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The Chair  
Australian Accounting Standards Board  
PO Box 204  
Collins St West  
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02 March 2015

Dear Ms Peach

**Ernst & Young's global submissions to the IASB - Exposure Draft ED/2015/8 - IFRS Practice Statement: *Application of Materiality to Financial Statements***

Please find enclosed Ernst & Young's global submissions to the IASB on the above exposure draft.

Yours sincerely

Ernst & Young

Encl:

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

26 February 2016

Dear Board members,

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

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on Exposure Draft ED/2015/8 - IFRS Practice Statement: *Application of Materiality to Financial Statements* (ED) from the International Accounting Standards Board (IASB or Board).

We support the Board's efforts to provide guidance on how to apply the concept of materiality in the preparation of financial statements. We believe it provides a helpful framework that entities will be able to rely on to operationalise to their specific circumstances. Furthermore, the ED will help to raise awareness of the issue of disclosure overload and encourage management to more actively pursue disclosure effectiveness by applying the materiality concept. Therefore, we believe the proposed guidance will be helpful in improving the effectiveness of financial statements.

However, in our view, some of the proposed guidance and the illustrations/examples require further clarifications. Our responses to the specific questions in the ED are provided in the Appendix.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas on +44 (0)20 7951 3152.

Yours faithfully

*Ernst + Young Global Limited*

## Appendix

### 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) We agree that the guidance should be issued as non-mandatory guidance based on the reasoning provided in paragraphs BC11-BC13 of the ED. Also, as further explained in Question 3, disclosure of immaterial information is not prohibited under IFRS, and thus guidance on how to apply the materiality concept is, by nature, non-authoritative. Furthermore, in reference to potential conflicts with local regulatory requirements, we believe the challenges that would be encountered in enforcing mandatory guidance on materiality are hard to overcome in practice.
- (b) We generally agree that a Practice Statement is the appropriate form for non-mandatory guidance on applying the concept of materiality.

However, we acknowledge that a need to revisit the Practice Statement may arise when the Principles of Disclosures project is finalised, either as a consequence of revisions to the definition of materiality, or as result of the standards-level review of disclosures. For instance, it may be that the inclusion of certain elements of the Practice Statement in an IFRS or an IFRS' application guidance may be appropriate. Furthermore, as preparers of financial statements are not very familiar with the form and, thus, might not perceive the proposed guidance as important, one might find that the Practice Statement format should be reconsidered as experience is gained through application.

We also believe the basis for conclusions section primarily includes background information, but little or no explanation for the specific guidance included in the ED. Thus, we believe the content of the basis for conclusions section in the ED cannot stand alone as a basis for conclusion. The IASB should, in the basis for conclusions, summarise the considerations made when developing the guidance (e.g., similar to the one provided in IFRS Practice Statement *Management Commentary*).

### 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 believe the examples provided in the ED are helpful. However, we recommend the Board to consider the following clarifications:

- ▶ Paragraph 28(a) indicates that materiality considerations will be more *sensitive* for items that “could trigger non-compliance with regulatory requirements or loan covenants”. We believe this means that there may be disclosures that are material for the items for which the regulatory requirements or loan covenants apply that would not be material without those externally imposed restrictions. However, if the Board is of a view that other materiality assessments may also be impacted, it should be clarified.
- ▶ Example 39(b) refers to “one speculative forward foreign exchange transaction”. In some jurisdictions, local corporate governance requirements prohibit speculative activities unless closely monitored. Therefore, the example provided might have limited application. Furthermore, generally we do not think the reason for a large loss (i.e., whether it is incurred on speculative activity or not) impacts the assessment of whether it is material or not.
- ▶ Paragraph 53(b) provides an example suggesting that, where an entity has several large defined benefit plans and some smaller plans, for the smaller plans, it might be sufficient to disclose only the key risks and sensitivities. We recommend the Board extending this example to illustrate that even for the larger plans, there might be circumstances where an entity would not need to provide all the disclosures required by IAS 19 *Employee Benefits*. For instance, in the case of a closed defined benefit plan, some of the disclosure requirements in IAS 19 may not be relevant. This will help to better illustrate the principles outlined in paragraph 50 of the ED, and in particular, that IFRS disclosure requirements should not be treated as a checklist, without regard to the entity’s circumstances and the needs of its primary users.
- ▶ Paragraph 53(c) of the ED indicates that an entity that has share-based payment transactions is not always required to disclose all the information required in paragraphs 44-52 of IFRS 2 *Share-based Payment*. It would be helpful if the Board clarifies why an entity would need to provide more disclosures for some share-based payment transactions than for others. Would qualitative factors, such as related party nature (i.e., some of the share-based payment arrangements are with key management personnel), impact the assessment of materiality of individual share-based payments?

