



EFRAG – Application of Materiality to Financial Statements

ICAEW welcomes the opportunity to comment on the draft European Financial Reporting Advisory Group (EFRAG) comment letter on the draft IFRS Practice Statement *Application of Materiality to Financial Statements* published by EFRAG on 27 November 2015, a copy of which is available from this [link](#).

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MAJOR POINTS

Welcome for the exposure draft

1. As we shall state in our forthcoming comments to the IASB, we welcome the exposure draft (ED) *Application of Materiality to Financial Statements*. We believe that the proposed Practice Statement would usefully draw together and explain existing requirements and help preparers make and defend decisions on materiality. However, we have identified a number of points in the draft where we think that there is scope for improvement, and these will be set out in our comments to the IASB.
2. In particular, we think it would be more helpful for the Statement to be structured in a way that reflects the thought processes that preparers would have to go through, and the considerations that they would have to take into account, in making decisions on materiality. A number of the examples could be improved. And it would also be helpful if the Statement were rather shorter and more succinct, so as to be more useful.
3. We have taken EFRAG's draft response into account in preparing our comments to the IASB, and we support the principal points in EFRAG's draft, except that unlike EFRAG we are broadly happy with the range of topics covered in the ED. As our views on the issues raised by the ED are set out in full in our response to the IASB, which we will shortly be sending to both the IASB and EFRAG, we have kept the comments in this response as brief as possible.

RESPONSES TO SPECIFIC QUESTIONS

4. Our responses to the specific questions in EFRAG's draft comments follow the draft's numbering, which begins with a question at paragraph 9 and is not consecutive.

Form of the guidance

Q9: Do you agree that the guidance should be issued in the non-mandatory form of a practice statement? If not, please explain your preferred form. If so, please explain how you believe a non-mandatory practice statement may result in positive changes in behaviour.

5. We agree with EFRAG that the guidance should be issued in the non-mandatory form of a Practice Statement. We believe that the guidance will help preparers in making decisions on materiality and in defending these decisions to regulators. A positive practical result of this may be that financial statements include fewer immaterial disclosures.

Q10: Do you consider that specific aspects of the proposed content of the guidance may cause enforcement issues or conflict with local regulations? Please specify which aspect, if any.

6. Paragraphs 5 and 6 of the ED suggest that the meaning of 'materiality' for the purpose of ongoing market disclosure obligations is the same as in financial reporting. We do not think that this is correct, and there may therefore in this respect be a conflict with local regulations, which in any case vary among jurisdictions. We are not aware of any other conflicts or of potential enforcement problems that might be caused by the guidance.

Illustrative examples

Q17: Do you agree that the inclusion of illustrative examples in the Practice Statement is helpful? If not, please explain.

7. We believe that the inclusion of illustrative examples in the Practice Statement is helpful, but we have a number of comments on the specific examples in the ED.

Q18: Do you agree with EFRAG's assessment that illustrative examples should focus on the areas discussed in Paragraph 13 [of EFRAG's draft comments]?

8. We agree with the approach suggested by EFRAG at paragraph 13 of its draft comments, namely that the examples in the Practice Statement should 'illustrate both decisions to include or to omit information from the financial statements and not over-emphasise the first aspect; and focus on those areas where judgement is assessed to be the most difficult to exercise'.

Q19: Do you believe that the illustrative examples currently included in the draft Practice Statement could have any unintended consequences or counter-productive effects? If so, please explain.

9. As stated above, we have a number of comments on the illustrative examples in the ED, but – except in relation to paragraph 28(b) of the ED (see below) – our concerns about them do not relate to their potential unintended consequences or counter-productive effects.

Content of the draft Practice Statement

Q44: Do you agree that the draft Practice Statement should primarily provide guidance on the topics identified in paragraphs 25 to 43 [of EFRAG’s draft comments]? If not, please explain which other topics should be covered.

10. We are broadly content with the range of topics covered in the ED.

Any other comments

Q51: Do you have any other comments on the draft Practice Statement or on EFRAG’s draft comment letter?

11. Our other comments will be set out in full in our response to the IASB. We draw attention to the more important ones below.

Timing

12. We agree with EFRAG that the IASB should issue the Practice Statement before the Principles of Disclosure project is completed.

Disclosure of irrelevant accounting policies

13. It would be useful for the Practice Statement to include guidance emphasising that it is pointless to disclose accounting policies for items that do not appear in the financial statements either for the current year or as comparatives.

Nature and magnitude

14. In our view, it is nearly always necessary to consider both the nature **and** magnitude of items in deciding questions of materiality. We therefore believe that the definition of materiality in the *Conceptual Framework*, which currently refers to ‘nature or magnitude’ (although this is misquoted in the ED), should be amended and that the Practice Statement should reflect this. However, the issue should be discussed in the Practice Statement in any case. If the *Framework* is not amended, then the Practice Statement should be in line with IAS 1, *Presentation of Financial Statements*, and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, rather than with the *Framework*. These standards refer to ‘size and nature’ before then referring to size or nature or both.

Entity accounts

15. It would be helpful for the Practice Statement to discuss the users of entity accounts and their needs.

Prospective materiality

16. We do not agree with the example at paragraph 28(b) of the ED, where an item is judged to be material in the current period because it is hoped that it will be material in the future. In our view, this would stretch the concept of materiality unduly.

Notes to the accounts

17. The discussion at paragraphs 45 to 48 of the ED implies that there are two levels of materiality: one for what should appear on the face of the accounts and another for what should be disclosed in the notes. It is not clear to us that there are currently two concepts in the *Conceptual Framework* or in IAS 1, *Presentation of Financial Statements*, (eg, see paragraph 112) or IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, and we do not think that there should be. If the IASB believes that there are two concepts, it would be

important to clarify this and to discuss how the two levels of materiality differ. Paragraphs 29 to 31 of EFRAG's draft comments touch on this issue.

Precision of estimates

18. It would be helpful to have some discussion of the degree of precision required for estimates in deciding whether the effect of recognition and measurement requirements is material.