



Tel: +44 20 7893 3300
Fax: +44 20 7487 3686
@: abuchanan@bdoifra.com
www.bdointernational.com

BDO IFR Advisory Limited
Contact:
55 Baker Street
London W1U 7EU
United Kingdom

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XG

14 March 2016

Dear Sir

Exposure Draft ED 2015/08: IFRS Practice Statement: Application of Materiality to Financial Statements

We are pleased to comment on the above Exposure Draft (the ED). Following consultation with the BDO network¹, this letter summarises views of member firms that provided comments on the ED.

We support the IASB's Disclosure Initiative project, and the development of guidance to assist in the application of materiality to general purpose financial statements. We agree that this has the potential to assist in improving the quality of information included in those financial statements.

While we agree that it is appropriate to issue the guidance as non-mandatory, we are not convinced that this should be in the form of a Practice Statement. Although this would be included within the Bound Volume, there is a risk that its inclusion at the end of the Basis for Conclusions to Standards and Interpretations would result in it being less apparent than would be ideal. We suggest that the guidance would instead be better issued as a non-mandatory Appendix to IAS 1 (which might be described as non-mandatory Application Guidance).

For the guidance itself, as an overall comment, we believe that this could be more clearly linked to a core principle to consider materiality in the context of the financial statements as a whole. This would then facilitate the initial consideration of the primary statements and note disclosures at a lower level, which would then be supplemented by consideration of the overall the picture presented by the financial statements.

Consistent with the IASB's wider Disclosure Initiative project focussing on the presentation and disclosure of items in financial statements, we suggest that at this point the guidance on materiality might restrict its scope to these areas, with recognition and measurement being dealt with at a later date. This is consistent with our view that the guidance on materiality should be subject to review and update in the context of wider developments, including guidance on materiality that might be issued by other standard setters such as the IAASB.

¹ Service provision within the international BDO network of independent member firms ('the BDO network') in connection with IFRS (comprising International Financial Reporting Standards, International Accounting Standards, and Interpretations developed by the IFRS Interpretations Committee and the former Standing Interpretations Committee), and other documents, as issued by the International Accounting Standards Board is provided by BDO IFR Advisory Limited, a UK registered company limited by guarantee. Service provision within the BDO network is coordinated by Brussels Worldwide Services BVBA, a limited liability company incorporated in Belgium. Each of BDO International Limited (the governing entity of the BDO network), Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and the member firms is a separate legal entity and has no liability for another such entity's acts or omissions. Nothing in the arrangements or rules of the BDO network shall constitute or imply an agency relationship or a partnership between BDO International Limited, Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and/or the member firms of the BDO network.

BDO is the brand name for the BDO network and for each of the BDO member firms.
BDO IFR Advisory Limited is a UK company limited by guarantee, registered in England under No 7295966.
Registered office: c/o Hackwood Secretaries Limited, One Silk Street, London, EC2Y 8HQ.
© 2016 BDO IFR Advisory Limited. All rights reserved.

Our responses to the questions in the ED are set out in the attached Appendix.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)20 7893 3300 or by email at abuchanan@bdoifra.com.

Yours faithfully

A handwritten signature in blue ink that reads "Andrew Buchanan". The signature is written in a cursive style.

Andrew Buchanan

Global Head of IFRS

Appendix

Question 1 - Form of the guidance

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 scope of materiality? Why or why not? If not, what alternative(s) do you propose and why?*

We agree that the guidance should be non-mandatory. Although, as drafted, the Practice Statement mainly brings together and summarises existing requirements that are set out in various IFRSs, its issue as a non-mandatory document would avoid the concerns set out in paragraph BC11.

However, we are not convinced that the issue of guidance as a Practice Statement is the most appropriate format. While some would favour its issue as educational material, we note that as noted in paragraph BC15, the extent of due process that will have been applied to the guidance on materiality is different from other educational material that the IASB has issued. We therefore suggest that consideration is given to its issue as a non-mandatory appendix to IAS 1 *Presentation of Financial Statements*, given that Standard's existing references to materiality.

