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Mr Hans Hoogervorst
International Accounting Standards Board
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Our ref RD/288

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Dear Mr Hoogervorst

Comment Letter on Exposure Draft ED/2017/6 *Definition of Material (Proposed amendments to IAS 1 and IAS 8)*

We appreciate the opportunity to comment on the International Accounting Standards Board's (the Board) Exposure Draft *Definition of Material (Proposed amendments to IAS 1 and IAS 8)* (ED). We have consulted with, and this letter represents the views of, the KPMG network.

We recognise that 'materiality' is one of the critical concepts underlying the preparation of financial statements (as well as the conduct of an audit). It is pervasive by its nature as it applies to recognition, measurement, presentation and disclosure.

We understand the Board's motivations for seeking to clarify the definition of *material*, as the need for consistent application of the concept of materiality when preparing financial statements is of importance to both preparers and auditors.

Overall, we support the Board's intention to align the definition of *material* in IFRS standards with the Conceptual Framework for Financial Reporting. We consider certain aspects of the proposed definition of *material* helpful. In particular, we support describing the threshold as "could reasonably be expected to influence" since it puts emphasis on judgement required in making materiality decisions. We also welcome the introduction of the reference to the 'primary users' as it clarifies who entities are communicating with and whose needs are to be considered in assessing when information is material.

We believe that currently the main practical challenge in applying materiality judgements relates to presentation and disclosure in the financial statements. Therefore, addressing the application of materiality in the context of presentation and disclosure is a crucial aspect in facilitating better communication in financial statements with a focus on providing more relevant and less irrelevant information.

However, we believe that to effectively apply the definition of *material* when making materiality judgements (in particular, judgements related to presentation and disclosure), preparers would benefit from a clearer framework for determining what information is **relevant** to the primary users of financial statements. We believe that having such framework is important if the Board is to significantly affect the behavioural aspects summarised in BC1-BC4 to the ED. In the absence of an IFRS principle-based disclosure framework with clearly defined disclosure objectives – i.e. *what* information is considered relevant and *why* it should be disclosed[1], we believe that any changes to the definition of *material* will likely have little, if any, impact.

As several key projects under the better communication agenda are still ongoing[2], we believe that changes to the definition of *material* would be better timed to coincide with the other actions we describe below.

In terms of the specific proposals, we are concerned that some aspects of the proposed amendments may be difficult to operationalise and could result in unintended consequences instead of improved understanding and application (see our response to question 1).

Our recommendation

In light of the above, we would encourage the Board to defer any refinements to the definition of *material* to allow the Board to:

- consider materiality more holistically in the context of the better communication agenda, as the Board makes sufficient progress on the Principles of Disclosure project and other related projects; and
- liaise with other stakeholders to coordinate the required steps to facilitate a behavioural change.

In our view, a behavioural change is more likely to occur if the various stakeholders took a collaborative effort to tackle the issue of better communication through the following actions.

- Accounting standard setters (IASB) – to establish clear disclosure principles framework and provide enhanced application guidance and educational material (e.g. expanding the examples in the recently published Materiality Practice Statement and clarifying what "obscuring" means);

[1] In our comment letter on the Principles of Disclosure discussion paper, we asked the Board to reassess *what* information is relevant and *why* it is relevant.
[2] Such projects include "Principles of Disclosure", "Primary Financial Statements" and the revised "Conceptual Framework".

— Regulators – to provide additional guidance to reassure preparers in making materiality judgements;

— Auditing standard setters (IAASB) – to revisit or clarify the application of materiality in an audit of financial statements in light of developments in IFRSs;

— Those charged with governance in the reporting entities – to challenge management over the lack of application of materiality judgments in the preparation and presentation of the financial statements; and

— Auditors – to reinforce the importance of entity-specific and relevant disclosures and to continue encouraging judgements instead of a “checklist mentality” – e.g. by referring to the recently issued Practice Statement and providing guidance on how to use their tools such as disclosure checklists and illustrative disclosures.

