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Mr Hans Hoogervorst
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Our ref MV/288
Contact Mark Vaessen

26 February 2016

Dear Mr Hoogervorst

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

We appreciate the opportunity to comment on the International Accounting Standards Board's (IASB) Exposure Draft ED/2015/8 IFRS Practice Statement: *Application of Materiality to Financial Statements*. We have consulted with, and this letter represents the views of, the KPMG network.

The appendix to this letter provides our responses to the specific questions posed in the ED and highlights our concerns. We provide our overall comments below.

We support the IASB's efforts in developing guidance on the application of materiality and agree with the stated objective of the Practice Statement to "assist management in applying the concept of materiality to general purpose financial statements prepared in accordance with IFRS". We feel, however, that for the proposed Practice Statement to be operational, further improvements are needed. In our view, to meet its objective, the Practice Statement will have to go beyond a summary of existing IFRS literature and, instead, provide a framework for the application of materiality to financial statements, in particular, to the financial statements as a whole.

We suggest that, building on the existing literature, this could be done by first identifying the key principles of materiality in the context of the financial statements as a whole (which may include refinements to the definition of materiality), before providing more specific guidance on presentation and disclosure; recognition and measurement; and misstatements.

Once the key principles are identified, we recommend that the Practice Statement focus on their application to presentation and disclosures in both the primary financial statements and the notes. It would be helpful if the Practice Statement outlined the process for evaluating which disclosure should be included or excluded from the financial statements and how misstatements in disclosures should be evaluated. We also believe that recognition and measurement issues are

not as pressing as application of materiality in the context of disclosures and could be dealt with at a later stage.

Considering growing calls to cut clutter from financial statements and make them more relevant to users, enhanced guidance that focuses mainly on presentation and disclosures would address an immediate need. It would also address an area that is most challenging in practice given the increasing complexity and volume of disclosures, in particular qualitative disclosures. Lastly, it would also help facilitate better dialogue amongst interested stakeholders including investors, preparers, auditors and regulators. In this regard, we encourage the IASB to actively liaise with the IAASB and other stakeholders and to consider their perspectives in further improving the Practice Statement.

Please contact Mark Vaessen +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix 1 – Specific Questions Posed by the IASB

Form of the guidance

Question 1: 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?***

We believe that a Practice Statement can be a useful vehicle, if it clarifies the fundamental principles to be applied in assessing materiality, and provides practical guidance for preparers in how they should structure their materiality considerations, in particular in deciding what information to include or exclude from the financial statements.

We encourage the IASB to liaise actively with the IAASB to enhance the guidance and continue its outreach with investors, preparers and regulators to understand what benefits they see from the guidance, whether they support it and in what form.

We recognise that due to legal or regulatory requirements on application of materiality in different jurisdictions, the non-mandatory status may be considered more appropriate.

Illustrative examples

Question 2: 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.

The examples in the proposed Practice Statement are predominantly derived from existing standards. We believe that they would be more helpful if they would clearly identify the principles they are intended to illustrate. The current examples also do not provide clear illustrations of some of the challenging areas covered in the proposed Practice Statement.

It would be helpful if examples could illustrate matters such as:

- Materiality judgements made in the context of:
 - The primary financial statements – level of aggregation and disaggregation;

- The notes – what information can be excluded and what should be included; and
- The financial statements as a whole, including re-evaluating whether the information presented and disclosed meets users' needs. This may lead to additional information to be included or removed.
- Qualitative materiality considerations where items are considered material due to qualitative rather than quantitative characteristics (e.g., remuneration disclosures).
- When immaterial information can obscure material information.
- Whether relevant information has been given sufficient prominence, e.g., by being disclosed on the face vs in the notes.

Content of the [draft] Practice Statement

Question 3: 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?***

Role of Comparative Financial Information

The examples in paragraphs 54-55 do not clearly demonstrate the intended purpose of comparative financial information.

