

22 February 2016

Mr Hans Hoogervorst
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30 Cannon Street
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Submitted electronically to: go.ifrs.org/comment

Dear Hans

ED/2015/8 IFRS Practice Statement *Application of Materiality to Financial Statements*

Thank you for the opportunity to comment on ED/2015/8 IFRS Practice Statement *Application of Materiality to Financial Statements* (Practice Statement). The draft Practice Statement has been exposed in New Zealand and some New Zealand constituents may have made comments directly to you.

We commend the IASB for attempting to change the behaviour of management by addressing the topic of Materiality through a Practice Statement.

We agree that the Practice Statement is the most appropriate form of non-mandatory guidance, and believe that it should be issued as soon as possible. We suggest that the objective of the Practice Statement should be extended to include preparers and auditors.

Our recommendations and responses to the specific questions for respondents are provided in the Appendix to this letter. If you have any queries or require clarification of any matters in this letter, please contact Judith Pinny (judith.pinny@xrb.govt.nz) or me.

Yours sincerely

Kimberley Crook
Chair – New Zealand Accounting Standards Board

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Appendix

Question 1 – Form of the Guidance

A Practice Statement is not a Standard. The IASB's reasoning for issuing guidance on applying the concept of materiality in the financial statements in the form of a non-mandatory Practice Statement is set out in paragraphs BC10–BC15.

- (a) Do you think that the guidance should be issued as non-mandatory guidance on applying the concept of materiality? 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?

- (a) In our view, it is appropriate that the IASB guidance on materiality is issued as non-mandatory guidance. Materiality is a pervasive concept throughout IFRS and one that requires the application of judgement. Non-mandatory guidance provides help without complicating the situation by adding a layer of prescription. In addition, if the guidance is non-mandatory, it does not run the risk of causing conflicts with legal frameworks in countries that have adopted IFRS.
- (b) We agree that a Practice Statement is the most appropriate form of non-mandatory guidance. Other forms of non-mandatory guidance, such as implementation guidance, illustrative examples, and Bases for Conclusions, are all part of individual standards, which does not work well for materiality, given its pervasiveness. Further, the Conceptual Framework, as an overarching principles document, does not seem to be the right place to include guidance on materiality that is likely to be widely used in practice.

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? Please be as specific as possible and explain why those example(s) would be helpful to entities.

In our view, the illustrative examples throughout the Practice Statement are helpful. We have identified one area in the Practice Statement where some further work on examples could help improve the Statement. Paragraphs 25 and 26 discuss quantitative thresholds for materiality. Determining quantitative thresholds and their use for preliminary assessments about materiality can be difficult in practice. Therefore, any examples that would help preparers of financial statements with the judgements required in this area would be welcome.

We also suggest inclusion of an example of when a type of revenue is presented as a separate line item, and 75% of this is from one customer, so it may be appropriate to also disclose this.

Question 3 – Content of the [draft] Practice Statement

The [draft] Practice Statement proposes guidance in three main areas:

- (a) characteristics of materiality;
- (b) how to apply the concept of materiality in practice when presenting and disclosing information in the financial statements; and
- (c) how to assess whether omissions and misstatements of information are material to the financial statements.

It also contains a short section on applying materiality when applying recognition and measurement requirements.

Please comment on the following and provide any suggestions you have for improving 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?

- (a) In our view, no additional content needs to be included in the Practice Statement. However, when we compared the Practice Statement with the NZASB's publication *Explanatory Guide Materiality for Public Benefit Entities (PBEs)*, we noted that the guidance for PBEs included:
 - a list of references to the PBE Standards where the term materiality is used;
 - a summary that reinforced the key messages on materiality; and
 - a Table of Contents.

We think that each of these are helpful additions to the guidance for PBEs, and that the IASB could consider including something similar in the Practice Statement.

- (b) We believe that the Practice Statement is written at an appropriate level.

We suggest that paragraph 1 of the Practice Statement be amended from "assist management" to "assist preparers, management and auditors". We also suggest that paragraph 2 of the Practice Statement include users in its scope.

- (c) We consider that the section on Recognition and Measurement should be developed and given more emphasis. We note that Recognition and Measurement has not been included in the Introduction and suggest that it be added both there and in the summary that we have

proposed. In paragraph 27(a) we suggest that the word “inadequate(ly)” be removed from the first and second sentence in this paragraph as it introduces negativity, and does not accomplish much by its inclusion.

In BC 19 we note that auditors also use audit materiality for planning. However, in the final assessment at the end of an audit, auditors and preparers apply materiality in the same way. Although auditors and preparers may have different judgements prior to this, they are applying the same concept of materiality.

- (d) We are not aware of any New Zealand legal requirements that would conflict with the guidance.

Question 4 – Timing

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). Nevertheless, the IASB thinks that to address the need for guidance on the application of materiality, it is useful to develop the Practice Statement now.

The IASB does not envisage that the discussion about the definition of materiality or any other topics in its Principles of Disclosure 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 Disclosure project. Do you agree with this approach?

We agree with the IASB; the Practice Statement should be issued as quickly as possible.

Question 5 – Any other comments

Do you have any other comments on the [draft] Practice Statement? As mentioned in Question 4, a discussion about the definition of materiality will be included in the Discussion Paper in the Principles of Disclosure project, so the IASB is not asking for comments on the definition at this time.

We note a typo in BC 7, line 1 where “that” is written twice.

We have no other comments.