

## STAFF PAPER

April 2015

## IASB Meeting

Project	Materiality
Paper topic	Due process steps and permission to ballot the Exposure Draft of a draft Practice Statement
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

**Objective**

1. The objective of this paper is to:
  - (a) set out the due process steps that the IASB has taken so far before the balloting of the Exposure Draft of a draft Practice Statement  
*Application of materiality to financial statements;*
  - (b) to ask the IASB to confirm that it is satisfied that it has complied with the due process requirements to date; and
  - (c) to ask the IASB to give permission for the staff to begin the balloting process.

**Structure of the Paper**

2. The structure of the paper is as follows:
  - (a) Background
  - (b) Effects analysis
  - (c) Intention to dissent
  - (d) Proposed timetable for balloting and publication
  - (e) Transition

- (f) Comment period
- (g) Confirmation of due process steps
- (h) Appendix A: Action taken to meet the due process requirements.

## **Background**

### ***Reasons for undertaking this project***

3. The IASB was informed at the Discussion Forum on Financial Reporting Disclosure in January 2013, in its related survey and by other sources, that there are difficulties applying the concept of materiality in practice when preparing the financial statements. Some interested parties are of the view that these difficulties contribute to a disclosure problem, namely, that there is both too much irrelevant information in financial statements and not enough relevant information. A number of factors have been identified for why materiality is not being applied well in practice. One of these is that there is limited guidance on materiality in IFRS, particularly how it should be applied to disclosures in the notes to the financial statements. In light of this feedback, the IASB decided to undertake a project on materiality.

### ***Work performed so far***

4. Throughout 2014 we consulted the IFRS Advisory Council; the Accounting Standards Advisory Forum (ASAF); World Standard-Setters (WSS); Global Preparers Forum (GPF); European Financial Reporting Advisory Group (EFRAG); International Organization of Securities of Commission Regulators (IOSCO); International Accounting and Assurance Standards Board (IAASB); and a number of accounting professionals and academics about the problems surrounding materiality and their causes. In addition, the staff carried out their own academic review and research. This included performing outreach with National Standard-Setters to help us to understand the application of materiality in their jurisdictions.
5. At its September 2014 meeting the IASB had a discussion on the general principles of materiality and the problems associated with its application. At this

meeting the IASB also discussed the research performed by the staff outlined in paragraph 4.

6. At its November 2014 meeting, the IASB discussed the next steps for the project and tentatively decided:
  - (a) to change the current definition of materiality in IFRS, but only to align the definitions in IAS 1 *Presentation of Financial Statements*, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and the *Conceptual Framework for Financial Reporting* with each other. However, the *Principles of Disclosure* discussion paper will describe the rationale for retaining the current definition of materiality, and will ask for feedback on this issue;
  - (b) to insert a paragraph in IAS 1 clarifying the key characteristics of materiality. This will also be included in the *Principles of Disclosure* discussion paper;
  - (c) to provide guidance on the application of materiality, which will take the form of a Practice Statement. However, there will be a question in the Invitation to Comment in the Exposure Draft asking whether respondents think a Practice Statement is the most appropriate form of guidance;
  - (d) to wait until further work has been performed on the Review of Standards project before considering possible changes to address the use of inconsistent or excessively prescriptive language in Standards; and
  - (e) not to include a reminder in each Standard that the requirements only apply if their application is material.
  
7. The content of a draft Practice Statement was discussed at the March 2015 IASB meeting. The IASB expressed broad support for the direction and content of the initial staff draft, but made some drafting and structural suggestions.

### ***Reasons for issuing guidance in a Practice Statement***

8. A Practice Statement is not an IFRS and is not an authoritative part of IFRS. However, unlike education material, it is subject to full due process procedures including public consultation. Furthermore, a jurisdiction can choose to mandate it. The staff have identified the following as the main advantages of choosing to publish guidance in the form of a Practice Statement:
- (a) Exposing the draft Practice Statement formally for public consultation will enable the IASB to get input from a wide range of stakeholders on the proposed content of the guidance and about whether the Practice Statement is the appropriate form for guidance on materiality.
  - (b) Non-mandatory guidance is expected to be favoured by those national standard-setters who are worried the guidance may conflict with their regulatory requirements or established guidance/practice on applying materiality.
  - (c) We only have one previous example of a Practice Statement, which was on management commentary, so there would be flexibility in its content and tone.
  - (d) A Practice Statement will be more accessible and credible than education guidance, because it would become part of the IFRS Bound Volume and will be subject to full due process.
  - (e) A Practice Statement was chosen over implementation guidance, which would accompany, and therefore be attached to, an individual Standard to reflect the fact that materiality is a pervasive concept that is applicable to all of the Standards and throughout IFRS.

