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EFRAG

Françoise Flores

Chairman EFRAG TEG

35 Square Meeûs

Berlin, 13 March 2012

B-1000 Brussels

Dear Françoise,

EFRAG's draft comment letter on the ESMA Consultation Paper – *Considerations of materiality in financial reporting*

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on EFRAG's draft comment letter on the ESMA Consultation Paper – *Considerations of materiality in financial reporting* issued on 9 November 2011. The ASCG welcomes the opportunity to contribute to the discussion of the concept of materiality.

We would like to specifically address the following issues:

- We have no indication that there is a significant diversity in practice related to the understanding and to the application of the concept of materiality.
- Should the need for additional regulation arise – that we have not identified so far – we deem the IASB to be in the appropriate position to promulgate any additional guidance in this area, impacting the entire IFRS constituency.

For further details, please see our comment letter to ESMA as attached to this letter.

If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr

President



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Steven Maijoor
Chairman
European Securities and Markets Authority
103 Rue de Grenelle
75007 Paris
France

Berlin, 13 March 2012

Dear Mr Maijoor,

ESMA Consultation Paper – *Considerations of materiality in financial reporting*

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on the ESMA Consultation Paper – *Considerations of materiality in financial reporting* issued on 9 November 2011. The ASCG welcomes the opportunity to contribute to the discussion of the concept of materiality.

We would like to specifically address the following issues:

- We have no indication that there is a significant diversity in practice related to the understanding and to the application of the concept of materiality.
- Should the need for additional regulation arise – that we have not identified so far – we deem the IASB to be in the appropriate position to promulgate any additional guidance in this area, impacting the entire IFRS constituency.

Please find our detailed comments on the questions raised in the consultation paper in the appendix to this letter.

If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr

President



Appendix

Question 1

Do you think that the concept of materiality is clearly and consistently understood and applied in practice by preparers, auditors, users and accounting enforcers or do you feel more clarification is required?

The ASCG believes that the concept of materiality is clearly and consistently understood as an entity-specific aspect of relevance. We acknowledge that the concept of materiality is based on quantitative as well as qualitative judgement in regard to the size and nature of the item, omission or misstatement. Also, specific facts and circumstances have to be taken into consideration for this judgement. Therefore, the concept of materiality will, by definition, result in some divergence in practice without negatively impacting the relevance of the information provided.

To our knowledge, there is no clear indication that the concept of materiality is misused in practice in a way that relevant information and decision usefulness are impaired. Therefore, we have not identified the need for additional regulation.

Question 2

Do you think ESMA should issue guidance in this regard?

As stated in our answer to Question 1, we have not identified the need for further regulation. If the need for additional regulation arises, we feel that further guidance should apply to the largest number of constituents worldwide in order to achieve a high level of comparability.

Therefore, we believe that a global governing body would be best-suited to improve the way the materiality concept is understood and applied. We feel that the IASB – if any additional guidance is needed at all - should incorporate such guidance in the conceptual framework of the IFRS standards.

Question 3

In your opinion, are ‘economic decisions made by users’ the same as users making ‘decisions about providing resources to the entity’? Please explain your rationale and if possible provide examples.

The ASCG believes that the expressions ‘economic decisions made by users’ and ‘decisions about providing resources to the entity’ are both to be understood as synonymous, if the expressions refer to the primary users.



Question 4

Is it your understanding that the primary user constituency of general purpose financial reports as defined by the IASB in paragraph 13¹ includes those users as outlined in paragraph 16 above²? Please explain your rationale and if possible provide further examples.

We believe that the primary user constituency of general purpose financial reports as defined by the IASB in paragraph 13 includes those users as outlined in paragraph 16, even though paragraph 16 explicitly lists present and past employees in addition to existing and potential investors, lenders and other creditors. Nevertheless, we would welcome a consistent wording.

Question 5

- (a) **Do you agree that the IASB's use of the word 'could' as opposed to, for example, 'would' implies a lower materiality threshold? Please explain your rationale in this regard.**
- (b) **In your opinion, could the inclusion of the expression 'reasonably be expected to' as per the Auditing Standards, lead to a different assessment of materiality for auditing purposes than that used for financial reporting purposes. Have you seen any instances of this in practice?**

We do not agree that the expressions 'could', 'could reasonably be expected' and 'would' imply a different materiality threshold or would lead to different assessments of materiality. We acknowledge that these expressions, linguistically, imply different probabilities and therefore would welcome a consistent wording. Even so, we do not see any practical implications from this differentiation.

