

STAFF PAPER

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Project	Disclosure Initiative: Materiality		
Paper topic	Comparative <i>versus</i> corresponding approach and conflicts with local regulations		
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Purpose of this paper

1. This paper considers the comments received on the Exposure Draft and should be read together with Agenda Paper 11A *Materiality - Cover paper*. It asks the Board whether members want to change the final *Practice Statement* in the light of comments relating to:
 - (a) the application of materiality to previous period¹ information presented in current period financial statements, including consideration of *comparative* approach versus *corresponding* approach (paragraphs 2–30); and
 - (b) potential conflicts between the final *Practice Statement* and any local legal or regulatory disclosure or materiality requirements (paragraphs 31–54).

¹ For purposes of this paper references to ‘prior period’ should be read as ‘prior periods’ when, according to local regulation, the financial statements should include amounts and disclosures for more than one period.

Comparative approach *versus* corresponding approach

Guidance proposed in the Exposure Draft

2. The Exposure Draft provided some guidance on how to apply materiality to prior period information. This was included in the section ‘Primary financial statements versus the notes’, under the heading ‘Reviewing note disclosures at each reporting date’.
3. The Exposure Draft stated that:

If a disclosure was material to the prior period’s financial statements, but the same level of detail or type of information is not material to the current-year financial statements, the disclosure often does not need to be repeated in the same level of detail (paragraph 54 of the Exposure Draft).
4. Paragraph 54(a) of the Exposure Draft also highlighted that ‘management should still provide sufficient information for comparisons to be made between years and to the extent that the information is relevant to understanding the current period financial statements, including the comparative information’.
5. Furthermore, according to paragraph 55 of the Exposure Draft, entities should not assess materiality ‘only by reference to the current reporting date’; the same paragraph of the Exposure Draft provided some examples of materiality assessment performed on prior period information.
6. Finally, the Exposure Draft only referred to ‘comparative information’ in providing its guidance. It did not distinguish, or discuss the difference, between the ‘comparative’ approach and ‘corresponding’ approach to prior period information, which are different and imply different auditor reporting responsibilities in respect of prior period information².

² The approach to be adopted is often specified by law or regulation but may also be specified in the terms of the audit engagement.

Summary of the feedback

7. Some respondents, such as the Australian Accounting Standards Board (AASB), acknowledged that the guidance provided in paragraph 54 of the Exposure Draft clarified ‘that information that was material to the prior period may not necessarily be material to the same extent in the current reporting period’ (CL89³).
8. However they encouraged the Board to ‘also address the converse scenario, that is, the extent to which comparative information may need to be included if the current period disclosure is material to an understanding of the financial statements’ (AASB CL89).
9. In particular, the Korea Accounting Standards Board (KASB) suggested the Board could clarify how to determine the level of information to be provided in the current financial statements when ‘an entity provided aggregated information in the prior periods because it was immaterial then, but the information has become material for the current period’ (CL51); in other words, the Board should clarify whether the prior year information should be provided at the same level of detail (ie disaggregation) as the current year material information.
10. One respondent, the Singapore Accounting Standards Council (Singapore ASC) CL93, stated that the description of ‘sufficient comparative information’ provided in paragraph 54(a) of the Exposure Draft (ie ‘relevant to understanding the current period financial statements, *including the comparative information*’ [emphasis added]) could lead to unintended consequences:

A possible but inappropriate interpretation is that information that is relevant to understanding the prior year financial statements should be reproduced in the current period financial statements; (...) The drafting should be refined such that the sufficiency of prior period information is assessed based on its relevance to an understanding of the current period financial position, financial performance and cash flows.

