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Exposure Draft: ED/2015/8 IFRS Practice Statement: *Application of Materiality to Financial Statements*

Dear Mr Hoogervorst

The European Banking Authority (EBA) welcomes the opportunity to comment on the IASB's Exposure Draft ED/2015/8 IFRS Practice Statement: *Application of Materiality to Financial Statements* (Practice Statement). The EBA has a strong interest in promoting sound and high quality accounting and disclosure standards for the banking and financial industry, as well as transparent and comparable financial statements that would strengthen market discipline.

The EBA welcomes the IASB initiative to develop guidance in applying the concept of materiality to general purpose financial statements in order to discourage the exclusive use of a checklist approach and quantitative thresholds for the preparation of the disclosures in the financial statements and to provide more qualitative guidance on how materiality should be applied to the financial statements.

However, the EBA would encourage the IASB to explore further whether the application of the concept of materiality is appropriately explained in the IASBs existing mandatory documents and whether some of the material in this Practice Statement could be included in the Conceptual Framework and/ or IASB existing mandatory documents where relevant.

The EBA believes also that some of the proposals may merit being further clarified in order to ensure that they can be applied in practice by the preparers. In addition to that, other elements of the proposals could be further emphasised in order to ensure that the key aspects in applying the concept of materiality are covered sufficiently.

The EBA believes also that the Practice Statement should clarify its scope of application to ensure that it does not pre-empt or limit in any way the information that an entity would be required to disclose under any other regulation, such as the application of the concept of materiality for Pillar III disclosures.

Our comments on the Practice Statement are set out in the Annex. We have not explicitly addressed the specific questions raised in the Exposure Draft of the Practice Statement.

If you have any questions regarding our comments, please do not hesitate to contact us.

Yours sincerely

(signed)

Andrea Enria

Encl: Annex

Annex

Form of the guidance

The EBA understands the IASB's reasoning for providing guidance on the application of materiality in the form of a non-mandatory Practice Statement, rather than as a mandatory component of a Standard as mentioned in BC10-15 of the proposals.

However, we believe that there are merits in the IASB exploring further whether the application of the concept of materiality is appropriately explained in the IASBs existing standards and whether some of the material in this Practice Statement could be included in the Conceptual Framework and/ or IASB standards such as IAS 1 *Presentation of Financial Statements*, which both include definitions of materiality. This would provide more prominence to the guidance and increase its authoritative status, helping to ensure its consistent application which may not be possible if the guidance is separated from the other IASB material where relevant requirements on materiality are also included.

Illustrative examples

We think that more examples are needed for the proposals to be used in practice. In particular, the Practice Statement in paragraph 46 raises the issue of considering materiality 'in the context of the primary financial statements' and 'in the context of the notes' but does not clarify the difference in judgements on materiality that are needed in these different contexts and whether criteria different from those in paragraphs 13 to 29 have to be applied for the assessment of materiality in the notes and the primary financial statements besides what it is already included in paragraph 47 and 48 of the ED. It would be helpful to use examples to illustrate how the different contexts could be taken into consideration when applying the concept of materiality, particularly for banks for which the primary statements are a small fraction of the length of the notes.

Mindful also that there is no 'one size fits all' approach in terms of the application of materiality and that this concept should be applied depending on the characteristics of each entity's business, the identified users' needs and the specific circumstances at the time of the preparation of the financial statements, we believe that there may be the need to draft examples referring to different types of entities – for example, how materiality would be applied in a corporate entity and how in a bank or financial entity.

Content of the [draft] Practice Statement

The EBA welcomes the proposed guidance on the application of the concept of materiality, which should enable more consistent application of this concept and enhance the quality and usefulness of the financial statements. However, we believe that the guidance could be further enhanced in the following areas:

- Structure

The Practice Statement contains several quotations of IFRS (particularly IAS 1) and the Conceptual Framework. The EBA would be concerned if the coexistence of similar concepts (for example, paragraph 7 of the Practice Statement which includes the definition of materiality under the Conceptual Framework, but also quotes IAS 1 and IAS 8) may lead to different interpretations by the preparers of financial statements. In order to address this, the Practice Statement could include a table with a description of any differences in the existing definitions and an explanation of how the existing definitions are consistent.

The structure of the Practice Statement could also be reviewed, by re-ordering some paragraphs, or moving them to other parts of the Practice Statement. For example, the reassessment of materiality at each reporting period as explained in paragraph 12 could be included in a separate paragraph to give more prominence to the dynamic nature of the materiality assessment. In addition, examples of such dynamic assessment are provided in paragraphs 54 and 55, which seem to apply only to notes in the financial statements. Therefore, it may be appropriate to expand the scope of application of those paragraphs to all information, and not only to information in the notes.

