

STAFF PAPER

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IASB Meeting

Project	Disclosure Initiative: Materiality		
Paper topic	Interim reporting		
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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, in the light of comments received, members want to include more guidance on the application of materiality to interim financial reports in the final *Practice Statement*.

Guidance proposed in the Exposure Draft

2. The Exposure Draft provided a short section on interim reporting comprising two paragraphs under the heading ‘Interim reporting’.
3. Paragraph 59 of the Exposure Draft stated that the same principles on the application of materiality to the annual financial statements also apply to interim financial reports; however, the *context* and *objectives* in which the concept is applied are different.
4. The same paragraph quoted the observation in IAS 34 *Interim Financial Reporting* that interim financial reports are intended to provide an update on the latest complete set of annual financial statements; accordingly, they focus on new activities, events, and circumstances and do not need to duplicate information previously reported (see paragraph 6 of IAS 34).

5. Paragraph 60 of the Exposure Draft also quoted from IAS 34, highlighting the fact that materiality for interim financial reports is assessed in relation to the interim period financial data, not forecast annual data.

Summary of the feedback

6. Overall, respondents asked for more practical guidance on how to apply materiality to interim financial reports. Some respondents argued the Exposure Draft simply quoted IAS 34 without providing any additional practical guidance.
7. In particular, respondents asked for more guidance on the following topics:

- (a) the differences, if any, between applying materiality to the interim financial report and applying it in annual financial statements:

The [Exposure Draft] does not provide robust descriptions about how [annual and interim financial reporting] are different (...). Hence, it would be helpful if the IASB provides additional descriptions about the nature of such differences (Accounting Standards Board of Japan (ASBJ) CL17¹).

- (b) how to deal with information that is deemed material to the interim financial report but not to the annual financial statements and *vice versa*:

The IASB could add practical examples to clarify whether:

- i. an item that is material during the interim period, but immaterial to the annual financial statements, should be disclosed only in the interim financial statements or in both interim and annual financial statements;
- ii. an item that is immaterial during the interim period, but expected to be material to the annual financial statements, should be disclosed only in the annual financial statements, or both.

¹ 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>

(Hong Kong Institute of Certified Public Accountants (HKICPA) CL48 and Asian-Oceanian Standard-Setters Group (AOSSG) CL90).

- (c) whether, in case of quarterly reporting, the assessment relates to the current interim period only (ie last 3 months) or the cumulative year to date ('questions arise as to how entities should consider the length of the interim period (ie 3 months versus 9 months) in the assessment', International Organization of Securities Commissions (IOSCO) CL95).
- (d) how the materiality assessment is affected by the fact that 'interim measurements may rely on estimates to a greater extent than measurements of annual financial data' (paragraph 23 of IAS 34) ('the Exposure Draft could illustrate how the "greater reliance on estimate", in interim reporting, (...), affects the application of materiality', European Financial Reporting Advisory Group (EFRAG) CL92).

Staff analysis

- 8. We considered the feedback received from respondents and addressed the main concerns raised as presented in paragraph 7(a)–(d).
- 9. In our view the 'Materiality Process' (as discussed in Agenda Paper 11D *The Materiality Process*) is applicable to all circumstances, and can be applied to the preparation of either the interim financial report or the annual financial statements.
- 10. Therefore, the final *Practice Statement* does not need to explain 'the factors that could influence determination of materiality for interim financial reporting and the aspects that would require judgements' as PricewaterhouseCoopers (PwC) CL81 suggested it should, because they are the same as those described for the annual assessment, but just applied:
 - (a) to a different *context*; and

- (b) with a different final *purpose*².
11. The different *context* in which entities make the materiality assessment for interim reporting purposes (compared to annual reporting purposes) derives from the basic principle that the Materiality Process should be applied on the basis of *the period the entity is reporting on*.
12. This means an entity should focus on the interim financial report in making its materiality assessment, ie:
- (a) any quantitative factors need to be assessed in relation to the interim period financial data, not forecast annual data³;
 - (b) information that is material to the interim financial report, need not be disclosed subsequently in the annual financial statements if it is not material to the annual financial statements(eg information quantitatively material on the basis of the current quarter figures, but not quantitatively material to the annual situation); and
 - (c) information that is not material to the interim financial report, need not be disclosed in the interim financial report even if it is expected to be material to the annual financial statements (eg if the entity has no material disposals of property, plant and equipment in the interim period, but expects such disposals to be material for the annual reporting period, information about disposals of property, plant and equipment need not be disclosed in the interim financial report).
13. In the context of quarterly reporting, the Materiality Process should be applied on the basis of both the current quarter situation and the year to date situation, because IAS 34 requires an entity to include, in the interim financial report, the statements of profit or loss and other comprehensive income for both periods (‘for the current interim period and cumulatively for the current financial year to