³ The reference CLxx refers to the ID number assigned to the comment letter. The comment letters can be found at <http://www.ifrs.org/Current-Projects/IASB-Projects/Disclosure-Initiative/Materiality/Exposure-Draft-October-2015/Pages/Comment-letter.aspx>

11. Finally, some audit firms (such as KPMG and PricewaterhouseCoopers (PwC)), as well as the International Organization of Securities Commissions (IOSCO), commented on the consequences for audit. For example, IOSCO noted that:

The guidance in paragraph 54 [of the Exposure Draft] may be unworkable with existing audit requirements since the approach being suggested appears to be more aligned with the “corresponding figure” approach discussed in ISA 710, which results in the auditor's opinion referring to the current period only (as opposed to opining on the financial statements of both the current and prior periods) (IOSCO CL95).

12. They suggested that ‘consideration is given to different approaches used in different jurisdictions (ie comparative financial information vs corresponding figures approach as defined in auditing literature)’ (KPMG CL69).
13. During outreach we met informally with some members and staff of the International Auditing and Assurance Standards Board (the IAASB) to discuss the content of the Exposure Draft. During the meeting they discussed the difference between the ‘corresponding’ and ‘comparative’ audit approach, suggesting it should be taken into account in drafting the final *Practice Statement*.

Staff analysis

14. We have considered the different approaches to prior period information as defined in the auditing literature in developing our analysis.
15. The International Standards on Auditing (ISAs) state:

There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in the terms of engagement (paragraph 2 of ISA 710).

The essential audit reporting differences between the approaches are: (a) For *corresponding* figures, the auditor's opinion on the financial statements refers to the

current period only; whereas (b) For *comparative* financial statements, the auditor's opinion refers to *each period for which financial statements are presented* [emphasis added] (paragraph 3 of ISA 710).

16. The amount of prior period information an entity needs to provide in the current financial statements differs depending on the approach applied. 'The level of detail presented in the *corresponding* amounts and disclosures is dictated primarily by its *relevance to the current period figures*' while 'the level of information included in (...) *comparative* financial statements is *comparable with that of the financial statements of the current period*' [emphasis added] (paragraph 6 of ISA 710).
17. IFRS Standards require an entity to present information in respect of the preceding period for all amounts reported in the current period's financial statements⁴ (see paragraph 38 of IAS 1 *Presentation of Financial Statements*). Moreover, an entity shall include prior period information 'for narrative and descriptive information if it is relevant to understanding the current period's financial statements' (paragraph 38 of IAS 1).
18. Consequently, some hold the view that the requirements in IFRS Standards reflect a corresponding figures approach to prior period information. However the Board noted that additional information related to the previous period might be required by law or other regulations and *does not prohibit* the inclusion of such additional information in the financial statements (see paragraph BC32E of IAS 1). Consequently both approaches should be considered as compatible with the requirements of IFRS Standards.
19. We agree with respondents that the guidance on prior period information provided in the Exposure Draft could be applied only in a 'corresponding' figures framework, ie when prior period information is included as an integral part of the current year financial statements and is intended to be read only in relation to the amounts and other disclosures relating to the current period⁵.

⁴ Except when IFRS Standards permit or require otherwise.

⁵ See paragraph 6(b) of ISA 710.

20. An entity might not be able to remove prior period information that is not necessary to understand the current period's financial statements when a comparative approach is applied⁶. This is because the level of prior period information to include will be the same required for *complete* financial statements—complete in themselves, capable to stand alone.
21. Consequently, in our view, there is no need for specific guidance on prior period information when a 'comparative' approach is taken.
22. We acknowledge that there are regulatory requirements which demand a 'comparative' financial statements approach for special purposes (eg for offering purposes or other major transactions), but this will fall outside the scope of the final *Practice Statement*. The final *Practice Statement* provides guidance on the application of materiality to IFRS general purposes financial statements.
23. We suggest that the Board explains the two possible approaches to prior period information in the final *Practice Statement*, but focuses on the 'corresponding' approach.
24. In a 'corresponding' approach, the practical guidance the Board should provide in the final *Practice Statement* should be in line with the requirement in the IAS 1 that 'an entity shall include comparative information for narrative and descriptive information *if it is relevant to understanding the current period's financial statements*' [emphasis added] (paragraph 38 of IAS 1).
25. Therefore, an entity needs to consider whether prior period information which was included in the prior period financial statements is still material to the current period (ie is needed in order to understand the current period financial statements):
 - (a) if it is material, an entity should disclose corresponding period information to the extent necessary to understand the current period financial statements; while
 - (b) if it is not material, the corresponding information can be excluded from the current period financial statements.

