

Mr Hans Hoogervorst
Chairman of the IASB
IFRS Foundation
30 Cannon Street
London
EC4M 6XH

10 January 2018

Dear Hans,

This letter sets out the comments of the UK Financial Reporting Council (FRC) on the Exposure Draft (ED) ED/2017/6 '*Definition of Material (Proposed amendments to IAS 1 and IAS 8)*'. Our main comments on the ED are summarised below with our detailed responses to the consultation questions included in the appendix to this letter.

We support the IASB's objective of removing inconsistencies between how materiality is defined in the Conceptual Framework for Financial Reporting (Conceptual Framework), IFRS Practice Statement 2 *Making Materiality Judgements* (Materiality Practice Statement) and IFRS Standards.

We believe the clarity of the proposed definition could be improved. First, we consider it should make clear that when the definition uses the term "information" it means the information that should be prepared in accordance with standards. Second, it implies that the materiality of information to be presented or disclosed in the financial can be assessed by considering the impact of misstating it. The materiality of information that should be included in the financial statements is, at least in part, independent of the materiality of a possible misstatement; material information can be immaterially misstated and, more importantly, immaterial information could be subject to a material misstatement.

If information to be included in the financial statements is misstated, we must assess the materiality of the misstatement – i.e. whether the difference between the information that should have been included and that which has been included could reasonably be expected to influence the decisions of users. For this reason, we recommend that both material information and material misstatements should be defined. We also note that maintaining the link between materiality and misstatements is central to the audit process.

We welcome the IASB's decision to include reference to the "obscuring" of information in IAS 1 *Presentation of Financial Statements* (IAS 1) because this aspect of achieving a fair presentation is not captured by the existing text in IAS 1. However, there should be some

consideration of degree – information can be more or less obscured by other information. The ways in which material information might be obscured could be elaborated on in the Materiality Practice Statement, to assist with the application of the concept.

However, we recommend relocating the references to “omitting” and “obscuring” to the requirements following the definition in order to simplify it. However, in doing this the IASB must ensure that such “errors” are seen to be of equivalent significance to a material misstatement.

We welcome the clarification of the threshold for material information from “could influence” to “could reasonably be expected to influence” because the existing wording may be interpreted too broadly; it could be argued that, in some particular circumstances, almost any information *could* influence decisions. The revised description of the threshold better reflects how the concept of materiality is understood and applied in practice. We support the reference to the “primary users” rather than “users” of financial statements because this is consistent with the purpose and audience of financial reporting as set out in the Conceptual Framework.

In our view, the concept of “individually or collectively” should be retained in the definition because it is integral to the process of identifying material information or misstatements, due to the fact that materiality can be cumulative. We note that this phrase is redrafted as “individually or in combination with other information” in the requirements following the definition in the ED. We believe the revised wording will have the same effect as the existing wording, if included in the definition itself.

In light of these concerns, we suggest that the definition is revised as follows:

“Information or a misstatement of information is material if it could reasonably be expected, individually or in combination with other information or misstatements, to influence the decisions that the primary users of an entity’s general purpose financial statements make on the basis of those statements.”

Material information should not be omitted or obscured to a degree that could influence those decisions.”

If you would like to discuss these comments, please contact me or Rosalind Szentpéteri on 020 7492 2474.

Yours sincerely



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Appendix – FRC responses to consultation questions

Question 1

The Board proposes amendments to IAS 1 and IAS 8 to align the definition of material between IFRS Standards and the Conceptual Framework, and to include in the definition some of the existing requirements in IAS 1. The Board also proposes to clarify the explanation accompanying the definition using existing guidance in IAS 1 and the Conceptual Framework.

(a) Do you agree that the definition of material and the accompanying explanation should be clarified as proposed in this Exposure Draft? If you do not agree, what changes do you suggest and why?

(b) Would any wording or terminology introduced in the proposed amendments be difficult to understand or to translate?