### 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. Do you agree with that proposal? Why or why not?

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?

- ▶ We generally support the proposed implementation guidance. Even though some may consider the guidance in the draft to be common sense, we believe implementation guidance in such a judgemental area will be helpful, even if it is not prescriptive. We agree with the analysis in BC7, including the conclusion that the ED stands a good chance of affecting management “incentives” to more actively pursue disclosure effectiveness by way of application of the materiality concept. We also believe that the judgement process expressed in the ED may provide a good basis for appropriate application of the materiality concept in practice. However, we believe, some of the proposed guidance requires further clarifications (see our comments to Question 2 and further below for our more specific concerns).
- ▶ We agree with the Board that the issue of determining whether information should be presented in the primary financial statements or in the notes is an area of particular difficulty in practice (paragraph BC5(b)). We appreciate the Board’s attempt to provide additional guidance in this area. We also agree that the process outlined in paragraphs 12-29 of the ED, i.e., identifying the primary users and their primary

information needs, applied along with the principles outlined in paragraphs 40-55, may provide a helpful basis for determining an appropriate balance between the information that should be presented in the primary financial statements and information that should be disclosed in the notes.

Nevertheless, we believe that the proposed guidance could be improved by reflecting the more practical aspects of the materiality assessments to be made in determining whether something should be presented in the primary financial statements or in the notes. For instance, one commonly raised question is whether an entity needs to disaggregate certain line items, e.g., revenue, into categories on the face of the primary financial statements or if provision of this information in the notes is sufficient. We are concerned that, without further clarification in the proposed guidance, determining the appropriate level of aggregation on the face of the primary financial statements and other issues regarding the interaction between the primary financial statements and the notes will remain an area of particular difficulty in practice.

- ▶ In certain industries, the materiality assessment may rely on different quantitative materiality thresholds depending on what primary financial statement one is considering. For example, the statement of financial position of a bank is usually much larger than a statement of financial position of an entity in a non-banking sector. As a result, in the banking sector quantitative materiality threshold for the statement of financial position, in many cases, is considered higher than quantitative materiality threshold for the statement of profit or loss and other comprehensive income. We believe this aspect should be addressed in the Practice Statement.

Similarly, certain elements of the primary financial statements or the notes may attract more attention from the users of financial statements for certain industries. For instance, due to regulatory requirements, liquidity and liquidity ratios are considered more important in the financial statements of a bank than in the financial statements of an insurance company. It would be helpful if the Board clarifies that an entity would need to consider such industry-specific aspects when assessing materiality.

- ▶ The section on “Recognition and measurement” in paragraphs 61 - 66 addresses some specific aspects of the materiality assessment regarding recognition and measurement. However, the paragraphs primarily relate to practices that an entity might use in its book-keeping, rather than providing useful guidance for making difficult materiality assessments on recognition and measurement. Although we agree that physical stock count and internal record keeping procedures are key elements of the process of preparing financial statements, we believe that reference to a situation in which a recognition and/or measurement requirement of a standard is not complied with in reference to it being immaterial, would be more relevant and provide helpful guidance. For instance, an entity may choose to capitalise some costs, even if according to the applicable standard it should be expensed, if the effect of doing so is immaterial.

- ▶ In the following section, we provide our more specific comments on the content of the ED:
  - We support the suggested clarification in paragraph 27(a), that just quoting the requirements within IFRS without tailoring its description in the accounting policy note is inadequate. However, we believe this clarification should be given more prominence in the [draft] Practice Statement as such tailoring will enhance the usefulness of the financial statements.
  - Paragraph 27(b) refers to financial effects of uncertainties and contingencies as a non-quantitative factor in the materiality assessment. The expected financial effect is a quantitative factor and, thus, not relevant in illustrating non-quantitative factors.
  - According to paragraph 43, materiality is to be assessed relative to line items, subtotals and totals on the face of the financial statements, “*as well as to each overall individual statement*”. It is not clear what the latter reference means, in particular taking into account that the totals of each statement are included among the measures to be considered. Furthermore, we believe the process explained in paragraph 43 is incomplete, as it ignores the last step in paragraph 32(c), i.e., the assessment of the presentation in the primary financial statements in the context of the complete set of financial statements.
  - The discussion in paragraph 43 seems to suggest that only certain lines should signpost the notes where the more detailed information can be found. However, generally, all lines in the primary financial statements require cross-references, if additional information is provided in the notes. The wording should be revised accordingly.
  - It is not clear what “Because of their structure” in paragraph 45 refers to. It may be read as suggesting that more detailed information may be omitted simply on the basis there is no room/space for it (rather than based on a materiality assessment). The difference between a) and b) is not clear. Therefore further clarification would be helpful.
  - Paragraph 52 states that, “An entity *must* provide information in addition to the information specified in IFRS if that information is relevant (...)” (emphasis added). We recognise that paragraph 15, paragraph 31 and paragraph 112 of IAS 1 all refer to disclosure of relevant information beyond what is specifically required in IFRS. However, the wording in the ED is different, and may be read to suggest a more onerous disclosure requirement than which follows from IAS 1 or other standards. To avoid unintentional consequences, we propose that the wording in paragraph 52 is amended to be more aligned with the similar requirement in IAS 1.
  - We recommend the Board to clarify the introduction to the examples in paragraph 53, as one may read it as illustrating the guidance in paragraph 52, which does not seem to be the case. Rather, paragraph 53 illustrates the concept discussed in paragraph 50, and it should be replaced accordingly.

