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29 March 2016

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: Practice Statement: Application of Materiality to Financial Statements

Our Ref: 2016/JE/C1/IASB/56

Dear IASB Members:

1. The International Organization of Securities Commissions (IOSCO) Committee on Issuer Accounting, Audit and Disclosure (Committee 1 or C1) thanks you for the opportunity to provide our comments regarding the International Accounting Standards Board (IASB or the Board) Exposure Draft, IFRS Practice Statement: *Application of Materiality to Financial Statements (the Practice Statement or PS)*.
2. IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting standards including rigorous application and enforcement. Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect a general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.



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Project Objective

3. Committee I members support the objective of the project, which we understand is to help management to apply the concept of “materiality” that is contained in IAS 1 when preparing general purpose financial statements in accordance with IFRS. Based on our individual experiences in enforcing IFRS, which includes considering management’s application of the concept of materiality, we can appreciate that different people can and do think about this concept of materiality differently.
4. In our members’ work they also see financial statements that include immaterial or boiler plate information and not enough relevant, entity specific information. We also agree with the fact that IFRS disclosure requirements are often perceived as checklists by preparers of financial statements. We thus welcome any initiative that helps in enhancing the quality of financial reports, such as this proposed guidance on the application of the concept of materiality.
5. As styled, members see the merit of the proposal as the fact that management can refer to this guidance and the basis for it in exercising professional judgement, which members feel will tend to promote consistency in the way the concept of materiality is applied by preparers of financial statements. Auditors may also find the guidance helpful in order to understand management’s materiality assessments and the financial statement and disclosure effects of such assessments. Nonetheless, we think the final guidance would be more helpful if in presenting it the Board better links it to the definition of materiality in IFRS, thus it would serve to better explain the definition of materiality. As presented it is difficult to tell whether the Board is trying to explain some but not all of the individual aspects of IAS 1’s materiality definition of “could reasonably be expected to be influenced”, such as the terms ‘could’ or ‘reasonably’, or whether the Board is trying to explain the entire phrase, or otherwise.

Form of the Materiality Guidance

6. Members appreciate the nature of the guidance presented in the proposed Practice Statement and believe it is useful to have such a broad spectrum of guidance contained within one document. Further, CI members considered and discussed the various pros and cons associated with the Board’s decision to propose that this document be in the form of a *Practice Statement* per se. Members considered these pros and cons both from



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the standpoint of the role of IFRS as a globally accepted set of accounting standards for cross border offerings and listings and the roles that IFRS has taken on as the, or as one of the, basis of the country's national accounting standards.

From the Perspective of the Cross-Border Use of IFRS

7. C1 members note IOSCO's past efforts over many years to foster the possibility that IFRS (as issued by the IASB) could become the set of globally accepted accounting standards that could be accepted by any one of its members as a common basis of preparation for the financial statements of inbound issuers who are engaging in cross-border capital raising and listing. The various reasons for this were stated at the time, such as efficiency, recognisability, common understanding among investors, and so forth.
8. While C1 members believe that the Board's materiality guidance will be helpful to the capital markets, members do not believe that the form of this guidance should jeopardize the universal cross-border acceptability of IFRS. That would be a trade-off that is too large. This potential trade-off would arise for countries that have guidance on materiality within existing company law, securities laws or regulations, or elsewhere such that it applies to inbound cross-border issuers. If the IASB were to issue its materiality guidance in a form whereby an inbound cross-border issuer would be required to comply with it in order to state compliance of its financial statements with IFRS (as issued by the IASB), then an issuer would not be able to state this compliance if the national materiality requirements with which it also needed to comply would preclude compliance with both. The more that the IASB publishes about materiality, the greater likelihood there is that this potential inconsistency could occur. If it does, then the benefits of IFRS as a common basis of preparation for cross-border purposes would be diminished. Even if such "dual compliance" were as a practical matter feasible under many or all national requirements today, national laws can change over time thus we also recommend that the Board factor this possibility into its thought process.

From the Perspective of the National Accounting Standards Use of IFRS

9. C1 members' views on the form that the Board's materiality guidance should take involve some different considerations when they consider this matter in the context of IFRS as the, one of the, or as a basis of their jurisdiction's national accounting standards. Generally, if a jurisdiction does not have existing materiality guidance that applies to its



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domestic listed companies, then C1 members see the benefit if the IASB were to issue the guidance in a form that makes it as likely as possible that the guidance would become part of the body of IFRS that a jurisdiction's domestic listed companies would apply without the jurisdiction needing to take its own actions to 'carve in' the Board's materiality guidance into those national requirements. In this regard members raise the possibilities that the Board could issue the guidance as part of IAS 1, as a Guide to implementation of IAS 1, or as part of the Conceptual Framework. At the same time, if a jurisdiction has materiality guidance that applies to its domestic listed companies then C1 members note this is a scenario that has pros and cons with respect to the form of the guidance that are similar to those for cross-border issuers, as described above.

