



Basel Committee on Banking Supervision

BANK FOR INTERNATIONAL SETTLEMENTS

**Chairman**

**Via email**

Mr Hans Hoogervorst  
Chairman  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
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**Exposure Draft of an IFRS Practice Statement: Application of Materiality to Financial Statements**

Dear Hans

The Basel Committee on Banking Supervision welcomes the opportunity to comment on the International Accounting Standards Board's (the IASB's) Exposure Draft *IFRS Practice Statement: Application of Materiality to Financial Statements* (the ED).

The Committee has a strong interest in the quality of banks' financial reporting – and therefore the accounting standards applicable to banks – for at least two reasons. Firstly, accounting information provides the basis for the Committee's prudential capital framework and a focus for regulators' surveillance of banks. Secondly, the more transparent financial reporting is, the more effective market discipline can be. The Committee regards effective market discipline as important. This interest in financial reporting means the Committee supports the timely development of well-designed, consistent and high-quality accounting standards.

Our detailed comments are set out in the annex to this letter but, to summarise:

- We welcome the exposure draft. We regard the application of the materiality notion as a very important aspect of high-quality financial reporting, yet it is a notion that is not always understood so we support the IASB's efforts to clarify it;
- We agree that this material should be issued in a non-mandatory form. Having said that, we would suggest that the IASB consider whether, in the light of the draft Practice Statement, the existing mandatory documents and conceptual framework deal with the subject in enough detail, appropriately and comprehensively;
- In the Basis for Conclusions to the draft Practice Statement the IASB explains that the main reasons for developing the guidance are a tendency of others to focus too much on the quantitative aspects of materiality and the lack of clarity about the difference between judgements about materiality in the context of

the primary financial statements and in the context of the notes. We agree that these issues are key ones to address. We think the draft Practice Statement largely succeeds in helping readers to understand that there is a lot more to the concept of materiality than a purely quantitative assessment. However, we think it is less successful at meeting the second objective. Although there are plenty of references in the text that draw attention to the fact that there are differences in how materiality is applied in the context of the primary financial statements compared to in the context of the notes, we think the draft is unclear how this is supposed to work in practice. We think it might therefore be helpful to consider including a wider range of examples illustrating the materiality assessment. Providing a step-by-step description of the process that needs to be followed in arriving at and applying the materiality judgement might also help in communicating this key difference;

- It is important to bear in mind there are other definitions of materiality that might apply to material published in the same financial report as information that falls within the scope of the proposed Practice Statement. For example, Pillar 3 disclosures that are produced in accordance with the European Union (EU) Capital Requirements Regulation are subject to the materiality concept described in the the European Banking Authority (EBA) guidelines on materiality (EBA/GL/2014/14). Financial reports produced by global firms need also to take into account other standard-setters' definitions of materiality. For example, the US Financial Accounting Standards Board (FASB) has recently proposed changing its definition of materiality to conform to the US Supreme Court's definition as used in the context of the antifraud provisions of the US securities laws;
- We are broadly supportive of the thinking behind issuing the Practice Statement and, at a high-level, about its content. However, we think that at a very detailed level the draft sometimes makes proposals that appear difficult to implement in practice and sometimes provides guidance that is insufficiently developed to be practical.

These comments have been prepared by the Committee's Accounting Experts Group, chaired by Rene van Wyk, Registrar of Banks, South African Reserve Bank and have been approved by the Committee. The Committee trusts that you will find its comments useful and constructive.

If you have any questions regarding our comments, please contact Mr van Wyk (+27 12 313 3601) or Xavier-Yves Zanota at the Basel Committee Secretariat (+41 61 280 8613).

Yours sincerely



Stefan Ingves

## Annex

### Detailed comments

#### Content of the draft Practice Statement

##### Users of financial statements

- 1 We note that, although the draft Practice Statement is described as applying to general purpose financial statements, most of the discussion about users' information needs seems to focus on the needs of primary users. It would be helpful if some material linking these two notions could be included in the final text;
- 2 We note that the ED's discussion of users is based on the material contained in the IASB's recent conceptual framework ED. We draw your attention to the comments we made on that topic in our response to the conceptual framework ED:

*We note that the draft framework's statement in paragraph 1.10 that general purpose financial reports are directed primarily at investors and creditors rather than for example regulators. However, we do not think it follows that the information needs of regulators can simply be ignored by standard-setters and preparers. Indeed, the statement that general purpose financial reports are directed primarily at the information needs of investors and creditors implies that other information needs are relevant in determining the form and content of those reports, and we believe the framework should be improved to acknowledge that the information needs of regulators are one such relevant factor.*