Question 6

- (a) **Do you agree that the quantitative analysis of the materiality of an item should not be determined solely by a simple quantitative comparison to primary statement totals such as profit for the period or statement of financial position totals and that the individual line item in the primary statement to which the item is included should be assessed when determining the materiality of the item in question? Please explain your rationale in this regard.**
- (b) **Do you agree that each of the examples provided in paragraph 22 a – e above³ constitute instances where the materiality threshold may be lower? Are there other instances which might be cited as examples? Please explain your rationale.**

We have aggregated our answers to Questions 6, 7 and 8.

¹ The paragraph number refers to the ESMA consultation paper.

² The paragraph number refers to the ESMA consultation paper.

³ The paragraph number refers to the ESMA consultation paper.



Question 7

Do you agree that preparers of financial reports should assess the impact of all misstatements and omissions, including those that arose in earlier periods and are of continued applicability in the current period, in determining materiality decisions? Please explain your views in this regard.

We have aggregated our answers to Questions 6, 7 and 8.

Question 8

Do you agree that preparers of financial reports should assess the impact of all misstatements and omissions as referred to in paragraphs 24 to 27⁴ above in determining materiality? Please explain your views in this regard and provide practical examples, if applicable.

Answer to Questions 6, 7 and 8

As stated in our answer to Question 1, the concept of materiality is based on quantitative as well as qualitative judgement in regard to the size and nature of the item, omission or misstatement. Also, specific facts and circumstances have to be taken into consideration for this judgement.

Therefore, we agree that quantitative and qualitative aspects have to be considered, when assessing materiality. Consequently, by looking at specific facts and circumstances, the assessment of materiality also has to include the impact of misstatements and omissions of earlier periods, if they are of continued applicability in the current period.

Again, we would like to emphasize that the assessment of materiality has to cover several relevant components and factors. In our view, this kind of complex judgement cannot be adequately covered by issuing lists of examples that may lead to a sort of 'checkbox-mentality'.

Question 9

- (a) Do you believe that an accounting policy disclosing the materiality judgements exercised by preparers should be provided in the financial statements?**
- (b) If so, please provide an outline of the nature of such disclosures.**
- (c) In either case, please explain your rationale in this regard.**

We firmly believe that an accounting policy disclosing the materiality judgements exercised by preparers should not be provided in the financial statements.

⁴ Question 8 should refer to paragraphs 24 to 27, not to paragraphs 23 to 26 (see ESMA document).



The assessment of materiality is complex and involves different considerations, facts and circumstances for each specific item. Therefore, we see no practical way of compressing these several issues into an accounting policy disclosing the materiality judgements in the financial statements.

Question 10

Do you agree that omitting required notes giving additional information about a material line item in the financial statements constitutes a misstatement? Please explain your rationale in this regard.

We have aggregated our answers to Questions 10 and 11.

Question 11

Do you believe that in determining the materiality applying to notes which do not relate directly to financial statement items but are nonetheless of significance for the overall assessment of the financial statements of a reporting entity:

- (a) the same considerations apply as in determining the materiality applying to items which relate directly to financial statement items; or**
- (b) different considerations apply; and**
- (c) if different considerations apply, please outline those different considerations.**

Answer to Questions 10 and 11

We believe that it would be beneficial if a discussion of materiality covers the quality of information given in the disclosures. Especially, that immaterial information is excluded in order to avoid an information 'overload'.

Therefore, we believe that a note should only be given, if the note itself is material. Any additional immaterial notes should be omitted, regardless of the materiality of the related line item in the financial statements.

In our view, the same considerations of decision usefulness apply to notes which do not relate directly to financial statement items.

As stated in our answer to Question 2, we believe the IASB would be best-suited to improve the way the materiality concept is understood and applied. In this regard, we feel the IASB should advise which notes are deemed as material in all cases.

Question 12

In your opinion, how would the materiality assessment as it applies to interim financial reports differ from the materiality assessment as it applies to annual financial reports?



Methodically, the materiality assessment as it applies to interim financial reports should not differ from the materiality assessment as it applies to annual financial reports. But, considering the fact that an interim financial report includes more estimates, different levels of thresholds may apply.