We encourage the Board to clarify and provide additional guidance for circumstances in which comparative information may or may not be provided on the basis of it not being material to the financial statements in the current year. It would also be helpful if consideration is given to different approaches used in different jurisdictions (i.e., comparative financial information vs corresponding figures approach as defined in auditing literature).

Also, the example in paragraph 55(b) refers to commentary information and trend analysis; this may be confusing as such information is normally within the scope of the management discussion and analysis section of an annual report and not in the financial statements.

Disclosures over significant judgements and estimates

Disclosures over significant judgements and estimates are key to enhancing the relevance and understandability of financial statements. Accordingly we recommend that guidance in this area be enhanced and given more prominence as opposed to being covered briefly in a section on misstatements (i.e., paragraph 69).

Omissions and misstatements in disclosures

While paragraphs 67-79 include guidance on misstatements, it is primarily focused on misstatements in recognition and measurement and does not explain how to evaluate misstatements in disclosures.

We also note that paragraph 67 suggests that “describing information ambiguously or obscuring material information” always results in a misstatement, however these may not be the only sources of misstatements in disclosures. Also, this paragraph does not provide any guidance as to how to make such assessments.

We believe that the IASB would benefit from getting input from other stakeholders, in particular the IAASB, on how to address omissions and misstatement in disclosures. We therefore recommend that the IASB liaise actively with the IAASB to enhance the guidance in this area.

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?

Materiality is a complex topic that includes many aspects and practical guidance in this area would help preparers in making their judgements. However, we believe that further improvements to the proposed guidance are necessary in order to drive the expected change in behaviour.

As noted in the cover note, our primary concern is that the proposed guidance may not be operational because, to a large extent it consists of a summary of existing IFRS literature and does not provide a framework for application of materiality to financial statements. In particular, we believe that the overriding concept of materiality for the financial statements as a whole should be given sufficient consideration in the Practice Statement. It would be helpful if the Practice Statement could build on existing literature to identify the key principles of materiality in the context of financial statements as a whole before delving into the topics of presentation and disclosure; recognition and measurement; and misstatements.

Once the key principles are identified, we recommend that the Practice Statement focus on their application to presentation and disclosure in the primary financial statements and the notes in order to help preparers make better judgements in this area, with an aim of providing relevant disclosure and reducing disclosure overload. The IASB could then consider whether additional guidance is needed in relation to other topics such as recognition and measurement.

Although we recognise that materiality is an entity-specific concept, it would be helpful if the document could address considerations that are relevant to evaluating which disclosures should be included vs excluded from the financial statements.

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

Considerations of users' needs

In providing guidance to preparers on information to be provided in the financial statements, paragraph 21 suggests that management needs to consider whether the primary users have any “special needs” and whether the information provided meets or exceeds the needs of an entity’s primary users. We are concerned that this concept of “special needs” is not consistent with the current definition of general purpose financial statements (CF OB2-OB10 and IAS 1.7) which focuses on the “common” information needs of a wide range of users.

Disclosure of accounting policies

Overall, we welcome guidance with respect to disclosure of accounting policies, but the guidance provided in paragraph 27(a) is too broad and generic. We encourage the Board to clarify principles and provide examples when disclosure of accounting policy is considered necessary. In particular, in circumstances where there are no explicit policy choices in IFRS, but multiple policies are considered acceptable.

It is also confusing to have “inadequate” and “immaterial” in the same sentence, i.e., if an accounting policy disclosure is considered inadequate then the accounting policy must be material in the first place, not immaterial.

Immaterial information

Paragraph 36 indicates that in some cases it may be helpful for a preparer to disclose the fact that a particular issue is immaterial to the entity and it provides an example of such a situation, i.e., where management may wish to inform users that the entity is not exposed to a risk that users of the financial statements otherwise would expect the entity to be exposed to. We believe caution should be taken with guidance encouraging the disclosure of immaterial items. Instead it may be helpful to explain further concepts of quantitative vs qualitative materiality and interactions between those with examples.