The Appendix to this letter contains our detailed responses to the questions on the proposals.

Please contact Reinhard Dotzlaw or David Littleford at +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix

This appendix contains our detailed responses to the proposals.

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?

As mentioned in our cover letter, we would encourage the Board to defer any refinements to the definition of *material* and instead coordinate any changes with the other actions that we consider essential to achieving the desired improvements.

If the Board nevertheless decides to proceed with the amendments to the definition of *material* in IAS 1 and IAS 8 (while aligning the definition in the forthcoming revised Conceptual Framework accordingly), we recommend that the Board consider the following issues which, in our view, make the proposed amendments difficult to operationalise and may have unintended consequences:

1. The proposed definition introduces the term ‘obscuring’. While the concept of obscuring financial information already exists in IAS 1, IFRSs neither define the term nor provide sufficient guidance on how this concept is to be applied (there is also a lack of examples in the recently published Practice Statement). Furthermore, the proposed definition refers to ‘obscuring’ by using terms that are vague, such as “not communicated clearly”.

   For example, it is not clear if either of the following would constitute “obscuring”:

   — disclosing multiple claims but the one with the maximum exposure is presented at the end;

   — providing a long description of all outstanding claims against the entity, regardless of whether they are material or immaterial.

Considering that IFRSs do not prohibit presentation of immaterial information and there is a lack of application guidance around the concept of obscuring, we believe that including the term in the definition would be difficult to consistently operationalise – for both preparers and auditors. Therefore, we recommend that the term is removed from the definition until it is further clarified.

2. Under the proposed definition of *material information*, what makes information material is the fact that omitting, misstating or obscuring it could reasonably be expected to influence decisions of the primary users. We welcome the new term, which may assist preparers in making judgements related to presentation and disclosure of financial information, subject to our concerns as noted below. However, we also believe that a definition of *material misstatement* remains essential.

   Defining *material information* is a change in approach from the existing standard, which defines material misstatements or omissions. This change in approach may be operational for *omissions* because the assessment is binary and does not involve a qualitative assessment – i.e. the information is either omitted or it is included. It may also be operational for *obscuring* for similar reasons – i.e. information is obscured or is not obscured, though we note that there is a degree of judgement that requires further elaboration (see point 1 above).

   However, we believe that the new approach is not operational for misstatements because amounts may be misstated by an immaterial amount or may be misstated by a material amount. For example, the fact that an amount (e.g. a contingent liability) could be misstated by a material amount does not make the information material to begin with (e.g. if the contingent liability had not been material if not misstated). Indeed, most information could be misstated to an extent that could reasonably be expected to influence decision of primary users.

   In addition, this change may also confuse auditors who plan and perform the audit to evaluate whether the financial statements are free from material misstatements.

   Accordingly, we recommend that the Board consider defining separately what are 'material information', 'misstatement'[3] and 'material misstatement'. The Board should avoid defining "material information" through the manner in which the information is misstated.

[3] The definition of 'misstatement' in International Standard on Auditing 450 *Evaluation of Misstatements Identified during the Audit* may be a useful starting point.

3. The proposed definition makes a reference to primary users, which we find helpful. However, we recommend that the drafting is clarified, consistent with the recently issued Practice Statement (paragraphs 21-23), so that in making materiality judgements the entity needs to consider the common information needs of its primary users rather than the unique information needs of specific users.

4. The proposed definition introduces a new term 'magnitude of information' that may add to confusion as another term used to describe attributes of material information.

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*?

We agree that the standards and the Conceptual Framework should be aligned.

We do not believe that IFRSs or the Materiality Practice Statement include sufficient guidance to apply the concept of 'obscuring' financial information. Therefore, if the Board decides to include the concept of obscuring in the definition of *material*, amendments should be made to the Materiality Practice Statement to illustrate how this concept is to be applied in practice.

Question 3
Do you have any other comments about the proposals in this Exposure Draft?

We have no further comments.