- In paragraph 64, second sentence, we suggest “departure from IFRS” is replaced by “policy”, as because of the materiality assessment, it is in fact not a departure from IFRS.
- We believe it would be helpful to clarify in paragraph 69 that, with respect to estimates, such as provisions and Level 3 fair value measurements, the difficulty that arises in identifying errors, to a great extent, reflects the fact that new information may provide new insights, and the timing of the new information may often be difficult to identify precisely. Therefore, in these circumstances, something may in hindsight appear as a prior period error, but, in fact, merely reflects new information obtained after the previous estimate was made.
- However, as drafted, paragraph 69 may be read that adjustments to estimates never reflect misstatements in previous periods. That is not the intention, we believe. We, therefore, recommend the Board to add the following clarification at the end of paragraph 69:

“... In other circumstances, it might be clear that an adjustment to an estimated value is, in fact, a result of an error made in a previous period, as opposed to new information or new developments. When considering whether an adjustment should be treated as a change in estimate or a correction of an error management should be guided by the requirements in IAS 8.”
- Paragraph 70(b) refers to “the preliminary announcement of financial information”. Such announcements are outside the scope of IFRS. Therefore, we recommend the Board to remove it, i.e., to reword paragraph 70(b) to only focus on financial statements that have been prepared but not yet authorised for issue.
- We believe the structure and wording in paragraph 71 is potentially misleading. The first sentence states that management should correct all material misstatements identified before the entity’s financial statements are authorised for issue. This contemplates that management has already considered the materiality of all identified misstatements. However, the third and fourth sentences suggest a second step, it seems, involving another assessment of whether the yet uncorrected misstatements are material in relation to individual line items, subtotals or totals in the financial statements. Therefore, we are concerned that the proposed paragraph 71 may be read as suggesting a two-step process of assessment of materiality of misstatements, with the second step in effect introducing a lower threshold of materiality. We do not think this is intended, nor do we think such a two-step approach is in line with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Therefore, we recommend the Board to revise the paragraph accordingly.



- Paragraph 78 is difficult to read, so we suggest to reword it as follows:

“However, if management intentionally misstates items to achieve a particular presentation or result, it has done so presumably because it thinks that particular presentation or result could reasonably be expected to influence the decisions of the primary users of the financial statements. Therefore, intentional and such misstatements of this kind are by nature material.”
- IAS 8 and the ED distinguish between intentional and other misstatements. In our view, ‘intentional’ does not refer to situations in which the entity has concluded that something is immaterial, and therefore has not applied the requirements of an IFRS. ‘Intentional’ refers to situations in which an entity has chosen to disregard a requirement of an IFRS with the intention to mislead the users of the financial statements. We believe clarifying this distinction would be helpful.
- We believe that the proposed guidance in paragraph 28(b) on further information on intended future actions tends to go beyond current disclosure requirements and would be more appropriately placed in guidance on management reporting.
- Please consider the following suggested rewording of footnote 25 on page 26: “See IAS 10 *Events after the Reporting Period* for the requirements about the date when the financial instruments statements are authorised for issue.”

#### 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 support the proposed timing.

We also support the Board in proceeding with the issue of this guidance in spite of the definition of materiality being the subject of discussion in the Principles of Disclosure project, for the reasons explained by the IASB in the ED.

We agree that, following the completion of its Principles of Disclosure project, the IASB should consider whether any consequential amendments to the Practice Statement are necessary. However, we also believe that, at that stage, the Board may, in the first instance, want to reconsider whether the form of the proposed guidance on materiality, i.e., a non-mandatory practice statement, is appropriate and whether there is a need for any consequential amendments to IFRS, as also explained in our response to Question 1 (b).

**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 further comments.