Concepts of preparers' vs auditor's materiality

Basis for Conclusions 18-20 focuses on the fact that auditors use materiality for different purposes during an audit than management does when preparing the financial statements. While we do not disagree with this, we are concerned that the Basis focuses on the differences and that it does not emphasise that, irrespective of how materiality is used by preparers (including audit committees, boards of directors) and auditors, both are focused on the same fundamental issues, i.e., what financial information will impact the decisions of users of the financial statements and whether or not the financial statements are free of material misstatement and in the end provide a fair presentation. This is key, especially given that some jurisdictions now require or permit the auditor to disclose a materiality level in their auditors' reports.

We encourage the IASB to work closely with the IAASB to provide appropriate clarification of "materiality" concepts. It is critical that these concepts are aligned.

Information material to future operations

We are concerned over examples introduced in the proposed Practice Statement having a forward-looking focus given that the context of financial statements reflect historical information. For example, paragraph 28(b) includes an example of items that could reasonably be expected to be key to the entity's future operations, even if they do not have a material effect on the financial statements in the current period. We believe that such information is normally within the scope of the management discussion and analysis section of an annual report and not in the financial statements.

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

We believe that discussion of recognition and measurement, including explanations of practical expedients, could be confusing if the intended focus of the Practice Statement is materiality in the context of disclosures. If such discussion is retained, we suggest to put it in context of the process that the preparer is expected to follow in making their materiality judgements. In particular, it would be helpful to acknowledge management responsibility for maintaining complete and accurate books and records and the interaction of such requirements with the preparation of financial statements that include all material disclosures.

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 believe this question would be best answered by preparers of the financial statements and/or local regulators.

Timing

Question 4: 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 encourage the IASB to continue its outreach with other stakeholders including investors, preparers and regulators, to understand what benefits they see from the guidance, whether they support it and in what form.

We do not believe it is necessary to defer the Practice Statement until the Principles of Disclosure project is concluded. However, we note that it is key to establish the founding disclosure principles – the clear, practical vision of what disclosure is for. Once the objectives of disclosure (both of primary statements and of the notes) are clearly defined on a conceptual basis, this should facilitate application of materiality and would enable the IASB to provide better, more practical guidance based on those objectives.

Any other comments

Question 5: 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 the following other comments not specifically addressed in this letter.

Clarity of Drafting

We note that drafting of the Practice Statement can be improved with particular focus on clear articulation of principles before introducing examples. For example, we expect some readers may be confused by the following:

- Paragraph 17 states “Across the range of possible primary users there may be a broad range of information needs and some may have dissimilar information needs and expectations. For example, some information might be useful to some primary users, but not others”. The use of “for example” in this sentence does not precede an example, but is rather a continuation of the preceding sentence.
- Paragraph 47 makes the point that “if information is material in the context of the primary financial statements then disclosure in the notes is not sufficient.” The example following this sentence appears to contradict this message.
- Paragraph 52 implies that sometimes it is not enough just to disclose information required by IFRS. However, the examples following in paragraph 53 appear to illustrate the opposite; that it is not always necessary to disclose all of the information required by IFRS disclosure requirements.
- Examples in paragraph 55 are meant to illustrate that materiality is not only assessed by reference to the current reporting date. However, the materiality of the information in the examples in paragraph 55 seem to be judged in the context of the current period and not on another basis as implied.

Consistency of use of terms

- The proposed Practice Statement uses both “present and disclose” information as well as “disclose” information – and these terms are not used consistently.
- The proposed Practice Statement introduces terms or concepts not currently used in IFRSs, for example “unusual transactions” (paragraph 28(c)).
- We recommend the IASB consider the use of terms in the Practice Statement and clarify different terms used in IFRSs that refer to materiality, e.g., key, significant, principal, and relevant, inadequate vs immaterial.