Aligning the definitions of material

We support the IASB's objective of removing inconsistencies between how 'material' is defined in the Conceptual Framework, IAS 1, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (IAS 8), and the Materiality Practice Statement. The inclusion of differently worded definitions in various documents may be confusing or lead to inconsistency in application.

The materiality threshold

In our view, the proposed clarification of the materiality threshold from "could influence" to "could reasonably be expected to influence" is appropriate because the existing wording could be taken to imply that the threshold is lower than we believe the IASB intended, given that it could be argued that almost any information *could* influence decisions in some circumstances.

We note that the wording "could reasonably be expected to" is already included in the requirements that follow the definition of 'material' in paragraph 7 of IAS 1 so this is simply being elevated to the definition itself to improve clarity. The revised description of the threshold better reflects how the concept of materiality is understood and applied in practice.

We also agree with replacing the term "users" with "primary users" to discourage the definition being interpreted too broadly and to reflect the purpose of and audience for financial reporting as set out in paragraph OB5 of the Conceptual Framework.¹

It is not clear why the words "individually or collectively" were removed from the definition. In our view, this concept should be retained in the definition because it is integral to the process of identifying material information or misstatements due to the fact that materiality can be

¹ Paragraph 1.5 of the Conceptual Framework Exposure Draft.

cumulative. We note that the IASB has redrafted this phrase as “individually or in combination with other information” in the requirements following the definition in the ED. We believe the revised wording will have the same effect, if included in the definition itself.

In our view, this is integral to the concept of materiality and is an essential part of identifying material information or misstatements because materiality can be cumulative. We note that the IASB has redrafted this phrase as “individually or in combination with other information” in the requirements following the definition in the ED. We believe the revised wording will have the same effect, but should be included in the definition itself.

Simplifying and clarifying the definition

First, we consider it should be made clear that when the definition uses the term “information” it means the information that should be presented in accordance with standards.

Second, we do not believe it is possible to determine the materiality of information required by standards by considering the impact of misstating that information in the financial statements, as the definition in the ED implies. Immaterial information can be materially misstated and vice versa. This issue does not arise with the existing definition in IAS 1 because it defines material omissions and misstatements rather than defining material information.

Example:

Having considered, *inter alia*, its financial position, financial performance, business model and the nature of gains on its investment property and applying professional judgement the directors of Company A have assessed that the decisions of users could reasonably be expected to be influenced by gains if in excess of CU5m.

In the year there is only one investment property gain of CU1m. The directors are considering whether this gain is material and thereby, in accordance with IAS 8 paragraph 8, whether the requirements of IAS 40 should be applied.

Applying the revised definition, the directors conclude that either omitting or obscuring the CU1m gain would not influence the decisions of users. However, in considering the impact of misstating, the assessment depends on the size of the misstatement. If the gain was presented as a CU10m gain then the decisions of users could reasonably be expected to be influenced. So a possible misstatement of the gain could influence decisions, therefore, according to the definition as expressed in the ED, the CU1m gain must be material and IAS 40 applies.

As the above example shows, if information is misstated, we must separately consider the materiality of the misstatement itself. For this reason, we recommend that both material information and material misstatements should be defined.

Defining materiality in relation to how the concept applies to both information and misstatements will maintain the link to misstatements which central to the audit process, while improving consistency with how the concept of materiality is described elsewhere in IAS 1 (for example, paragraphs 29-31 which refer directly to material classes of similar items, material line items, material information and material disclosures).

Paragraph BC9(c) of the ED states that the proposals relocate “the description of material misstatements, and other wording that explains rather than defines material, from the definition into the explanatory paragraphs that accompany the definition.” As a result, the ED effectively defines material misstatements separately in the paragraphs that follow the definition of material information: “A misstatement of information is material if it could reasonably be expected to influence decisions made by the primary users.” We believe it would be clearer and simpler to define both material information and material misstatements in the main definition, as follows:

“Information or a misstatement of information is material if it could reasonably be expected, individually or in combination with other information or misstatements, to influence the decisions that the primary users of an entity’s general purpose financial statements make on the basis of those statements. Material information should not be omitted or obscured to a degree that could influence those decisions.”