In addition, in order to increase the practical use of the Practice Statement, the IASB could consider adding as an example in the Practice Statement a step-by-step approach, which could help preparers of the financial statements in applying the concept of materiality or even assist them in the presentation of financial statements in general. For instance, this approach may include the following steps:

1. Identification of the main users of the financial statements (paragraphs 13-20 of the Practice Statement)

2. Determining the specific needs of those users (paragraphs 21-23 of the Practice Statement)

3. Determining which IFRS presentation and disclosure requirements shall be met and which requirements could be omitted (paragraphs 12, 24-29, 54-55, 56-60, 67-79 of the Practice Statement)

4. Determining whether there is any other information that should be disclosed (even if not specifically required by IFRS) because that information would be considered as essential or highly useful by users, and conversely information omitted because it would be considered immaterial (paragraphs 11, 21, 34-36, 50-51 of the Practice Statement)

5. Determining/ reviewing/ ordering the presentation and disclosure in the financial statements to ensure that, to the extent possible, the most material information is highlighted and that less prominence is given to information of relatively lower usefulness (paragraphs 30-33, 37-48 of the Practice Statement)

- Scope of the Practice Statement and interaction with other guidance on materiality

We understand that the IASB is aware that regulators may have different descriptions of what is considered material in filings other than financial statements (BC16). In addition, financial statements may include information by way of a cross reference to another statement, such as a management commentary or risk report and the Practice Statement applies to these cases as well (paragraph 3). For EU banks, this other statement and its cross-referred information may contain regulatory disclosures (such as Pillar III disclosures) that are subject to a specific guidance regarding the application of materiality (EBA/GL/2014/14 *EBA Guidelines on materiality, proprietary and confidentiality and on disclosure frequency under Articles 432(1), 432(2) and 433 of Regulation (EU) No 575/2013*[1]).

In order to ensure clarity in the scope of application of the Practice Statement, the IASB should clarify that this Practice Statement doesn't intend to pre-empt or limit in any way the information that an entity is required to disclose under any other regulation.

- Consistency and interaction with other IFRS

In some instances, it seems that the wording of the Practice Statement needs to be aligned with the wording in IAS 1 to ensure consistency across the different texts. For instance paragraph 24 of the Practice Statement refers to IAS 1.7 but appears more restrictive, as it states that "*the assessment of whether information is material depends on its size and nature*" while IAS 1.7 refers to "*the size or nature, or a combination of both*".

In addition, the Practice Statement could emphasise more that a proper application of materiality should lead both to the possible omission of immaterial information and to the possible provision of more information, in the notes or in the primary financial statements, on material elements beyond minimum IFRS requirements (as per paragraph 11 and 52).

The interaction also between principles in the Practice Statement and some requirements in IFRS need to be clarified. For example, the Practice Statement could clarify that the application of minimum requirements under IFRS (e.g. IFRS sometimes refers to 'at a minimum') is subject to the materiality assessments.

1 http://www.eba.europa.eu/regulation-and-policy/transparency-and-pillar-3/guidelines-on-materiality-proprietary-and-confidentiality-and-on-disclosure-frequency

- Consideration of the needs of users of financial statements

Paragraph 21 of the Practice Statement mentions that in making assessments as to what is material firms need to take into account whether the reporting entity's primary users have any special needs. In addition, paragraph 32 of the Practice Statement mentions that management should assess whether information is material within the context of different parts of the financial statements. The EBA believes that the proposals would be more capable of being implemented in practice if they provided more guidance for assessing the 'special needs' of users of the financial statements and the 'materiality of information within the context of different parts of the financial statements'.

Additionally, the guidance in paragraphs 13-23 of the Practice Statement is focused on the primary users of financial statements, which doesn't include regulators. However, the EBA would like to reiterate its view[2] that regulators, though not considered as primary users by the IASB, do have an interest in accounting data and information and, therefore, we encourage the IASB to take into account their needs also in developing this guidance.

- Key-drivers of future performance

Paragraph 20 (OB3) of the Practice Statement mentions that the users of the financial statements need information to help them assess the prospects for future net cash inflows to an entity.

We believe that the Practice Statement could further emphasise that certain items may be considered as material and deserve a specific disclosure/ careful review since the activities of an institution make them key-drivers of future results, whose impacts are likely to be significant in subsequent periods.

- Assessing the materiality of omissions and misstatements

Omission and misstatements are included in a separate section of the Practice Statement. Nevertheless, this section could be further clarified. In particular, the criteria to assess the materiality of omissions and misstatements in paragraph 67 of the ED are not stated and therefore the IASB should clarify explicitly whether and how the criteria in paragraphs 11 to 29 apply also in the case of omissions and misstatements. We also believe that additional examples on how to apply materiality in the case of omissions and misstatements could be provided.

[2] EBA Comment letter on the Exposure Draft ED/2015/3: Conceptual Framework for Financial Reporting: *The EBA acknowledges the decision of the IASB to define primary users strictly. However, banking regulators also rely on financial information to carry out their duties, in particular accounting data is used as a basis for prudential assessments. For this reason, we believe that the IASB should recognise regulators more strongly as users in paragraph 1.10 of the ED as currently it only says that regulators "may also find general purpose financial reports useful".*

- Interim Reporting

For interim reporting, we would welcome the Practice Statement providing additional clarification on whether the same level of materiality should be applied in the context of interim reporting, as compared to the annual reporting process.

Timing

Considering that the IASB plans to discuss the definition of materiality within its Principles of Disclosure project, we think that it is important that the IASB's constituents are provided the opportunity to comment further on this Practice Statement in light of the outcome from the discussion on the Principles of Disclosure project.

Other comments

The use of the word 'material' may be inaccurate in some parts of the Practice Statement, which seems contradictory to one of the objectives of the ED which is to encourage a better understanding of this notion. For example:

(a) Paragraph 11 uses the phrase "material to the complete set of financial statements". We consider materiality both as a pervasive consideration and in the context of the detail in the financial statements and therefore this sentence could be confusing.

(b) Paragraph 19 refers to the notions of 'relevance' and 'materiality'. The IASB could explain further the interaction between these two notions. For example, can information be material without being relevant and does it also mean that immaterial information is not relevant?

(c) Paragraph 37 quotes IAS 1 referring to "not sufficiently material". The Practice Statement could provide more guidance on how to apply this assessment in practice.