



Our Ref.: C/FRSC

Sent electronically through the IASB Website (www.ifrs.org)

26 February 2016

Mr Hans Hoogervorst
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Hans,

**IASB Exposure Draft ED/2015/8 IFRS Practice Statement:
*Application of Materiality to Financial Statements***

The Hong Kong Institute of Certified Public Accountants is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing and ethics for professional accountants, in Hong Kong. We are grateful for the opportunity to provide you with our comments on this Exposure Draft.

We support the issuance of non-mandatory guidance on materiality in the form of a Practice Statement. In general, we consider that the draft Practice Statement would provide useful guidance and practical examples for preparers to determine how to exercise judgement when assessing materiality of financial information. Therefore, we agree that the Practice Statement should be issued without waiting for the completion of the Principles of Disclosure project.

Nevertheless, we have suggested improvements in the Appendix of this letter that would clarify the proposed content and examples in the Practice Statement. In particular, adding application guidance and/or examples that illustrate how the decisions to omit immaterial information from the financial statements, and how materiality affects the extent of qualitative disclosures, would be very useful in the context of exercising judgement.

Our responses to the questions raised in this Exposure Draft are explained in more detail in the Appendix.

If you have any questions regarding the matters raised in this letter, please contact me or Eky Liu, Associate Director of the Standard Setting Department (eky@hki CPA.org.hk).

Yours sincerely,

Christina Ng
Head of Financial Reporting

Detailed comments on IASB ED/2015/8 IFRS Practice Statement: *Application of Materiality to Financial Statements*

Question 1 – Form of the guidance

- (a) Do you think that the guidance should be issued as non-mandatory guidance? Why or why not?
- (b) Do you think that a Practice Statement is the appropriate form for non-mandatory guidance on applying the concept of materiality? Why or why not? If not, what alternative(s) do you propose and why?

We support the issuance of non-mandatory guidance on the application of materiality in the form of a Practice Statement. In arriving at this conclusion, we considered and agreed with the rationale set out in paragraphs BC11–BC15 of ED/2015/8.

Question 2 – Illustrative examples

Do you find the examples helpful in the [draft] Practice Statement? Do you think any additional practical examples should be included? If so, what scenarios should the examples address?

We consider that the illustrative examples in the draft Practice Statement are helpful.

However, we suggest that the IASB provides additional practical examples in the Practice Statement to illustrate the application of materiality in the following areas:

- Most of the examples in the draft Practice Statement illustrate the decisions to include information in the financial statements based on the factors set out in the draft Practice Statement. We consider that the Practice Statement should illustrate decisions to include and to omit information from the financial statements. Examples that illustrate the decisions to omit immaterial information from the financial statements should be added to the Practice Statement so as not to over-emphasise on the need to provide disclosures.
- Paragraph 54(b) illustrates a scenario where an entity can consider aggregating some of the prior year information in the comparative reconciliation for the current year financial statements if there are only limited changes in the current year. We would like to clarify whether, on the flipside, an entity should disaggregate the comparative information that was immaterial if the amount in the current year becomes material and is separately disclosed.

As an example, paragraph 18 of IFRS 8 *Operating Segments* requires an entity to restate its comparative segment information to separately reflect a newly reportable segment. However, it is unclear whether this requirement should be generally applied to disclosures outside of IFRS 8. Therefore, we suggest that the IASB clarifies, by providing an example that illustrates whether restatement of immaterial comparative figures is necessary when the amount in the current year is material.

- The examples in paragraphs 27 and 28 of the draft Practice Statement illustrate how management should consider the qualitative aspect of the information when assessing materiality. We recommend that the IASB includes an additional example that illustrates whether an item that is immaterial in amount but material in nature should be disclosed separately, e.g. fines or penalties paid/payable as a result of breach of legislation.
- Paragraphs 59 and 60 of the draft Practice Statement only reproduce the relevant requirements about assessments of materiality in IAS 34 *Interim Financial Reporting*. It would be more useful to provide guidance and examples to illustrate how those requirements apply in practice. For example, 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.

Question 3- Content of the [draft] Practice Statement

- (a) Do you think that any additional content should be included in the Practice Statement? If so, what additional content should be included and why?**
- (b) Do you think the guidance will be understandable by, and helpful to, preparers of financial statements who have a reasonable level of business/accounting knowledge and IFRS? If not, which paragraphs/sections are unclear or unhelpful and why?**
- (c) Are there any paragraphs/sections with which you do not agree? If so, which paragraphs/sections are they and why?**
- (d) Do you think any paragraphs/sections are unnecessary? If so, which paragraphs/ sections are they and why?**
- (e) Do you think any aspects of the guidance will conflict with any legal requirements related to materiality within your jurisdiction, or a jurisdiction in which you file financial statements?**

We consider that the Practice Statement is helpful to, and understandable by, preparers of financial statements.