*We think the ED implies that, because regulators have the power to require firms to provide special purpose financial reports, regulators do not have information needs in respect of general purpose financial reports. Yet there are considerable advantages – for both regulators (in terms of for example governance and context/association) and preparers (in terms of cost) – in regulators obtaining key pieces of information they need from general purpose financial reports (and in particular general purpose financial statements) and from the books and records from which those reports and statements are prepared rather than special purpose financial reports. That is why regulators use accounting information as the basis for their prudential capital framework.*

*We would in particular like to see the comment in paragraph 1.10 (that regulators may also find general purpose financial reports useful") corrected to make it clear that the general purpose financial statements contain information that is of vital importance to regulators around the world;*

##### Other definitions of materiality and interactions with other guidance

- 3 It is worth bearing in mind that the FASB has recently proposed changing its definition of materiality to conform to the US Supreme Court's definition as

used in the context of the antifraud provisions of the US securities laws. Not having a globally-agreed definition could cause some difficulties for international entities' financial reporting;

- 4 We note also that the footnote to paragraph 7 of the ED explains that there are slightly different definitions of materiality in the IASB's literature. We assume that the intention is to converge those definitions on a single definition;
- 5 Paragraph 2 states that the draft Practice Statement "is intended to be applied in preparing general purpose financial statements in accordance with IFRS." This statement is important because other financial reports can be subject to other materiality definitions. For example, the Pillar 3 reports that are produced in accordance with the EU Capital Requirements Regulation need to adopt the materiality concept described in the EBA guidelines on materiality (EBA/GL/2014/14) rather than this ED;
- 6 There is a risk that, as paragraph 3 of the draft Practice Statement states that the proposed guidance applies to information that is incorporated into the financial statements by cross reference, more than one notion of materiality might apply to the same piece of information; EBA's notion and the IASB's notion for example. It is essential that the proposed Practice Statement is able to accommodate this without causing firms to non-comply with regulatory definitions for example.

#### Gaps in the practical guidance provided

- 7 Although an objective of the draft Practice Statement is to provide practical guidance on how to apply materiality in the context of primary financial statements and on how that differs from applying it in the context of the notes, in our view the draft Practice Statement contains insufficient practical guidance on the subject;
- 8 The draft Practice Statement emphasises the importance of materiality being determined on the basis of the specific information needs of users of the reports. Paragraph 21 for example talks of the need to take into account any "special needs". This is a fundamental point, and it would be helpful if additional guidance could be included in the Practice Statement on how these information needs might be ascertained, bearing in mind they presumably change over time and are to some extent based on the circumstances surrounding a financial report's publication;
- 9 Another important point made in the ED is the statement in paragraph 32 that "management should...assess whether information is material within the context of different parts of the financial statements...." We would welcome more application guidance on how this might be done in practice.

#### **Examples in the ED**

- 10 We would be in favour of a broader range of examples being included in the final Practice Statement. We think this is necessary to more fully illustrate the process that is involved in assessing and applying materiality, and in illustrating other aspects of the guidance. One area where this would be particularly welcome is on the judgements that need to be made from a

qualitative perspective about what to include/exclude in the notes and primary financial statements. We recognise the IASB's desire to avoid publishing anything that might be applied unthinkingly, but the absence of such examples prevents some of the material in the draft Practice Statement from providing genuinely useful practical guidance;

- 11 For example, paragraph 43 starts by saying management needs to consider whether an item is material by considering it "relative to individual lines, subtotals and totals on face of an individual statement, as well as to each overall individual statement". We think it would be useful to illustrate, using a common-place example, why that is the case. More explanation as to how it would be done would also be useful. More generally, some examples about materiality in the context of measurement uncertainty (because that is an area where materiality is relevant both to the estimation process and to the supporting disclosures) would be useful.

### **The non-mandatory nature of the material**

- 12 We agree that this material should be issued in a non-mandatory form. We recognise that this means that the guidance might not be applied in a consistent manner, but agree that national frameworks and guidance make it difficult to develop mandatory material on the subject;
- 13 Having said that, we would suggest that the IASB consider whether, in the light of the material in this draft Practice Statement, its existing mandatory documents and conceptual framework deal with the subject in enough detail, appropriately and comprehensively. For example:
  - (a) Paragraph 9 states that "applying the concept of materiality ensures that financial information that could reasonably be expected to influence the decisions that users make on the basis of [general purpose] financial statements is separately presented in the primary financial statements or separately disclosed in the accompanying notes." However, that will be the case only if there is something in an accounting standard that requires it. We do not think there currently is;
  - (b) Paragraph 11 states that the "requirements in IFRS must be applied if their effect is material to the complete set of financial statements." Again, that will be the case only if a standard requires it;
  - (c) The penultimate sentence of paragraph 69 ("Consequently, the disclosures...") is a very important one and we believe should be repeated in a mandatory document;
- 14 On the subject of the conceptual framework, we note that the draft Practice Statement makes hardly any reference to the conceptual framework's notion of 'relevance'. The relationship between relevance and materiality is important to understand and worth addressing in the Practice Statement.