⁶ The prior period information an entity is required to present when the comparative approach is applied are generally the same presented for the current year of the latest financial statements.

26. Further, if prior period information is needed to understand the current period financial statements, we suggest that it should be included in the current period financial statements, regardless of whether that information was included in the prior period financial statements, ie regardless of the entity's materiality assessment in the prior period. Identifying the prior period information needed would be driven by the current period financial statements because the objective is to support the understandability of the current period information.

Staff recommendation

27. We recommend the Board acknowledges, in the final *Practice Statement*, the existence of different approaches to previous period information as defined in the auditing literature: the 'corresponding' and 'comparative' approach. This would avoid confusion for the readers.
28. We also recommend the Board focuses on the 'corresponding' approach in the final *Practice Statement*, and clarifies that the assessment of whether to disclose previous period's information should be made on the basis of its relevance to understanding the current year financial statements, as required by IAS 1.
29. Accordingly, we recommend that the Board includes in the final *Practice Statement* guidance to clarify that prior period's information which is material to the current period (ie is needed in order to understand the current period financial statements) should be included, together with all the details needed to understand the current period financial statements. This assessment of what information to include about the prior period is independent of the prior period's materiality assessment ie is independent of whether that information was included in the prior period financial statements.
30. Consequently an entity should not automatically reproduce prior period information in the current period financial statements but it may need to include prior period information that wasn't included in the prior period financial statements, if this is needed to understand the current period financial statements.

Questions for the Board**Question 1—corresponding *versus* comparative approach**

Do you agree that the Board should acknowledge in the final *Practice Statement* the existence of two different approaches to prior period information, being the 'corresponding' and 'comparative' approach?

Question 2—corresponding approach

Do you agree that, in the final *Practice Statement*, the Board should focus on providing guidance in the context of the 'corresponding' figures approach?

Question 3—guidance on corresponding period information

Do you agree that, in the final *Practice Statement*, the Board should clarify that the assessment of whether to disclose prior period information should be made on the basis of its relevance to understanding the current year financial statements?

Interrelation with local requirements

Guidance proposed in the Exposure Draft

31. The Basis for Conclusions of the Exposure Draft dealt with the relationship between the guidance on materiality provided by the Board and any other guidance or requirements on materiality provided by other relevant authorities.
32. Paragraph BC10 of the Exposure Draft reinforced a concept already presented in the Introduction, that the Board proposed ‘non-mandatory guidance’ in the Exposure Draft. Entities would not be required to apply the guidance in the final *Practice Statement* in order to state compliance with IFRS Standards.
33. The Board’s reasoning for proposing non-mandatory guidance was provided in paragraph BC11 of the Exposure Draft:

The IASB noted that if it issued mandatory guidance in a Standard, concerns about creating conflicts with national legal frameworks could add complexity when developing the guidance. Nevertheless the IASB noted that even though some jurisdictions have legal or regulatory requirements about materiality, this should not necessarily result in a conflict with the guidance in this [Exposure Draft] (provided that those local requirements do not prevent an entity from applying requirements in IFRS if the effect of doing so would be material).

34. Moreover, the Board noted that ‘IFRS would not prohibit an entity from providing additional information in order to meet local requirements in a jurisdiction’ (paragraph BC12 of the Exposure Draft) and that ‘IFRS does not prohibit entities from disclosing immaterial information (...) it requires them to consider whether disclosure of immaterial information results in material information being obscured’ (paragraph 35 of the Exposure Draft).
35. Finally, in the body of the Exposure Draft the Board acknowledged that:
 - (a) ‘materiality is a general concept that is widely used both in financial reporting and for other purposes’ (paragraph 4);

- (b) ‘some jurisdictions use materiality principles, and supplementary guidance, to enforce [their disclosures] obligations’ (paragraph 5); and
- (c) ‘the way in which the term “materiality” is understood in the contexts above is expected to be consistent with the way in which the term is expected to be applied to financial reporting’ (paragraph 6).