### **Effects Analysis**

9. The guidance in the draft Practice Statement is designed to clarify the concept of materiality and to provide guidance on its application, rather than to change the existing requirements in IFRS. As such, we do not expect any excessive costs associated with the application of the Practice Statement.

10. We expect to see a better understanding and application of the concept of materiality by preparers and others, following the publication of the Practice Statement. We also think the guidance in the draft Practice Statement will enhance awareness of the role of materiality and will help to promote changes in those behaviours, such as risk aversion and adherence to checklists, that many see as the key driver of disclosure problems.
11. We expect that the draft Practice Statement will encourage preparers to exercise better judgement, leading to a reduction in the amount of immaterial information in the financial statements and an increase in the quality and accessibility of information. This will improve the information available to the primary users of the financial statements.

### **Basis for Conclusions**

12. Because the guidance in the Practice Statement is not intended to amend the existing requirements in IFRS, the staff do not propose that the IASB should include a Basis for Conclusions with the Practice Statement. Instead, the introduction to the Practice Statement could briefly explain the reasons for issuing guidance in the form of a Practice Statement. .

### **Proposed timetable for balloting and publication**

13. We expect the balloting process of the draft Practice Statement to commence later this month, with publication of the Exposure Draft in July 2015.

### **Transition**

14. The Practice Statement is intended to clarify the existing requirements in IFRS and will be a non-mandatory document. Consequently, we do not intend to propose transition requirements or set an effective date.

## Comment period

15. The *Due Process Handbook* proposes a minimum period of 120 days for comments on an Exposure Draft. The staff are not aware of any reason to extend or shorten this period and therefore we propose a 120-day comment period.

## Confirmation of due process steps

16. In Appendix A of this paper we have summarised the due process steps we have taken so far. We note that the required due process steps for the publication of the draft Practice Statement have been completed. If the IASB is satisfied that it has been provided with sufficient analysis, and undertaken appropriate consultation, to support the publication of an Exposure Draft of the draft Practice Statement, the staff request permission to start the balloting process.

### Questions to the IASB

1. Are IASB members satisfied that all due process steps required to date that relate to the publication of the draft Practice Statement have been complied with?
2. Do IASB members agree that a Basis for Conclusions should not be issued with the draft Practice Statement?
3. Do IASB members agree with the proposed timetable for publication and give the staff permission to start the balloting process?
5. Do IASB members agree with a comment period of 120 days for the draft Practice Statement?

## Appendix A: Action taken to meet the due process requirements

<i>Step</i>	<i>Required/ Optional</i>	<i>Metrics or evidence</i>	<i>Evidence provided to DPOC</i>	<i>Actions</i>
<b>Board meetings held in public, with papers available for observers. All decisions are made in public session.</b>	Required	<p>Meetings held.</p> <p>Project website contains a full description with up-to-date information.</p> <p>Meeting papers posted in a timely fashion.</p>	<p>Members of the IASB have discussed with the DPOC the progress of the due process that is being conducted on major projects.</p> <p>The DPOC has reviewed, when appropriate, the comments that have been received from interested parties on the due process that the IASB followed.</p>	<p>The IASB discussed the materiality project at its meetings in March 2014, September 2014, November 2014 and March 2015. The Practice Statement was discussed at the November 2014 and March 2015 meetings.</p> <p>Details of the project are available on the IASB website. All papers have been posted on a timely basis.</p>
<b>Consultation with the Trustees and the Advisory Council.</b>	Required	<p>Discussions with the Advisory Council.</p>	<p>The DPOC has met with the Advisory Council to understand stakeholders' perspectives.</p> <p>The Advisory Council Chair is invited to Trustees' meetings and meetings of the DPOC.</p>	<p>The materiality project was discussed with the IFRS Advisory Council on 13 October 2014.</p> <p>The IASB's progress on its work on materiality was reported to the Trustees and the DPOC at their April 2014, July 2014, October 2014 and February 2015 meetings.</p>

