

EFRAG SECRETARIAT PAPER FOR PUBLIC EFRAG TEG MEETING

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IFRS Draft Practice Statement on Materiality

Follow-up on EFRAG's recommendations

Objective

- 1 The objective of this paper is to provide an overview on whether and how the concerns expressed by EFRAG in its comment letter on ED/2015/8 *IFRS Practice Statement: Application of Materiality to Financial Statements* (the 'Materiality Practice Statement ED') have been addressed by the IASB in its redeliberations.

Background

- 2 On 28 October 2015, the IASB issued the Materiality Practice Statement ED, requesting comments by 26 February 2016.
- 3 EFRAG issues its final comment letter in March 2016 generally supporting the initiative but raising a number of concerns which are summarised in the table below.
- 4 At its October, November and December 2016 meetings, the IASB made a number of tentative decisions to address the concerns raised by constituents.
- 5 At the December meeting, the IASB indicated that was satisfied that all the due process steps required were complied with and instructed the IASB staff to begin the balloting process. The IASB expects to issue the Materiality Practice Statement in late June 2017.

Follow-up on EFRAG’s recommendations

1 The following table shows how the issues and recommendations in EFRAG’s comment letter on the Materiality Practice Statement ED have been addressed by the IASB tentative decisions made to date.

Views and recommendations in EFRAG’s final comment letter	IASB’s redeliberations (tentative decisions)	Source
Agree with the issue of non-mandatory guidance in the form of a practice statement.	<ul style="list-style-type: none"> Confirm that the guidance on applying the concept of materiality to IFRS financial statements would be issued as a Materiality Practice Statement. 	IASB Meeting November 2016.
Clarify the objectives of the guidance to state that the practice statement can be useful, beyond preparers, to promote a common understanding of materiality by all those involved in the issue of financial statements	<ul style="list-style-type: none"> Clarify that the Materiality Practice Statement addresses the application of materiality in preparing financial statements but acknowledge that the Practice Statement may benefit other parties in addition to those involved in preparing financial statements. Replace the term 'management' with the term 'entity' throughout the Practice Statement 	IASB Meeting October 2016.
Structure the guidance along the key steps of the process inherent in decisions on materiality. EFRAG identified five major steps that could be a basis for structuring the guidance.	<ul style="list-style-type: none"> Include in the Materiality Practice Statement a four-step 'Materiality Process' for applying materiality (judgements to an entity's financial statements. Explain that when an entity assesses whether an item of information is material on the basis of a qualitative factor, it should also consider quantitative factors; and Include related party transactions as an example of a qualitative factor considered in making a materiality assessment. <p>[The above tentative decisions were discussed at the joint EFRAG CFSS and EFRAG TEG meeting in June 2016].</p>	IASB Meeting October 2016.
The guidance should be drafted in a more concise and practical way and focus on areas where it is most difficult to exercise judgement and in particular how materiality applies to Notes Versus Primary Financial Statements.	<ul style="list-style-type: none"> State that a single materiality assessment should be applied to all information included in the financial statements. Explain that an entity should select where to disclose material information within the financial statements (i.e. primary financial statements or the notes) in a way that communicates the information effectively and efficiently. 	IASB Meeting October 2016.

IFRS Draft Practice Statement on Materiality – Follow-up on EFRAG’s recommendations

Views and recommendations in EFRAG’s final comment letter	IASB’s redeliberations (tentative decisions)	Source
	<ul style="list-style-type: none"> • Describe how an entity should use a materiality assessment to decide how much to disaggregate information and how much detail to include, in the context of the primary financial statements and the notes. • Clarify that providing additional information to meet local legal or regulatory requirements is permitted by IFRS Standards. However, such information should not obscure information that is material according to the IFRS Standards. 	
<p>Illustrative examples should illustrate both decisions to include and omit information and focus on those areas where judgement is the most difficult to exercise.</p>	<ul style="list-style-type: none"> • Not addressed in tentative decisions. 	
<p>Clarify the guidance on ‘materiality and misstatements’ which may be perceived to be inconsistent with the guidance contained in IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>.</p>	<ul style="list-style-type: none"> • Remove guidance from the Materiality Practice Statement implying that an error is always material if it is made intentionally to achieve a particular presentation or result. • Clarify that the assessment of the materiality of a ‘cumulative error’ should be based on conditions existing when the financial statements for the period are authorised for issue. 	IASB Meeting November 2016
<p>Clarify the guidance on Materiality and stewardship</p>	<ul style="list-style-type: none"> • Remind that that information needed to assess the stewardship of management is necessary to meet the objective of financial reporting and therefore, in assessing materiality of information, an entity should consider whether that information is needed to assess stewardship. 	IASB Meeting November 2016
<p>Clarify the guidance on Materiality and interim financial reporting</p>	<ul style="list-style-type: none"> • Emphasise that when applying a materiality assessment to the interim financial report an entity needs to consider the same factors it considers in the assessment for the annual financial statements; • Specify that an entity needs to apply a materiality process taking into account that the context and purposes of the interim financial report are different from those of the annual financial statements; and 	IASB Meeting October 2016.

IFRS Draft Practice Statement on Materiality – Follow-up on EFRAG’s recommendations

Views and recommendations in EFRAG’s final comment letter	IASB’s redeliberations (tentative decisions)	Source
	<ul style="list-style-type: none"> Specify that although interim measurements may rely more on estimates than annual financial measurements, that fact alone does not make the interim information more material. 	
Clarify the reference to ‘obscuring information’ in the final Practice Statement as it could be interpreted differently	<ul style="list-style-type: none"> Not addressed in tentative decisions. 	
Clarify the guidance about Materiality and disclosures on assumptions, estimates and uncertainties.	<ul style="list-style-type: none"> Not addressed in tentative decisions. 	
Clarify the guidance in paragraph in paragraph 22 suggesting that an entity should consider how users ‘think the entity should be managed’.	<ul style="list-style-type: none"> Use the term ‘expectations’ of primary users (paragraph 17 and 22 of the draft Practice Statement) only in the same way as it is used in the Conceptual Framework. Reconsider references to the ‘special needs’ of primary users and to ‘subsets’ or ‘classes’ of primary users in the Practice Statement. Revise the guidance provided on ‘users of the financial statements and their decisions’ in the Practice Statement to convey the concept of ‘meeting the maximum amount of common information needs of an entity’s primary users’. <p>[The above tentative decisions were discussed at the joint EFRAG CFSS and EFRAG TEG meeting in June 2016].</p>	IASB Meeting October 2016
Clarify the guidance in paragraph 28(a) of the draft Practice Statement suggesting that an entity considers items ‘that could trigger non-compliance with regulatory requirements and loan covenants’.	<ul style="list-style-type: none"> Include in the Practice Statement specific guidance on how to assess the materiality of information about the existence and the terms of a covenant, or a covenant breach. Emphasise that, in making the above assessment, an entity may consider the consequences of a breach on the entity’s financial position, financial performance and cash flows; and the likelihood of the breach occurring. 	IASB Meeting November 2016