We welcome the inclusion of the reference to “obscuring” and believe this should be retained in the requirements accompanying the definition because this aspect of achieving a fair presentation is not captured by the existing text in IAS 1. We agree it is important to emphasise that material information should not be omitted or obscured to such a degree that it could reasonably be expected to influence decisions of users. We believe that a statement to this effect should be included in the requirements following the definition in paragraph 7 of IAS 1, rather than as part of the definition itself (as shown above). However, this should be done in such a way as to ensure that material misstatements, the omission of material information or the obscuring of information to such a degree that it could reasonably be expected to influence decisions are seen to be of equivalent significance as they can all undermine a fair presentation.

It may also be helpful for the IASB to encourage consistent interpretation of the term “obscuring” by elaborating on how material information might be obscured in the Materiality Practice Statement, for example: inappropriate prominence or placement of information (including disclosure of a large volume of immaterial information, making material information difficult to locate); aggregating or disaggregating information in an inappropriate manner given its nature or function; or the use of unclear language, descriptions or formatting.

Question 2

The Board issued the Materiality Practice Statement in September 2017 and expects to issue a revised Conceptual Framework in the second half of 2017. If any changes are made to IFRS Standards as a result of the proposals in this Exposure Draft, the Board will make amendments to these two documents.

The Board believes that the guidance in both the Materiality Practice Statement and the forthcoming revised Conceptual Framework will not be affected by the proposed amendments in this Exposure Draft, other than to update the definition of material (see paragraphs BC22–BC24).

Do you have any comments on the proposed amendments to the Materiality Practice Statement or to the forthcoming revised Conceptual Framework?

Proposed definition for inclusion in the Conceptual Framework

We agree that the definitions of ‘material’ in the Materiality Practice Statement and the forthcoming revised Conceptual Framework should be consistent with the amended definition in IAS 1 (and IAS 8 if a duplicate definition is retained in IAS 8 as proposed in the ED).

We suggest that the proposed definition to be included in the Conceptual Framework is revised as follows:

“Information or a misstatement of information is material if it could reasonably be expected, individually or in combination with other information or misstatements, to influence the decision that the primary users of an entity’s general purpose financial report make on the basis of that financial report. Material information should not be omitted or obscured to a degree that could influence those decisions.”

The reference to “financial information about a specific reporting entity” in the definition of materiality that was recently proposed for inclusion in the revised Conceptual Framework might be interpreted such that the totality of publicly available financial information regarding a company needs to be considered when determining whether an item of information is material in the context of its general purpose financial report. This contrasts with the definition of materiality for financial statements proposed in this ED which requires only the information in the general purpose financial statements to be considered when making materiality judgements in the context of those financial statements.

This interpretation of the Conceptual Framework definition would make it impracticable to apply, and may lead to the impression that financial information is not required to be included in the financial report if it is available from other sources. We do not believe this is the IASB’s intention and therefore suggest that the phrase “financial information about a specific reporting entity” is replaced with “that financial report”. This would make the scope of the definition consistent with the scope of the definition in the Standards.

Consistency of language

In our view, it would also be helpful for the IASB to take this opportunity to make the language used to describe materiality in IAS 1, IAS 8 and elsewhere more consistent. For example, the terms ‘immaterial’ and ‘not material’ appear to be used interchangeably in IAS 1 and the Materiality Practice Statement. We suggest that the IASB either clarifies that these terms have the same meaning or uses one of the terms consistently throughout, to avoid potential misinterpretation that they imply different ‘levels’ of materiality.

Question 3

Do you have any other comments about the proposals in this Exposure Draft?

Duplication

In our view, the duplication of the definition of 'material' in IAS 1 and IAS 8 is unnecessary. We suggest that the duplicate paragraphs are removed from IAS 8 and a cross-reference provided to IAS 1 instead.