AUSTRIAN FINANCIAL REPORTING AND AUDITING COMMITTEE

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Dear Mr. Maijoor,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, I appreciate the opportunity to comment on the Consultation Paper "Considerations of materiality in financial reporting" (February 2012). Principal authors of this comment letter were Erich Kandler, Christoph Krischanitz, Roland Nessmann, Gerhard Prachner and Gerhard Schwartz.

General comments

We strongly believe that ESMA should not endeavour to become involved in issuing guidance on considerations of materiality in financial reporting, as this matter should be dealt with exclusively by the financial reporting standard setters. While we welcome any debate on materiality and the associated debate of the relevance of the recent information overload in financial reporting as evidenced by the rapidly growing number of pages that typical annual financial statements nowadays require, we believe it is up to the standard setters and the preparers – in cooperation with their statutory auditors – to determine what should be included in financial statements within a given financial reporting framework. We note that ESMA refers quite often to the preparers´ point of view, but point out that ESMA is an organisation charged with the monitoring of securities and financial markets, including the European Enforcement Coordination forum, which is clearly different both from standard setting that addresses what preparers have to do, and monitoring the auditors' adherence to the applicable auditing standards.

In addition, we see no appropriate means for ESMA to issue any binding guidance to preparers without creating an undesirable conflict with those charged with financial accounting standard setting and the preparation of the applicable interpretations.

Q 1: Do you think that the concept of materiality is clearly and consistently understood and applied in practice by preparers, auditors, users and accounting enforcers or do you feel more clarification is required?

First, we would emphasise that there is an abundance of literature dealing with the various aspects of materiality. In particular, there is SAB 99 (Staff Accounting Bulletin of the SEC – US Securities and Exchange Commission) which is widely recognised as a key publication on financial statement materiality. Further, we believe that the concept of materiality is generally understood reasonably well, but not very consistently applied. The distinction must be made between materiality as applied by preparers and auditors when assessing the true and fair view of general purpose financial statements on the one hand, and materiality as understood by users, who in certain situations may have very different information expectations. Users' concept of materiality may vary widely, just as the information that is sought from financial statements varies. In our opinion, accounting enforcers should apply the materiality concept that preparers and auditors would generally consider reasonable in the circumstances. It should also be noted that the materiality that auditors apply in determining the scope of the audit procedures is not necessarily the same (quantitative amount) as that which preparers may have to apply when preparing financial statements. Nevertheless, the overall concept of assessing materiality for financial statements is conceptually the same for both preparers and auditors.

Q 2: Do you think ESMA should issue guidance in this regard?

We strongly believe that ESMA's report on this consultation should conclude that there is no need for ESMA to prepare additional guidance for materiality in financial reporting. Taking note of the language on page four of the consultation paper "ESMA will go further and publish a final report later in 2012," we do not believe that ESMA should issue guidance with respect to materiality in financial reporting. This is a task to be handled by the responsible standard setters for financial reporting. It is therefore up to IASB and IFRIC (or national standard setters, for that matter) to determine what should be deemed material from a preparer's point of view. To add further emphasis we refer to item six on page five where it is correctly stated that "materiality should be assessed according to the relevant reporting framework". Those in charge of developing the reporting framework and those in charge of applying the reporting standards should have the primary responsibility for providing guidance on materiality.

Q 3: In your opinion, are 'economic decisions made by users' the same as users making 'decisions about providing resources to the entity'? Please explain your rationale and if possible provide examples.

In our opinion there is only one materiality in financial reporting to be applied by each and every group of stakeholders when assessing the true and fair view of financial statements. Although one may argue that the first term is broader than the second, which may be limited to investors only, we do not see any reason for differentiating in the materiality concept of financial reporting. Different stakeholder groups may have different interests and information needs from financial statements, but they should be provided the information applying the same concept of materiality.

Q 4: Is it your understanding that the primary user constituency of general purpose financial reports as defined by the IASB in paragraph 13 includes those users as outlined in paragraph 16 above? Please explain your rationale and if possible provide further examples.

Yes, we believe that the definition used by the IASB is broad enough and encompasses all groups of stakeholders. General purposes financial statements are not designed to and do not necessarily cover all matters and concerns that any one user may - quite legitimately – have. Such matters need to be addressed in other reporting or disclosure frameworks taking into account the various legal and economic restrictions.

Q 5a: Do you agree that the IASB's use of the word 'could' as opposed to, for example, 'would' implies a lower materiality threshold? Please explain your rationale in this regard.

We do not believe that the word "could" and "would" imply a different concept of materiality or a different threshold for materiality considerations. It may be that the standard setter should make clear that there is no distinction.