Prominence of the Materiality Guidance

10. Regardless of the form in which the Board issues its final guidance on materiality, C1 members wish to emphasize the importance for the Board to make that guidance both visible and retrievable to those who use IFRS.

Role of Practice Statements More Broadly

11. In considering the proposed Practice Statement, C1 members raised the question of the basis on which the Board decides to issue Practice Statements versus other types of guidance (e.g., standards, guides to implementation, educational material, and so forth). If the Board decides to finalize the guidance in the form of a Practice Statement, members suggest that the IASB expand the discussion in the Basis for Conclusions about the reasoning, in this context, for issuing a Practice Statement. Members believe this expanded discussion should better enable users to understand how this type of guidance fits into the current, and any expected near-term future, array of guidance on the application of IFRS that is available to entities, their managers, and auditors, among others.

Illustrative Examples

12. C1 members believe that including examples is very helpful because they give a more practical aspect to the document, which otherwise might come across as quite theoretical and therefore not appear helpful to the day to day work of management. Later in this letter we have noted some specific suggestions on the drafting of and inclusion of those



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examples as well as some additional examples that could further enhance the proposed guidance.

13. In addition to the included examples, we think it would be helpful if the IASB added a comprehensive illustration that listed or showed the steps that management should go through in applying the various points made in the Practice Statement. This would help to tie its various points together. A step-by-step illustration could help preparers of financial statements in applying the concept of materiality in practice. Such an illustration could, for instance, demonstrate the application of materiality in determining whether a disclosure specified in IFRS may be omitted.

Timing

14. Members are comfortable that the Board would issue the final guidance on materiality in advance of the Board's other improvements within its Enhanced Disclosure Initiative because members see the guidance on materiality as enhancing those initiatives but not as dependent on them. More timely guidance on materiality would be helpful regardless of the nature or timing of those other improvements, or whether it may later be subject to consequential amendments from them.

Content

15. C1 members found the presentation of the proposed guidance to be understandable as grouped among sections for the (a) characteristics of materiality; (b) how to apply materiality in the context of disclosures; and (c) how to assess whether omissions and misstatements are material. Nonetheless, C1 members found certain aspects of the content to be either unclear or to differ from members' working knowledge of the concepts and practices surrounding materiality, both those that are currently practiced and, in some cases, those that members see as necessary in order to be able to effectively present audited financial statements to the public capital markets. These points of concern are described in the paragraphs, below, and have been presented consistent with the associated topics within the Practice Statement.



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Scope

16. Paragraph 3 states that the proposed guidance also applies to information that is incorporated in the financial statements by cross-reference. In order to avoid confusion, members believe the IASB should clarify that this statement is not intended to pre-empt or limit in any way the information that an entity would be required to disclose these under any other regulation.
17. Paragraph 5 refers to the application of materiality principles and supplementary guidance to issuers on an ongoing basis. This paragraph should be revised to clarify that materiality principles and guidance also apply to initial disclosure by issuers, such as registration statements and initial offering documents.
18. Members also believe the Practice Statement should broadly acknowledge that legal or regulatory requirements in the entity's jurisdiction are beyond the scope of IFRS but nevertheless affect the materiality assessment. While this statement is included in paragraph 66 as it relates to the use of practical expedients, members noted it could be equally applicable to other aspects of the analysis.
19. Finally, members observe that the guidance in paragraphs 74-76 on correcting prior period errors in the current period conflicts with existing securities regulations in some jurisdictions, which require restatement of prior period filings in certain circumstances. Members suggest the proposed Practice Statement be revised so as to alleviate this conflict.

Judgment

20. Members agree the assessment of materiality requires the use of significant judgment, considering both quantitative and qualitative factors, and that the principles outlined in paragraph 12 are helpful. In addition to those principles, the guidance should clearly state that this assessment is an iterative process. The guidance in paragraphs 32 and 56, among others, suggest the iterative nature but an explicit statement to this effect should be added.
21. Members note that paragraph IN5 of the proposed practice statement states ... "this guidance does not aim to provide a complete list of considerations for making judgements about materiality when preparing the financial statements." Members feel that in order to



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present a more balanced message that the following should be added: “Likewise, exclusion by an issuer of information described in this guidance does not imply that an issuer has made a material omission.”