### **Timing**

- 15 We note that the intention is to consult in a few months' time – through the Discussion Paper on Principles of Disclosure (PoD)) – on the possible need to revise the definition of materiality. Bearing that in mind, we suggest the

IASB gives stakeholders an opportunity at that stage to comment further on any implications the PoD discussion paper might have on the guidance in this ED.

### **Interim reporting**

- 16 We would welcome the proposed Practice Statement providing additional clarification on the application of materiality in interim reports, where there is generally a higher reliance on estimates compared to the annual financial statements. As it stands, paragraph 60 merely repeats IAS 34.23.

### **Minor comments**

- 17 We think the paper has a number of potentially loose uses of the word 'material'. Bearing in mind that one of the objectives of the paper is to encourage a better understanding of the notion, loose use of language needs to be avoided. For example:
- (a) Paragraph 11 uses the phrase “material to the complete set of financial statements”. Bearing in mind the definition of material and the need to consider materiality both in an overarching way and in the context of the detail in the financial statements, this seems unhelpful;
  - (b) Paragraph 19 appears to mix up the separate notions of ‘relevance’ and ‘materiality’;
  - (c) Paragraph 36 contains three unhelpful uses of the word: “immaterial to the entity”, “material amount” and “immaterial amount”;
  - (d) Paragraph 37 quotes IAS 1 referring to “each material class” and “sufficiently material”;
- 18 We also think that some parts of the paper go beyond a discussion of 'materiality'. For example:
- (a) Paragraph 43 ends by saying that, when presenting line items, management should assess which items serve as useful signposts to link the face of the statements with the detail in the notes to help the primary users navigate through the financial statements. We think that has more to do with the understandability and clarity of the financial statements than materiality;
  - (b) Paragraph 42 talks about the need to present items or classes of items separately “because of their relative size or nature”, implying either that only size and nature are relevant to an assessment of materiality (which surely cannot be right) or that this discussion is not about materiality at all;
- 19 We also suggest that the IASB looks again at certain statements made in the draft Practice Statement because they might be the source of confusion or misunderstanding. For example:
- (a) Paragraph 27(a) states that an accounting policy note is material if users would be unable to understand the financial statements sufficiently were

it not disclosed. It then states that an accounting policy note that merely quotes an IFRS requirement is inadequate and potentially immaterial. We agree that it will usually be inadequate, but we do not understand why it would be potentially immaterial simply because it says nothing more than the IFRS. If knowledge of a particular accounting policy is material, that is the case even if the description could be much better;

- (b) Paragraph 37 refers to IAS 1.30A's reference to "aggregating material items that have different natures or functions"; paragraph 38 then talks more broadly about "related or similar items". We think an important issue in this context is what it is about the item that makes it material. It might be its nature or function, but it might be something else instead;
- (c) Paragraph 51(a) seems to suggest that providing "all the specified disclosure requirements related to" a disclosure objective is necessary if all material information relating to those objectives is to be deemed to have been provided. This seems a bit confused – is 'requirements' the right word – and also questionable; why would all that information necessarily be material?
- (d) IAS 1.17(c) requires entities to provide disclosures that are additional to those required by IFRS "when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance." Paragraph 52 appears to be restating this requirement in terms of "information that is relevant to an understanding of the financial statements and could reasonably be expected to influence decisions that primary users make on the basis of the financial statements". We would prefer paragraph 52 to be much more closely grounded in IAS 1 and the conceptual framework than it is at present;
- (e) We find paragraph 62 confusing. It starts by saying IFRS are applied if their effect is material (which we think is the same as the more usual "IFRS should be applied unless the effect is immaterial"). It then refers, as a specific example of this principle, to IAS 8, which states that financial statements do not comply with IFRS if they contain certain intentional but immaterial errors. We agree with IAS 8 but are not sure whether this is an application of the notion of materiality or of the principle set out at the beginning of the paragraph;
- (f) The implication of the last few words of paragraph 53(b) is that nothing but information about "key risks and sensitivities" will be material in the context described. We do not understand why that should necessarily be the case;
- (g) Paragraph 57 states that the public availability of information in a wider context than the financial statements does not relieve the entity of the obligation to disclose information required by IFRS if that information is material. We agree but nevertheless suggest that the IASB might wish to develop its thinking here further to explain how a disclosure in the financial statements of information that is already publicly available can 'make a difference' to users' decision-making (ie be material).