

18 January 2016

The Chairman
IASB
By email

Dear Sir

Re: Exposure Draft ED/2015/8 “The Application of Materiality to Financial Statements”

Who we are and why we are commenting on this ED

Westworth Kemp Consultants value the opportunity to provide feedback into the development of the proposed Practice Statement, “The Application of Materiality to Financial Statements”.

We advise on financial reporting, assurance and compliance issues, particularly in the context of litigation and dispute resolution (www.westworthkemp.com.au). The nature of our work is such that we often see instances where financial reporting has failed as a communication tool for stakeholders and we are therefore keen to contribute to the establishment of sound conceptual underpinnings for accounting standards including materiality.

Overall support for the project

We congratulate the IASB on its adoption of this challenging but essential project.

We wholeheartedly endorse the thesis of this paper which reiterates the fundamental premise of financial reporting, which is to communicate to designated users of financial reports understandable financial information about an entity. The focus on the users of financial statements sets materiality in the context of financial reporting as a form of communication and moves away from viewing financial reporting legalistically as a compliance exercise with a “bright line” numerical thresholds approach to materiality.

We like the lucid language used in the paper. We found it clear and believe it would be accessible to financially literate readers, such as company directors. Broad accessibility is important, because this paper should be read by directors and others who are not accountants but are responsible for financial reports. It will assist them in making judgements on what information should be included in the financial statements and how it should be presented.

The paper very clearly articulates an obligation for anyone responsible for financial reports to exercise their judgement to ensure that those financial reports are clear and understandable to financially literate readers. This is in stark contrast to some of the situations we encounter in our litigation work where there is at best minimalist compliance with the letter of the disclosure requirements of the standards, without providing meaningful information to a user.

The purpose of the paper is ostensibly narrower, that is, it provides guidance on materiality. However, the paper is also emphasising the role of financial reporting as a means of communicating information about the business. As such, it is a very important paper and should be more than a guidance paper, perhaps part of the Conceptual Framework. Our concern is that if it only has the status of Practice Statement, like Management Commentary, it will not be given the attention it deserves.

Detailed responses to the IASB's questions

We set out below our responses to the questions in 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?*

(a) While we can see difficulties in issuing the paper as a standard, we are concerned that as a non-mandatory Practice Statement, it will not receive the attention it deserves. It is our experience that the concept of materiality is not well understood and the guidance in the paper has the potential to significantly improve financial reporting if it is adopted widely. In our work, we have found many instances where the fundamental principle of good communication, based on an understanding of materiality and relevance to the needs of users, does not inform the preparation of financial reports.

We have found many instances where:

- Statements of accounting policies are long, uninformative and do little more than follow the template of an accounting firm's pro-forma;
- Notes provide numerical information but no descriptive words;
- Notes are complex and poorly worded and sometimes inarticulate;
- Preparers and auditors are focussed on ostensible compliance rather than substance and communication.

We have also found instances where directors have devolved their responsibilities for financial reporting to accounting specialists. The cause for this is often that financial reporting is seen as a complex compliance exercise, outside the skill set of non-specialists.

This Exposure Draft sets out an explicit statement that financial reporting should provide clear communication to financially literate readers about an entity's activities. Financial reports therefore should be understandable by directors and informed investors.

(b) We therefore think that this Exposure Draft is far too important to be just guidance. In our view this Exposure Draft should form part of the Conceptual Framework. While still not mandatory, inclusion in the Conceptual Framework would emphasise the paper's importance in the preparation of meaningful financial reports.

It lucidly articulates a principle that is fundamental to financial reporting, namely, that financial reporting should provide clear communication about an entity based on an understanding of materiality and relevance.

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 find the examples included in the Exposure Draft helpful.

We do not believe that the inclusion of further scenarios will enhance the Exposure Draft. Further scenarios will be conducive to narrow sophistic analysis of the examples. This will distract from the primary principles that the Exposure Draft so clearly articulates.

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:

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

(b) 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?

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

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

(e) 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?

(a) We believe that in its present form the Exposure Draft clearly articulates the principle that financial reporting is the process of communicating the financial aspects of an entity's business that must be based on an understanding of materiality and relevance. It needs no further content.

(b) In our view its principles will be readily understood by financially literate people who are responsible for financial reports.

(c) There are no parts of the paper with which we disagree.

- (d) We do not think that any parts of the paper are unnecessary. We expect that the breadth of the Exposure Draft's thesis and the fact that it requires the responsible exercise of judgment will alarm some accountants and we anticipate some will be looking for a more prescriptive paper. However, we exhort the IASB not to surrender to pressure to narrow the views expressed in the Exposure Draft or to be more prescriptive.
- (e) We find no conflict between the Exposure Draft and legal requirements in Australia.

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?

The Exposure Draft should be issued now. We refer to our earlier comments on the form it should take. Most particularly the resultant paper should be given prominence. It should form part of the Conceptual Framework or have a status equivalent to it.

Question 5—Any other comments

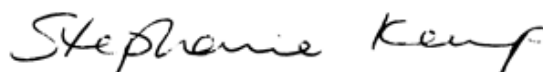
Do you have any other comments on the [draft] Practice Statement? As mentioned in Question 4, a discussion about the definition of materiality will be included in the Discussion Paper in the Principles of Disclosure project, so the IASB is not asking for comments on the definition at this time.

We have no other comments.

Yours faithfully



C N Westworth, LLB, FCA, FAICD,
DipCI Arb



S C Kemp, MA, FCA