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Dear Jean-Paul

Thank you for providing the Financial Reporting Council (FRC) with the opportunity to comment on your draft comment letter (DCL) to the IASB on the Exposure Draft (ED) ED/2017/6 '*Definition of Material (Proposed amendments to IAS 1 and IAS 8)*'. Our detailed comments on EFRAG's DCL are set out in the appendix to this letter and we have included our response to the IASB for your information.

Like EFRAG, we support the IASB's objective of improving the consistency between how 'material' is defined in the Conceptual Framework for Financial Reporting (the Conceptual Framework), IFRS Practice Statement 2 *Making Materiality Judgements* (the Materiality Practice Statement) and IFRS Standards.

We believe the clarity of the IASB's proposed definition could be improved. First, we consider it should make clear that when the definition uses the term "information" it means the information that should be prepared in accordance with standards. Second, it implies that the materiality of information to be presented or disclosed in the financial can be assessed by considering the impact of misstating it. The materiality of information that should be included in the financial statements is, at least in part, independent of the materiality of a possible misstatement; material information can be immaterially misstated and, more importantly, immaterial information could be subject to a material misstatement.

If information to be included in the financial statements is misstated, we must assess the materiality of the misstatement – i.e. whether the difference between the information that should have been included and that which has been included could reasonably be expected to influence the decisions of users. For this reason, we recommend that both material information and material misstatements should be defined. We also note that maintaining the link between materiality and misstatements is central to the audit process.

We welcome the IASB's decision to include reference to the "obscuring" of information in IAS 1 *Presentation of Financial Statements* (IAS 1) because this aspect of achieving a fair presentation is not captured by the existing text in IAS 1. However, there should be some consideration of degree – information can be more or less obscured by other information. Our letter to the IASB also suggests that further guidance on how information might be obscured is added to the Materiality Practice Statement, to assist companies with the practical application of this concept.

We agree with EFRAG's proposal to relocate the references to "omitting" and "obscuring" to the requirements following the definition, thus simplifying it. However, in doing this the IASB must ensure that such "errors" are seen to be of equivalent significance to a material misstatement.

Like EFRAG, we welcome the IASB's proposed clarification of the threshold for material information from "could influence" to "could reasonably be expected to influence" because the existing wording could be interpreted too broadly; it could be argued that, in some particular circumstances, almost any information *could* influence decisions. We agree with EFRAG that the revised wording helpfully emphasises the need to apply professional judgement when identifying material information. The revised description of the threshold better reflects how the concept of materiality is understood and applied in practice. We also support replacing the term "users" with "primary users" because this is consistent with the purpose of and audience for financial reporting, as set out in the Conceptual Framework.

In our view, the concept of "individually or collectively" should be retained in the definition because it is integral to the process of identifying material information or misstatements, due to the fact that materiality can be cumulative. We note that the IASB has redrafted this phrase as "individually or in combination with other information" in the requirements following the definition in the ED. We believe the revised wording will have the same effect as the existing wording, if included in the definition itself.

In light of these concerns, our letter to the IASB suggests that the definition is revised as follows:

"Information or a misstatement of information is material if it could reasonably be expected, individually or in combination with other information or misstatements, to influence the decisions that the primary users of an entity's general purpose financial statements make on the basis of those statements. Material information should not be omitted or obscured to a degree that could influence those decisions."

If you would like to discuss these comments, please contact me or Rosalind Szentpéteri on 020 7492 2474.

Yours sincerely



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Appendix – FRC comments on EFRAG’s DCL

Question 1

The Board proposes amendments to IAS 1 and IAS 8 to align the definition of material between IFRS Standards and the Conceptual Framework, and to include in the definition some of the existing requirements in IAS 1. The Board also proposes to clarify the explanation accompanying the definition using existing guidance in IAS 1 and the Conceptual Framework.

(a) Do you agree that the definition of material and the accompanying explanation should be clarified as proposed in this Exposure Draft? If you do not agree, what changes do you suggest and why?

(b) Would any wording or terminology introduced in the proposed amendments be difficult to understand or to translate?

Like EFRAG, we support the IASB’s objective of removing inconsistencies between how ‘material’ is defined in the Conceptual Framework, IAS 1 and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (IAS 8), and the Materiality Practice Statement. However, we have some concerns regarding both the IASB’s proposed definition and EFRAG’s alternative proposal.

First, we consider it should be made clear that when the definition uses the term “information” it means the information that should be presented in accordance with standards.

Second, we do not believe it is possible to determine the materiality of information required by standards by considering the impact of misstating that information in the financial statements, as the definition in the ED implies. Immaterial information can be materially misstated and vice versa.

Example:

Having considered, *inter alia*, its financial position, financial performance, business model and the nature of gains on its investment property and applying professional judgement the directors of Company A have assessed that the decisions of users could reasonably be expected to be influenced by gains if in excess of CU5m.

In the year there is only one investment property gain of CU1m. The directors are considering whether this gain is material and thereby, in accordance with IAS 8 paragraph 8, whether the requirements of IAS 40 should be applied.

Applying the revised definition, the directors conclude that either omitting or obscuring the CU1m gain would not influence the decisions of users. However, in considering the impact of misstating, the assessment depends on the size of the misstatement. If the gain was presented as a CU10m gain then the decisions of users could reasonably

be expected to be influenced. So a possible misstatement of the gain could influence decisions, therefore, according to the definition as expressed in the ED, the CU1m gain must be material and IAS 40 applies.

As the above example shows, if information is misstated, we must separately consider the materiality of the misstatement itself. For this reason, we have recommended to the IASB that both material information and material misstatements should be defined, so do not support EFRAG's proposal to remove all references to misstatements from the definition.