<i>Step</i>	<i>Required/ Optional</i>	<i>Metrics or evidence</i>	<i>Evidence provided to DPOC</i>	<i>Actions</i>
<b>Outreach meetings with a broad range of stakeholders, with special effort to consult investors.</b>	Optional	Extent of meetings held.  Evidence of specific targeted efforts to consult investors.	The DPOC has received a report of outreach activities. The DPOC and the IASB have reviewed the outreach plan for the ED and its approach to the optional steps to ensure extensive outreach and public consultation.	Ongoing discussions with IAASB, IOSCO, ESMA, SEC.  Discussions with ASAF on 26 September 2014 and 26 March 2015.  Discussions with CMAC 26 February 2014.  Discussion with GPF on 11 March 2014.  Discussions with WSS on 29 September 2014.
<b>Public discussions with representative groups.</b>	Optional	Extent of discussions held.	The DPOC has received a report of outreach activities.	Not considered necessary. The IASB has received sufficient input from the Discussion Forum on Financial Reporting Disclosure and discussions with ASAF, WSS, IAASB, IOSCO, SEC, EFRAG and outreach with National Standard-Setters.
<b>Round-table meetings between external participants and members of the IASB.</b>	Optional	Extent of meetings held.	The DPOC has received a report of outreach activities.	Not considered necessary. The IASB has received sufficient input from the Discussion Forum on Financial Reporting Disclosure and discussions with ASAF, WSS, IAA SB, IOSCO, SEC, EFRAG and outreach with National Standard-Setters



<i>Step</i>	<i>Required/ Optional</i>	<i>Metrics or evidence</i>	<i>Evidence provided to DPOC</i>	<i>Actions</i>
<b>Analysis of the likely effects of the forthcoming Standard or major amendment, for example, initial costs or ongoing associated costs.</b>	Required	Publication of the Effect Analysis as part of the Basis for Conclusions.	<p>The IASB has reviewed, with the DPOC, the results of the Effect Analysis and how it has considered such findings in the proposed Standard.</p> <p>The IASB has provided a copy of the Effect Analysis to the DPOC at the point of the Standard's publication.</p>	An initial analysis of the effects has been performed in paragraphs 9-11.
<b>Finalisation</b>				
<b>Due process steps reviewed by the IASB.</b>	Required	Summary of all due process steps discussed by the IASB before a Standard is issued.	The DPOC has received a summary report of the due process steps that have been followed before the Exposure Draft is issued.	<p>This paper will be discussed by the IASB at this April 2015 meeting.</p> <p>The staff will provide the DPOC with a copy of this paper.</p>
<b>The ED has an appropriate comment period.</b>	Required	<p>The period has been set by the IASB.</p> <p>If outside the normal comment period, an explanation from the IASB to the DPOC has been provided, and the decision has been approved.</p>	The DPOC has received notice of any change in the comment period length and has provided approval if required.	In accordance with the <i>IFRS Due Process Handbook</i> we are proposing a comment period of 120 days at this April 2015 meeting (see paragraph 15).
<b>Drafting</b>				
<b>Drafting quality assurance steps are adequate.</b>	Required	The Translations team has been included in the review process.	The DPOC has received a summary report of the due process steps that have been followed before the ED is issued.	The Translations team will be asked to review the pre-ballot draft.
<b>Drafting quality assurance steps are adequate.</b>	Required	The XBRL team has been included in the review process.	The DPOC has received a summary report of the due process steps that have been followed before the ED is issued.	To be considered in due course. However, the Practice Statement will not change any existing requirements in IFRS.

<i>Step</i>	<i>Required/ Optional</i>	<i>Metrics or evidence</i>	<i>Evidence provided to DPOC</i>	<i>Actions</i>
<b>Drafting quality assurance steps are adequate.</b>	Optional	<p>The Editorial team has been included in the review process.</p> <p>In addition, external reviewers are used to review drafts for editorial review and the comments collected are considered by the IASB.</p>	<p>The DPOC has received a summary report of the due process steps that have been followed before the ED is issued, including the extent to which external reviewers have been used in the drafting process.</p>	<p>The Editorial team will be asked to review the pre-ballot draft.</p> <p>We have received comments from IOSCO, IAASB, ESMA and the SEC on our first draft of the draft Practice Statement.</p>
<b>Publication</b>				
<b>ED published.</b>	Required	ED has been posted on the IASB website.	The DPOC has been informed of the release of the ED.	To be done in due course.
<b>Press release to announce publication of ED.</b>	Required	<p>Press Release has been published.</p> <p>Media coverage of the release.</p>	The DPOC has been informed of the release of the ED.	A press release announcing the ED will be prepared in due course