Summary of the feedback

36. Some respondents were concerned about how to apply the guidance outlined in the Exposure Draft in jurisdictions where different local disclosure requirements also apply. One such view was expressed by the South African Institute of Chartered Accountants (SAICA) CL58:

[regulators] in certain cases require certain additional disclosures in the financial statements, and in some cases this disclosure would not be considered material when applying [the Board’s] guidance, but would only need to be included to comply with regulation.

37. The Federation of Accounting Professions of Thailand (FAP) shared the same concern (‘some regulators (...) require the regulated companies to prepare their financial statements based on the regulators’ policies which differ from Materiality principles’, CL54); as well as the European Banking Authority (EBA) (‘for EU banks [financial statements] may contain regulatory disclosures (such as Pillar III disclosures) that are subject to a specific guidance regarding the application of materiality’, CL57).

38. They suggested either to ‘clarify that [the Exposure Draft] doesn’t intend to preempt or limit in any way the information that an entity is required to disclose under any other regulation’ (EBA CL57) or to ‘interact with the regulators to ascertain their level of acceptance of materiality for such mandatory disclosures⁷’ (SAICA CL58).

39. Some other respondents highlighted potential practical issues:

⁷ Disclosure that would not be considered material applying the Board’s guidance, but is required to comply with local regulation.

- (a) legal or regulatory requirements ‘could result in a conflict with the proposed guidance if they require the disclosure of additional information regardless of materiality and such disclosures obscure material information’ (Singapore ASC CL93);
 - (b) ‘deciding to disclose or not to disclose certain information [based on the Board’s guidance] might expose management and auditors to the risk of being criticised by another stakeholder (regulators, court, shareholders...) which might take a different view on the materiality assessment’ (Federation of European Accountants (FEE) CL31); and
 - (c) ‘an issuer would not be able to state this compliance [with IFRS Standards] if the national materiality requirements with which it also needed to comply would preclude compliance with both’ (IOSCO CL95).
40. Respondents did not report examples of any situations they encounter in practice in which the Exposure Draft guidance conflicted with local regulations, however, according to IOSCO ‘the more that the IASB publishes about materiality, the greater likelihood there is that this potential inconsistency could occur’ (CL95).
41. Deloitte Touche Tohmatsu Limited (DTTL) suggested that entities preparing IFRS financial statements ‘will need to be sensitive to how materiality is defined and applied in a particular jurisdiction’ (CL76); instead of being the source of potential conflicts, local regulations are a ‘factor that a preparer (...) would consider in making materiality judgements’ (CL76).
42. Finally, some respondents disagreed with the wording in paragraphs 4–6 of the Exposure Draft:
- The Board states an expectation that materiality applied to financial reporting is consistent with materiality used in the context of legal agreements, takeover offers and price relevant information. We think that this expectation could potentially create conflicts with local requirements in case the guidance was mandatory. Also, we do not think that stating such an expectation is necessary for the purpose of this PS (SIX Swiss Exchange Regulation (SIX) CL 43).

Paragraphs 5 and 6 suggest that the meaning of ‘materiality’ for the purposes of ongoing market disclosure obligations is consistent with its use in financial reporting. We do not think that this is correct and we suggest that the point should be deleted (Institute of Chartered Accountants in England and Wales (ICAEW) CL16).