Defining materiality in relation to how the concept applies to both information and misstatements will maintain the link to misstatements which is essential from an audit perspective, while improving consistency with how the concept of materiality is described elsewhere in IAS 1 (for example, paragraphs 29-31 which refer directly to material classes of similar items, material line items, material information and material disclosures).

We note that the ED effectively defines material misstatements separately in the paragraphs that follow the definition of material information. We believe it would be clearer and simpler to define both material information and material misstatements in the main definition. We therefore suggest that the alternative definition proposed by EFRAG in its covering letter and in paragraph 7 of the DCL is redrafted as follows:

"information or a misstatement of information is material if it ~~that can~~ could reasonably be expected to, individually or collectively in combination with other information or misstatements, to influence the economic decisions that the primary users of an entity's general purpose financial statements make on the basis of those statements."

We think that using of the word "can" rather than "could" as EFRAG has proposed might alter the interpretation of the materiality threshold, because "can" might be taken to imply a stronger assertion and therefore a need to provide evidence that the threshold has been met, rather than use professional judgement. We agree with the "could reasonably be expected to" threshold proposed by the IASB.

Our proposed redrafting also emphasises that materiality judgements are made in the context of the information provided in the financial statements (in line with the definition proposed by the IASB). Without this restriction in scope, some might think that a company must consider all possible factors that might influence the decisions of the primary users even if they are not relevant to the financial statements. We also agree with the IASB that the word "economic" should be deleted. It is not clear to us how companies should distinguish between "economic decisions" and other decisions or why this would be beneficial.

Paragraph 12 of EFRAG's DCL requests that the IASB explains the effect of the proposal to remove the words "individually or collectively" from the definition. In our view, this concept is integral to the process of identifying both material information and material misstatements and should be retained in the definition, due to the fact that materiality can be cumulative. We note that the IASB has redrafted this phrase as "individually or in combination with other information" in the requirements following the definition in the ED. We believe the revised wording will have the same effect as the existing wording, if included in the definition itself, and consequently have included this in the definition we have proposed.

We welcome the introduction of the term “obscuring” because this is an aspect of achieving a fair presentation that was not captured by the existing text in IAS 1. While our proposal does not include the terms “omitting” and “obscuring” in the definition of materiality itself, our letter to the IASB proposes that these terms are located in the requirements immediately following the definition in IAS 1. This must be done in such a way as to ensure that misstating, omitting and obscuring are seen to be of equivalent significance.

In our view, all of the possible interpretations of the term “obscuring” listed in paragraph 9 of EFRAG’s DCL are types of obscuring and it would be helpful for the IASB to explain this and provide examples in the Materiality Practice Statement, as EFRAG alludes to in paragraph 10 of its DCL.

EFRAG Question to Constituents

Do you agree with EFRAG’s suggestion that the terms ‘obscuring’, ‘misstating’ and ‘omitting’ from the definition should not be included in the definition of ‘material’ as these concepts relate to principles of fair communication? Can you identify specific areas where the proposed exclusion might create legal issues in the specific context of your jurisdiction?

In our view, both material information and material misstatements need to be defined because it is not possible to infer the materiality of one from the other. In the audit process, the concept of materiality is closely entwined with the concept of misstating and certain aspects of the audit standards are constructed around this relationship. Auditors need to assess the materiality of both any misstatements identified, therefore removing the reference to misstatements from the definition of materiality as EFRAG proposes might have unintended consequences.

We agree that it is not necessary to include the terms “omitting” and “obscuring” in the definition itself, but that a statement that information should not be materially misstated nor material information omitted or obscured to such an extent that the decisions of users could reasonably be expected to be influenced should be included in the requirements following the definition in paragraph 7 of IAS 1.

Question 2

The Board issued the Materiality Practice Statement in September 2017 and expects to issue a revised Conceptual Framework in the second half of 2017. If any changes are made to IFRS Standards as a result of the proposals in this Exposure Draft, the Board will make amendments to these two documents.

The Board believes that the guidance in both the Materiality Practice Statement and the forthcoming revised Conceptual Framework will not be affected by the proposed amendments in this Exposure Draft, other than to update the definition of material (see paragraphs BC22–BC24).

Do you have any comments on the proposed amendments to the Materiality Practice Statement or to the forthcoming revised Conceptual Framework?

We agree with EFRAG that definitions of ‘material’ in the forthcoming revised Conceptual Framework and the Materiality Practice Statement should be consistent with the revised definitions in IAS 1 and IAS 8.

Our response to the IASB notes that the reference to “financial information about a specific reporting entity” in the definition of materiality that is expected to be included in the revised Conceptual Framework might be interpreted such that the totality of publicly available financial information regarding a company needs to be considered when determining whether an item of information is material in the context of its general purpose financial report, whereas the

definition proposed in the ED requires only the information in the general purpose financial statements to be considered when making materiality judgements in the context of those financial statements.

This interpretation of the Conceptual Framework definition would make it impracticable to apply, and may lead to the impression that financial information is not required to be included in a financial report if it is available from other sources. We do not believe this is the IASB's intention and have therefore suggested that the phrase "financial information about a specific reporting entity" is replaced with "that financial report". This would make the scope consistent with the scope of materiality for the financial statements, while reflecting the wider remit of the Conceptual Framework.

We agree with EFRAG's suggestion that the IASB should take this opportunity to improve the consistency between the language used to describe materiality elsewhere in the Standards and in the Materiality Practice Statement.

Question 3

Do you have any other comments about the proposals in this Exposure Draft?

In our view, the duplication of the definition of 'material' in IAS 1 and IAS 8 is unnecessary. Our response to the IASB suggests that the duplicate definition is removed from IAS 8 and a cross-reference provided to IAS 1 instead.