Whatever the format in which the guidance is ultimately issued, we believe that it would be appropriate for it to be included as part of the Bound Volume of IFRSs. Without this, there is a risk that preparers of financial statements may not focus on the guidance, which has the potential to be of significant practical benefit.

Question 2 - Illustrative examples

Do you find the examples helpful in the [draft] Practice Statement? Do you think any additional examples should be included? If so, what scenarios should be examples address? Please be as specific as possible and explain why those example(s) would be helpful to entities.

Consistent with our observations in the response to question 1 above, we note that the examples in the draft Practice Statement are derived primarily from the text of existing IFRSs.

While we do not object to this approach, we believe that in some respects additional examples would be helpful. For example, paragraphs 30 to 33 discuss materiality in the context of the financial statements as a whole, and it would be helpful to add examples in this section to show how the principle of materiality might be applied at this level. This would include quantitative and qualitative considerations, together with an overall assessment of whether the financial statements meet the needs of users after the separate consideration of information to be included in the primary financial statements and the notes has been completed.

Our specific comments on examples included in the draft Practice Statement are:

Paragraph 27 a)

It is suggested that, if an entity simply quotes the requirements of IFRS without tailoring the description of an accounting policy will be inadequate and potentially immaterial. We do not believe that this will always be the case; a material transaction or balance in the primary financial statements may be adequately described by quoting from the relevant IFRS if the related accounting treatment is straightforward.

Paragraph 28 b)

We agree that materiality may be more sensitive for an item that is currently not material but is expected to become material in future periods. We suggest that this point is linked to the discussion about misstatements made intentionally to mislead (paragraphs 77 to 79). For example, the inappropriate classification of a joint arrangement as a joint operation instead of a joint venture may, even if the joint arrangement is immaterial in the current period, lead to certain expectations about future financial statements by users. Similarly, the omission of a depreciation charge may also be inappropriate if in future periods the cumulative amount of depreciation on the related asset(s) is expected to become material.

Paragraph 35

We agree with the proposed text. However, it would be helpful to add some additional text to this paragraph so that it reads:

‘...results in material information being obscured, meaning that the financial statements may be misleading.’

Paragraph 39 b)

Although we agree with the point that is being made, we are not convinced that the proposed text is wholly consistent with IAS 21.52a), in combination with IAS 1.32 and 33, and note that IAS 1.35 states that:

‘In addition, an entity presents on a net basis gains and losses arising from a group of similar transactions, for example foreign exchange gains and losses or gains and losses arising on financial instruments held for trading. However, an entity presents such gains and losses if they are material.’

We suggest that the final two sentences are linked more clearly to the requirements of IAS 1.35, with it being made clear that aggregation would not be acceptable.

Paragraph 47

This paragraph notes that:

‘...if information is material in the context of the primary financial statements then disclosure in the notes is not sufficient.’

However, the proposed text then goes on to illustrate circumstances in which management decide to present a single amount for revenue on the face of the primary financial statement, with this single amount being disaggregated in the note. This appears to contradict the earlier statement. We are also not convinced that the earlier statement will always be appropriate; the fact that an entity has two very significant revenue streams does not automatically mean that these should be disaggregated on the face of the statement of comprehensive income.

Paragraph 54 a)

We are not convinced that information about a material prior period business combination could justifiably be excluded from the current period comparative note disclosures simply because the combination took place during the prior period. While the point that is made about comparability might be relevant if the combination took place at the start of the prior period, if it took place (say) half way through the prior period then we would expect the prior year comparative information to be included.

Paragraphs 54 b) and c)

We are not convinced that comparative information could always be reduced or excluded simply because there have been limited changes to one or more balances during the current reporting period. For example, we would expect that the reasons for, and assumptions underlying, a significant charge for impairment in a prior period would continue to be relevant in explaining why there was a substantial charge for impairment in the prior period and no charge for impairment in the current period.