However, in terms of the content of the Practice Statement, we recommend the following improvements:

- Adding examples of exercising judgement when preparing qualitative disclosures

The draft Practice Statement contains guidance and examples that mainly focus on the application of materiality on quantitative disclosures. We note that in practice, there are also problems with qualitative disclosures, that is, they are either too excessive or too little. In particular, boilerplate information is often found in the following disclosures:

- i. Financial risk management objectives and policies, and the various risk analyses under IFRS 7 *Financial Instruments: Disclosures*;

- ii. Objectives, policies and processes for capital management as required by IAS 1 *Presentation of Financial Statements*; and
- iii. Significant judgements and major sources of estimation uncertainty under IAS 1.

We think that different types and sizes of entities are exposed to different levels of financial risks. Entities are expected to disclose detailed risk analyses if the risks that they are exposed to are material to the entities. For entities with low financial risks, the information disclosed is expected to be less detailed and, in some cases, may not even be necessary. Likewise, entities with foreign operations would be subject to a higher foreign currency risk than a company with only local operations, and hence those entities would disclose its foreign currency risk management and analyses in greater detail.

We therefore recommend that the IASB adds application guidance and examples that illustrate how materiality affects the extent of qualitative disclosures.

- Adding references to relevant accounting standards

References to relevant accounting standards should be added to the illustrative examples in paragraphs 54 and 55 of the Practice Statement so that readers know which accounting standards they should refer to for the disclosure requirements in the examples. For example, reference to IAS 16 *Property, Plant and Equipment* should be added in the scenario illustrated in paragraph 54(b) of the Practice Statement.

- Clarifying the proposed illustrative examples

Paragraphs 54 and 55 illustrate how materiality is assessed by reference to the current and prior year financial statements. However, the examples provided in these two paragraphs do not clearly illustrate the extent of disclosures that are considered sufficient for users of financial statements for decision-making. Therefore, we recommend that the IASB adds the following additional guidance:

- i. In paragraph 54(a), the IASB should explain what disclosures about a prior year's business combination is needed in the current year's financial statements so that sufficient information is provided for comparison and for the understanding of the current period financial statements.
- ii. In paragraph 54(b), the IASB should clarify in the example what information can be aggregated in the reconciliation. Paragraph 54(b) states that it may be appropriate to aggregate 'some of the information' that was presented separately in the prior year reconciliation of property, plant and equipment when preparing comparative information for the current period financial statements if there have been limited changes in the current period. The example does not clearly explain the meaning of 'some of the information' that can be aggregated. We think that this could lead to conflict with paragraph 73(e) of IAS 16, which specifies the items that are required in a reconciliation of property, plant and equipment.
- iii. In paragraph 55(a), the IASB should elaborate further how information about a prior year business combination might be material in the current period if it can

explain the effects of current period adjustments arising from that business combination. The IASB could provide examples to indicate the nature of additional information about prior year business combination in this case.

- Explaining the reasons for including practical expedients on internal record keeping procedures

We find it strange to include practical expedients on internal record keeping procedures for recognition and measurement assessment in paragraphs 63-66 of the draft Practice Statement. In addition, no such practical expedients are included in any of the IFRS. The IASB should explain the objective of these paragraphs more clearly in the basis for conclusions to the Practice Statement.

Question 4 – Timing of issuance

The IASB plans to issue the Practice Statement before the finalisation of its Principles of Disclosure project.

The IASB has tentatively decided to include a discussion on the definition of materiality, and whether there is a need to change or clarify that definition within IFRS, in the Discussion Paper for its Principles of Disclosure project (expected to be issued early in 2016).

The IASB does not envisage that the discussion about the definition of materiality or any other topics in its Principles of Disclosures project will significantly affect the content of the Practice Statement. Nevertheless, the IASB will consider whether any consequential amendments to the Practice Statement are necessary following the completion of the Principles of Disclosures project. Do you agree with this approach?

We support the IASB's decision to issue the Practice Statement before the finalisation of its Principles of Disclosure (PoD) project as the project is in its infancy and the IASB only aims to issue the PoD discussion paper in the first half of 2016. We think that waiting for the completion of the PoD project will unduly delay the provision of useful guidance.

Nevertheless, we recommend that the IASB closely monitors the results of the PoD project and other ongoing projects, such as the Conceptual Framework, and updates the Practice Statement on a timely basis.

~ End ~