Users of the financial statements and their decisions

22. Members agree the identification of the primary users of financial statements and the specific needs of those users is a necessary prerequisite to an appropriate materiality assessment. The definition of materiality in IAS 1 refers to “users of financial statements.” The Conceptual Framework further defines primary users as potential investors, lenders and other creditors and that these users need to be provided with information that is helpful to them in assessing the entity’s prospects for future net cash inflows and the sustainability of the entity’s performance. Members suggest the Practice Statement could be further enhanced with an example wherein the characteristics of, and decisions to be made by, different primary users are discussed and compared in order to demonstrate how management would determine whether the information to be provided would meet the needs of those primary users.

Qualitative and quantitative assessment

23. Members agree the assessment of materiality includes both quantitative and qualitative considerations and believe the elements discussed in paragraphs 24-29 are helpful to the analysis. In particular, the example in paragraph 27(a), which addresses accounting policy and uncertainties, is helpful guidance that is incremental to what is in current practice. However, members believe the discussion should be clarified that an entity would need to consider quantitative and qualitative factors for all items, not simply in those cases where qualitative and quantitative aspects of an assessment are at extreme odds with each other. They also feel the Practice Statement could be further enhanced with an example that demonstrates how to assess an item that is qualitatively material but quantitatively immaterial, and vice versa.
24. As it relates to the examples in paragraph 28, members had the following observations:
- a. Members agree that non-compliance with regulatory requirements or loan covenants may be a qualitative consideration when evaluating materiality, as noted in paragraph 28(a). However, some members read this example to suggest the loan covenants are



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an element of financial reporting that should be disclosed, particularly if the associated debt is material. If the IASB intends for the qualitative considerations outlined in paragraph 28(a) to result in incremental disclosure beyond the current requirements in IFRS, this should be considered as part of the IASB's broader Disclosure Initiative.

- b. The discussion in 28(b) could be expanded to include consideration of the main risks, uncertainties, and threats the entity is exposed to and how these factors are considered when considering an entity's future operations.
- c. Members also agree that related party transactions may be of "particular importance to the primary users." While 28(c) provides an example of a related party transaction, some read the guidance to imply the nature of related party transactions should only be considered if they are rare or unusual or have special terms. Members, therefore, suggest the IASB highlight related party transactions as a standalone factor in paragraph 28, as opposed to an example of "rare or unusual transactions."
- d. Finally, the following items may also suggest a matter is qualitatively material and could be added to further enhance the guidance: (1) the matter masks changes in earnings or trends; (2) the matter hides the entity's failure to meet analyst's expectations; and (3) the matter affects management compensation.

Immaterial information

25. Members observe the guidance in paragraph 30A of IAS 1 and agree that an entity should not reduce the understandability of its financial statements by obscuring material information with immaterial information. They also agree that the examples in paragraph 36—which clarify that, in some cases, disclosing the fact that a particular issue is immaterial to the entity may in itself be material information— provide a helpful clarification to the principle in IAS 1.
26. While highlighting that providing too much immaterial information may obscure material information, the guidance also acknowledges that IFRSs currently do not prohibit entities from disclosing immaterial information. Further, paragraph 113 of IAS 1 notes that entities should present notes in a "systematic manner." Members suggest the guidance could be enhanced through a discussion of the application of materiality when assessing



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whether notes are presented in a “systematic manner”, including whether the structure and organization of the financial statement notes results in the disclosures being misleading.

Aggregating and disaggregating information

27. Members observe that the examples in paragraph 39 are helpful and should be retained in the final guidance. In particular, members noted that:
- a. Paragraph 39(a) may be particularly helpful in light of the recently issued lease standard; and
 - b. Paragraph 39(b) regarding currency translation adjustment is helpful in illustrating the application of materiality concepts and also highlights an area of accounting disclosure that is relevant in the context of current volatility in some currencies.

Disclosures specified in IFRS

28. Members agree that materiality should be applied to quantitative and qualitative disclosures individually and in the aggregate in the context of the financial statements taken as a whole; therefore, some, all, or none of the disclosure requirements in an IFRS may be material in a particular issuer situation. As part of its broader Disclosure Initiative project, members also suggest the IASB consider whether entities should provide disclosures about the materiality assessments it made when determining that some, all, or none of the disclosures in an IFRS are immaterial. Said another way, could the fact that management has concluded that certain otherwise required disclosures are not material ever constitute material information for investors?
29. As it relates to the examples in paragraph 53, members had the following observations:
- a. Consistent with the comments in paragraph 24(c) above, given that share based payment plans are often granted to key management personnel, members questioned how to qualitatively consider the related party nature of the arrangements when evaluating whether it is appropriate to summarize some of the information in paragraphs 44-52 of IFRS 2. Additional clarification would be a helpful enhancement.