Paragraph 79

The final paragraph indicates that it is presumed that, if management use an inappropriate discount rate, this is being done in order to achieve what would appear to be a misleading presentation. We do not believe that this will always be the case, with the focus instead needing to be on whether the effect of using the inappropriate discount rate is quantitatively or qualitatively material. We suggest that the example is amended to read:

- a) ...
- b) Management deliberately choosing to use an inappropriate discount rate in order to reduce the amount of the liability in a way which is either quantitatively or qualitatively material.

A deliberate choice by management to use such an inappropriate discount rate would be material because management is doing so in order to 'achieve a particular.....'

Question 3 - Content of the [draft] Practice Statement

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 any additional content should be included in the [draft] Practice Statement? If so, what additional content should be included and why?*

One of the key drivers for the IASB's Disclosure Initiative project has been comments by users of financial statements that the information that they contain is standardised and uninformative, and does not convey information specific to the reporting entity itself. There is very little commentary in the draft Practice Statement on this topic, and we suggest that consideration is given to enhancing the guidance to encourage the disclosure of entity specific information.

Linked to this point, an area which many preparers find challenging in practice is the criteria to be applied in deciding on the information to be disclosed about the judgements made in the process of applying accounting policies (IAS 1.122), and disclosures about sources of estimation uncertainty (IAS 1.125). Further guidance would be helpful

- 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?*

We believe that the draft Practice Statement represents a good foundation for the development of practical guidance to assist in the application of the concept of

materiality. However, further clarity is needed of the overall core principle on which materiality should be based. This is that, although consideration of information to be provided in the primary financial statements and in the notes is important, this needs to be brought together through, and supplemented by, consideration of the financial statements as a whole, with information either being added or deleted as appropriate in that context.

We are not convinced that the proposed guidance on misstatements made intentionally to mislead is clear. We do not believe that all immaterial errors resulting from an intentional misstatement automatically give rise to a misleading presentation; for example, management might have chosen not to update a discount rate applied when determining the carrying amount of a liability simply because the change in discount rate is insignificant. Instead, the principle in IAS 8.41 would appear to be that if an immaterial error has been made intentionally, then this will result in the financial statements failing to comply with IFRS if the effect on those financial statements is to introduce a material misstatement (whether quantitative or qualitative) on the line item or disclosure that is directly affected, or on a line item or disclosure that is indirectly affected. As an example, a deliberate immaterial error in the carrying amount of an asset or liability might result in an entity complying with a significant debt covenant by a marginal amount, when the correction of that error would have resulted in the reclassification of significant financial liabilities from non-current to current.

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

Other than as set out elsewhere in the letter, we agree in principle with the proposed guidance.

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

Consistent with our view that the draft Practice Statement should be regarded as a first step towards a more comprehensive document, to be developed as the Disclosure Initiative project progresses and in the context of developments elsewhere, it is possible that the scope could be restricted at this stage to presentation and disclosure only.

- 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 suggest that it would be appropriate for this point to be addressed by regulatory authorities.

Question 4 - Timing

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 agree that guidance based on the draft Practice Statement should be issued before the Principles of Disclosure project has been finalised. Although much of the content repeats existing requirements of IFRS, we believe that it is very helpful to bring together that guidance in one place, which will assist in a better understanding, and application, of materiality.

However, we suggest that it would be appropriate for the guidance to be issued now to be viewed as a first step towards updated guidance to be issued in the context of the Principles of Disclosure project, and work undertaken by other standard setting bodies such as the IAASB. We encourage the IASB to liaise with those other standard setting bodies, to assist in ensuring that any guidance that is issued by different standard setters is consistent.

Question 5 -Any other comments

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 asked for comments on the definition at this time.

We note that IFRSs use various terms and descriptions to describe the extent of significance of transactions, and recognition thresholds. It would be helpful for the Practice Statement to be based around the same terms and descriptions.