Q 5b: In your opinion, could the inclusion of the expression 'reasonably be expected to' as per the Auditing Standards, lead to a different assessment of materiality for auditing purposes than that used for financial reporting purposes. Have you seen any instances of this in practice?

We believe that the expression "reasonably be expected to" as it is used in the auditing standards does **not** lead to a different assessment of materiality for auditing purposes. This is because the overall assessment of a true and fair view expressed in the audit opinion deals with the financial statements taken as a whole and their compliance with the underlying financial reporting framework. There should therefore be no difference. We are not aware of any instances in practice where materiality for financial reporting purposes has been defined differently to materiality for the overall expression of the audit opinion.

Q 6a: Do you agree that the quantitative analysis of the materiality of an item should not be determined solely by a simple quantitative comparison to primary statement totals such as profit for the period or statement of financial position totals and that the individual line item in the primary statement to which the item is included should be assessed when determining the materiality of the item in question? Please explain your rationale in this regard.

Q 6b: Do you agree that each of the examples provided in paragraph 21 a – e above constitute instances where the quantitative materiality threshold may be lower? Are there other instances which might be cited as examples? Please explain your rationale.

We strongly believe that there should be only one quantitative threshold for materiality for the financial statements overall, and that this should not be changed for individual line items. We believe, however, that other matters disclosed and individual line items may be of such qualitative importance that disclosures are required even if the quantitative amount involved is below the threshold for financial statement materiality. There could very well be instances where a lower quantitative materiality threshold needs to be applied because of qualitative concerns (such as those mentioned in 22a-e) when even a smaller quantitative misstatement may lead to qualitatively very different outcomes (e.g., covenant breach or similar very significant matters). We acknowledge, however, that materiality may be assessed differently for issues involving valuation (with a P&L / equity impact) compared with matters of presentation (allocation to accounts) only.

Q 7: Do you agree that preparers of financial reports should assess the impact of all misstatements and omissions, including those that arose in earlier periods and are of continued applicability in the current period, in determining materiality decisions. Please explain your views in this regard.

Yes, we agree with this approach, and overall financial reporting materiality should be applied.

Q 8: Do you agree that preparers of financial reports should assess the impact of all misstatements and omissions as referred to in paragraphs 23 to 26 above in determining materiality? Please explain your views in this regard and provide practical examples, if applicable.

Yes, we agree.

Q 9 a-c: Do you believe that an accounting policy disclosing the materiality judgments exercised by preparers should be provided in the financial statements? If so, please provide an outline of the nature of such disclosures. In either case, please explain your rationale in this regard.

We do not believe that there should be disclosures with respect to the accounting materiality judgments exercised by preparers. Such a disclosure would inevitably involve discussions of items considered immaterial by the preparer, resulting in unnecessary discussion of immaterial items. In addition, any more detailed disclosure of quantitative or qualitative thresholds for materiality will automatically encourage the idea that financial statements are permitted to be “wrong” by up to this amount.

Q 10: Do you agree that omitting required notes giving additional information about a material line item in the financial statements constitutes a misstatement? Please explain your rationale in this regard.

The materiality concept implies that financial statements are not considered wrong if the standards are not applied to immaterial items. On the other hand, if a required note involves a material line item it has to be provided irrespective of whether this information is quantitative or qualitative. If a line item is deemed not material, quantitative information may be omitted but qualitative information – if required by the applicable standard - will generally need to be provided.

Q 11: Do you believe that in determining the materiality applying to notes which do not relate directly to financial statement items but are nonetheless of significance for the overall assessment of the financial statements of a reporting entity:

(a) the same considerations apply as in determining the materiality applying to items which relate directly to financial statement items; or

(b) different considerations apply; and
(c) if different considerations apply, please outline those different considerations.

If a disclosure item is considered significant by the relevant financial reporting framework, the overall quantitative materiality may not be applied. The disclosure is required in any case if it involves qualitative aspects, and where quantitative disclosure is required it is needed even if the item is below the overall quantitative materiality threshold for that entity. It could be suggested to the standard setter that quantitative disclosures specifically required even if of no or limited quantitative materiality (e.g., dealings in own shares) should be expressly described as such.

Q 12: In your opinion, how would the materiality assessment as it applies to interim financial reports differ from the materiality assessment as it applies to annual financial reports?

There is no difference in the materiality assessment between interim financial statements and the assessment applied to annual financial reports. It should, however, be noted that certain disclosures and information do not need to be provided for interim financial information.

Please do not hesitate to contact me if you wish to discuss any aspect of our comment letter in more detail.

Kind regards

Romuald Bertl
Chairman