² The Exposure Draft referred to ‘objective’ in paragraph 59. However we believe that the term ‘purpose’ is more consistent to the concept described in paragraph 6 of IAS 34: ‘The interim financial report is *intended to provide an update on the latest complete set of annual financial statements*’ [emphasis added].

³ A concept already stated in the Exposure Draft (paragraph 59) and in paragraph IN9 of IAS 34.

date⁴). An entity should therefore refer to the current quarter situation or the year to date situation depending on the piece of information it is assessing.

14. In our view, although an interim financial report does not have the same final purposes as annual financial statements, that difference in *purposes* does not affect how the quantitative, entity-specific qualitative and external qualitative factors⁵ are considered within the Materiality Process. However, that difference in purposes plays an important role in the subsequent step ‘Organise the information within the draft financial statements’.
15. The purpose of an interim financial report is to provide an update on the latest complete set of annual financial statements. If material information—material to the interim period the entity is reporting on—was already disclosed in the latest annual financial statements, that information does not need to be reproduced in the interim financial report, unless something new occurs or an update is needed.
16. Finally, in our view, although interim measurements may rely on estimates to a greater extent than measurements of annual financial data, that fact does not necessarily make the estimated information more or less material. In deciding whether information derived from estimation is material, the same Materiality Process should be applied as to any other piece of information. The fact that information is derived from estimation does not itself constitute a ‘materiality factor’ within the Materiality Process.
17. However, *when information about estimation uncertainty or sensitivity is assessed as material* – and therefore disclosed – this might result in greater disclosure in the interim financial report than in the annual financial statements because of the greater reliance on estimates in interim reporting compared with the annual.

Staff recommendation

18. We recommend the Board expands the guidance on interim reporting in the final *Practice Statement*. This would address the practical concerns raised by respondents on the application of materiality to the interim financial reports.

⁴ See paragraph 20 of IAS 34.

⁵ Please refer to Agenda Paper 11D *The Materiality Process*, on the materiality factors.

19. In particular, we recommend that, in the final *Practice Statement*, the Board:
- (a) emphasises that an entity needs to consider the same materiality factors as it considers in the annual assessment, ie apply the Materiality Process, in the application of materiality to the interim financial reports. In our view the Materiality Process does not change when applied to the interim financial statement.
 - (b) specifies that an entity needs to apply the Materiality Process taking into account that the *context* and *purposes* of an interim financial report are different, ie:
 - (i) information in the interim financial report is assessed in relation to the interim period financial data, not forecast annual data;
 - (ii) in the case of quarterly reporting the Materiality Process is applied on the basis of both the current interim period data and the data for the current financial year to date;
 - (iii) information that is material to the interim financial report, but not material to the annual financial statements need be disclosed only in the interim financial report;
 - (iv) information that is not material to the interim financial report but is expected to be material to the annual financial statements need not be disclosed in the interim financial reports; and
 - (v) information that is material to the interim period, but was already presented and disclosed in the latest annual financial statements does not need to be reproduced in the interim financial report, unless something new occurs or an update is needed.
 - (c) specifies that although interim measurements may rely on estimates to a greater extent than annual financial data, that fact does not make the estimated information more material. In our view, the fact that information comes from an estimate does not make it more or less material. However, when information about estimation uncertainty is assessed as material – and therefore disclosed – relying on estimates for interim financial data to a greater extent than for annual financial data

might result in greater disclosure in the interim financial report compared with the annual.

Questions for the Board

Question 1—additional guidance on how to apply materiality to interim financial reports

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

- (a) emphasise that an entity needs to consider the same factors as it considers in the annual assessment in applying materiality to the interim financial report;
- (b) specify that an entity needs to apply the Materiality Process taking into account that the context and purposes of the interim financial report are different; and
- (c) specify that although interim measurements may rely on estimates to a greater extent than annual financial data, that fact does not make the estimated information more or less material?