IFRSs.

Nonetheless, we think the guidance can be helpful. In our view, the main blocking issues for applying materiality do not relate to the understanding of materiality but the more costly process of actively applying and justifying materiality judgement. In this context, we think the proposed guidance might have some merits by providing a form of compendium and reminder about the concept of materiality and its implications for preparing financial statements. For example, the guidance could be helpful for preparers in discussion with enforcement bodies as an additional point of reference for explaining and justifying the process of materiality application. It might also be helpful in reminding preparers to exercise a constant review process whether disclosures are still considered to be material compared to previous reporting periods.

Furthermore, the guidance is helpful in making preparers aware that materiality judgement must be considered in different contexts, ie materiality in the context of different roles/objectives of providing information that is often missing in current IFRSs. For example, the Practice Statement refers to the distinction of primary financial statements versus the notes and their different roles. So far, this distinction does not exist in current IFRSs but will be proposed in the upcoming Discussion Paper in the Principles of Disclosure project as amendment to IAS 1. Therefore, the application guidance appears to go beyond what is defined in current IFRSs. In our view, clarification of the context for providing information is helpful - but the IASB must provide context, ie the role/objective of particular information, more clearly in IFRSs and not as part of non-mandatory guidance. We think this could be achieved with a review of existing IFRS disclosure guidance in particular Standards.

[*t.b.d.*]

[1] We also refer to our response to the consultation document by ESMA on materiality in March 2012: http://www.drsc.de/docs/press_releases/2012/120313_CL_IFRS-FA_ESMA_Materiality.pdf?date=2015-11-2

Response to question 3(f):

As we have already addressed in our response to question 1, we do not agree with the statement in paragraph IN6 of the ED that the application guidance is not required in order to state compliance with IFRS. We think an entity cannot declare compliance if it applies an approach that is considered inappropriate or inadequate in the application guidance of materiality.

[*t.b.d.*]

Response to question 3(g):

[*t.b.d.*]

Response to question 3(h):

We are not aware of potential conflicts with other legal requirements in our jurisdiction. However, we refer to the fact that IFRS Practice Statements are not endorse in our jurisdiction. Therefore, the proposed guidance could not develop a legally bind character for preparers if it remains as an IFRS Practice Statement.

Question 4 — Timing

The IASB plans to issue the Practice Statement before the finalisation of its Principles of Disclosure project.

The IASB 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, in the Discussion Paper for its Principles of Disclosure project (expected to be issued early in 2016). Nevertheless, the IASB thinks that to address the need for guidance on the application of materiality, it is useful to develop the Practice Statement now.

The IASB does not envisage that the discussion about the definition of materiality or any other topics in its Principles of Disclosure project will significantly affect the content of the Practice Statement. Nevertheless, the IASB will consider whether any consequential amendments to the Practice Statement are necessary following the completion of the Principles of Disclosure project. Do you agree with this approach?

We think it is difficult to anticipate whether the Principles of Disclosure project will significantly affect the content of the proposed guidance regarding the application of materiality to the financial statements. We think any need to change or to clarify the definition of materiality could represent a significant change that would require reconsideration of proposed guidance in the ED. Therefore, in our view, the IASB should consider the feedback on the Discussion Paper for its Principles of Disclosure project before finalising guidance regarding the application of materiality.

Furthermore, in our view, new implications or changes to the application guidance on materiality might not only arise from the discussion of amending the definition of materiality. For example, it is our understanding that the IASB will include in the Discussion Paper for its Principles of Disclosure project some proposals for introducing a two-tier approach for note disclosures[2]. Such a two-tier approach, if introduced for IFRSs, would ultimately imply a different context of materiality application and therefore a potential object for application guidance.

Similarly, any disagreement with the proposed description and implications of the different roles of the primary financial statements and the notes as part of the Discussion Paper for the Principles of Disclosure project could significantly impact the proposed guidance in this ED. The guidance in the ED might also be expanded if the feedback on the upcoming Discussion paper would be supportive for some conclusions in the Discussion Paper. For example the ED does not include the implication about when a particular statement is seen as a primary financial statement. In the Principles of Disclosure project it is presumed that each primary financial statement is required to be disclosed in a complete set of financial statements, ie <u>materiality cannot be used</u> [emphasis added] to determine whether individual primary financial statements should be disclosed[3].

Question 5 — Any other comments

Do you have any other comments on the [draft] Practice Statement? As mentioned in Question 4, a discussion about the definition of materiality will be included in the Discussion Paper in the Principles of Disclosure project, so the IASB is not asking for comments on the definition at this time.

[2] Agenda Paper 11B, IASB Meeting, September 2015.
[3] Agenda Paper 11B, IASB Meeting, March 2015.

We think the IASB should address the issue of disclosure terminology indicating different levels of materiality. For example paragraph 48 of IAS 7 requires the disclosure of the amount of significant [emphasis added] cash and cash equivalent balances held by the entity that are not available for use by the group. We think it is helpful to clarify whether – in the IASB's view - such a disclosure requirements should be amended for its terminology or otherwise the IASB would provide more clarification how the term 'significant' should be considered in the context of applying materiality.

[*t.b.d.*]