Staff analysis

43. In our view the guidance in the Exposure Draft already answers respondents’ main questions. However, given that respondents made these comments, the Board may need to revise the explanations in the final *Practice Statement*.
44. A Practice Statement is not a Standard and its application is not required in order to state compliance with IFRS Standards. Any potential conflict between legal or regulatory requirements and the final *Practice Statement* could be solved by disregarding the guidance provided in the final *Practice Statement* and just applying the requirements of IFRS Standards.
45. Moreover, the final *Practice Statement* will focus on the application of materiality in preparing financial statements under IFRS Standards; it does not aim to provide any guidance on the concept of materiality for local regulation purposes.
46. Furthermore, the Board explained that IFRS Standards do not prohibit entities from disclosing additional information for regulatory purposes (even if that information might be not material according to the Exposure Draft guidance) provided that any such information does not obscure information that is material for IFRS Standards purposes⁸.

⁸ See paragraph 35 and the Basis for Conclusions of the Exposure Draft; see also paragraph BC30F of the IAS 1: ‘Paragraph 30A [of IAS 1] emphasises that an entity should not reduce the understandability of its financial statements by providing immaterial information that obscures the material information in financial statements or by aggregating material items that have different natures or functions. Obscuring material information with immaterial information in financial statements makes the material information less visible and therefore makes the financial statements less understandable. The amendments do not actually prohibit entities from disclosing immaterial information, because the Board thinks that such a requirement would not be operational; however, the amendments emphasise that disclosure should not result in material information being obscured’.

47. Where jurisdictions require additional disclosures in the financial statements, entities would need to include them regardless of their materiality, providing that no material information is obscured by information that is not material.
48. Some of the ‘reliefs’ provided by the Board’s guidance on materiality (in terms of information that can be excluded from the financial statements because not material) might not be compatible with local regulations. If that is the case, an entity would not be able to use those ‘reliefs’ if it wishes to state compliance with local regulations.
49. Ensuring that information that is not material does not obscure material information is a matter of how to organise the information in the financial statements; consequently, appropriate organisation of that information would allow entities to comply with both local regulation and IFRS Standards.
50. Similar considerations apply when local regulations prescribe a different materiality framework; entities would apply the most stringent approach, organising the information in the financial statements so that information assessed as material for IFRS Standards purposes is not obscured.
51. The only potential we can see for conflict would be if information was assessed as material for IFRS Standards purposes, but is not material according to the local regulations and cannot be included in the financial statements because local regulations prohibit the inclusion of immaterial information. However, no comment letters reported this problem (they focused on disclosures required under local regulations being not material for IFRS Standards purposes).
52. Finally, we agree with respondents proposing to remove the references to other concepts of materiality (legal, regulatory, etc.) from the introductory paragraph of the final *Practice Statement* (paragraph 4–6 of the Exposure Draft). Our main reasons are:
 - (a) other concepts of materiality are beyond the scope of the final *Practice Statement*; and
 - (b) any mention of other concepts of materiality could cause confusion, since the purposes for applying other concepts of materiality may be different.

Staff recommendation

53. We recommend that the Board emphasises in the final *Practice Statement* that:
- (a) providing guidance on how to interpret and apply the concept of materiality for local regulations is not an objective of the final *Practice Statement* and does not fall within its scope. An entity will need to refer to local guidance, if any, in order to comply with local regulatory requirements.
 - (b) providing additional information to meet local regulatory requirements is not prohibited by IFRS Standards, even if that information is not material for IFRS Standards, provided that material information is not obscured.
54. We also recommend the Board removes the references to other concepts of materiality from the introductory paragraphs of the final *Practice statement*. This should avoid any potential confusion on the objective of the final *Practice Statement*.

Questions for the Board**Question 4—interrelation with local regulations requirements**

Do you agree that, in the final *Practice Statement*, the Board should emphasise that:

(a) providing guidance on how to interpret and apply the concept of materiality for local regulation is not an objective of the final *Practice Statement*; and

(b) providing additional information to meet local regulatory requirements is not prohibited by IFRS Standards, even if that information is not material for IFRS Standards, provided that material information is not obscured?

Question 5—reference to other concepts of materiality

Do you agree that the Board should remove references to other concepts of materiality from the introductory paragraphs of the final *Practice Statement*?