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- b. Members recommend the example in 53(d) on IFRS 8 *Operating Segments* be removed in order to avoid any potential inconsistency that may arise as a result of the IASB's current project on IFRS 8.
- c. Members also suggest adding an example that demonstrates how the entity's industry or line of business may be considered when evaluating the specific disclosure requirements. For instance, an example on the requirements in IFRS 7 for a non-financial entity could be used to demonstrate this consideration.

Reviewing Note Disclosures at each Reporting Date

- 30. Members note that it is typical for public companies to be required by regulation to present comparative annual financial statements that include an audit opinion for all periods presented. In other situations management may choose to present comparative financial statements even if this is not required. Historically this has resulted in note disclosure being included for anything that is integral to each period presented in the primary statements so that the financial statements for each period, in and of themselves, are presented fairly in accordance with the applicable accounting framework. Members are thus concerned that the guidance in paragraph 54 could result in an inappropriate reduction of information provided in the notes related to the prior year(s), and thus the corresponding compliance of the prior year(s) financial statements with the applicable accounting framework. This presents a concern particularly in situations in which the prior period financial statements were not prepared or are not available (e.g., financial statements prepared for an initial public offering). This concern arises because the Practice Statement suggests that "if a disclosure was material to the prior period's financial statements, but the same level of detail or type of information is not material to the current-year financial statements, the disclosure often does not need to be repeated in the same level of detail."
- 31. Members also feel the guidance in paragraph 54 may be unworkable with existing audit requirements since the approach being suggested appears to be more aligned with the



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‘corresponding figures’ approach discussed in ISA 710¹, which results in the auditor’s opinion referring to the current period only (as opposed to opining on the financial statements of both the current and prior periods). Members recommend the IASB discuss this guidance further with audit standard setters to understand whether the guidance could result in additional issues between preparers and auditors in determining whether a “clean” audit opinion can be issued on the financial statements of the prior year(s) presented.

Interim reporting

32. Members recommend that the Practice Statement be further enhanced by providing a more robust discussion of the factors that are unique to interim financial statements. For instance, questions often arise as to whether, and if so how, a materiality analysis would differ for an interim period versus an annual period. Further, if the interim assessment differs, questions arise as to how entities should consider the length of the interim period (i.e., 3 months versus 9 months) in the assessment and the fact that in preparing interim financial statements management may place a higher reliance on the use of estimates than is the case in preparing the annual financial statements.

Practical expedients

33. As drafted, the guidance in paragraphs 63-66 on practical expedients could be read to encourage the use of practical expedients, which we do not believe was the IASB’s intent. Further, the guidance is drafted in the context of internal record keeping but it is unclear how the use of practical expedients aligns with the guidance in paragraph 11 and that a requirement in IFRS need not be applied if the effect of not applying it is not material. If the discussion on practical expedients is retained, it should clearly reconcile to the principle in paragraph 11.

¹ International Standard of Auditing 710 – Comparative Information – Corresponding Figures and Comparative Financial Statements



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Omissions and misstatements

34. Members observe that paragraph 76 of the proposed Practice Statement could be read such that, if the correction of a prior period error in the current year would result in a material misstatement to the current year financial statements, then retrospective correction to the prior period financial statements may be required. For example, the accumulation of immaterial errors over several prior periods could aggregate to a material misstatement such that, if it were corrected in the current year, it would cause the current year to be materially misstated. In this instance, members agree that retrospective correction to the prior period financial statements may be required and believe the Practice Statement should more clearly articulate how paragraph 76 aligns to IAS 8.
35. Consistent with the observations in paragraph 32, members also observe that the guidance could be enhanced by discussing how to evaluate prior period errors when the next set of financial statements authorised for issue are for an interim period.

Other observations

36. Members observed that paragraph 11, which notes that a requirement in IFRS need not be applied if the effect of not applying it is not material, is closely related to the guidance in paragraphs 49-53 regarding the application of materiality to disclosures specified in IFRS and paragraphs 78-79 regarding the use of practical expedients. As such, they suggest a reference be made in paragraph 11 to paragraphs 49-53 and to paragraphs 78-79.
37. The Practice Statement is not always consistent in the way it refers to IAS 1, IAS 8, IAS 34 and the Conceptual Framework. In some cases the paragraphs of standards are fully quoted, sometimes they are “summarized”, and sometimes there is a footnote reference to the standard. Members suggest the Practice Statement should reference these standards on a consistent basis.



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We appreciate your thoughtful consideration of the comments raised in this letter. If you have any questions or need additional information on the recommendations and comments that we have provided, please do not hesitate to contact me at 202-551-5300.

Sincerely,

Julie A. Erhardt
Chair
Committee on Issuer Accounting, Audit and Disclosure
International Organization of Securities Commissions