February 10th, 2016

International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom

Dear IASB members,

Exposure Draft – IFRS Practice Statement – Application of Materiality to Financial Reporting

The Israel Accounting Standards Board welcomes the opportunity to comment on the IASB's Exposure Draft *IFRS Practice Statement – Application of Materiality to Financial Reporting* published in October 2015.

We support the IASB's objective to undertake a project to improve the disclosures in financial reporting, that includes the publication of a document regarding materiality.

The process of preparation of financial statements includes recognition, measurement, presentation and disclosure. Application of materiality is required through all the stages of preparation of financial statements. Therefore, we believe that a publication regarding the application of materiality to financial reporting should be comprehensive and should relate to the application of materiality in recognition and measurement in equal prominence as to its application in disclosure and presentation.

Please find below our detailed comments for the questions raised in the ED:

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? 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?

This document is issued by the IASB as part of a project to improve the disclosures in the financial statements and to reduce the information overload in the financial statements of entities. In order for this document to make a change in the way management filters information for its financial reporting, the publication regarding the application of materiality should be mandatory. However, in our opinion it should be phrased as a formal accounting standard and should be comprehensive, ie it should include guidelines relating to all elements of preparation of financial statements – recognition, measurement, disclosure and presentation.

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 these example(s) would be helpful to entities.

We believe that examples are important to illustrate the application of the concept of materiality. However, in our opinion some examples included in the Practice Statement, for example paragraph 53(a), are too straight-forward and do not illustrate the complexity of materiality, ie scenarios where there are some factors that support separate disclosure while other factors do not support separate disclosure. Other examples included in the Practice Statement, such as the examples in paragraph 28, contribute to the application of the concept of materiality.

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) Additional content:

Paragraph 26 states that "However, while quantitative thresholds are not in themselves determinative, they can be a helpful tool in applying the concept of materiality. A quantitative threshold may provide the basis for a preliminary assessment that an amount is likely to be material or immaterial; for example if it is below a specified percentage of profit or net assets. However, a materiality assessment also requires consideration of the nature of the item and the entity's circumstances." We believe that additional examples could be useful. One possible example is an entity that its business is investment properties and therefore should determine the quantitative threshold of its total assets or equity rather than its profit since these are the most representative components of the entity. Another example could be a retailer that should determine the quantitative component of its revenue rather than its profit since it better reflects its business volume.

(c) Paragraphs we do not agree with:

(i) **Objective (paragraph 1)** - Paragraph 1 states that the objective of the Practice Statement is to assist management in preparing financial statements. In our opinion, the Practice Statement need not emphasise that its objective is to assist **only** management since all the International Financial Reporting Standards are for preparers of financial statements. Furthermore, paragraph BC18 acknowledges that auditors may use similar principles as management does when making judgments in applying the concept of materiality. Therefore, we believe that paragraph 1 should be redrafted as follows: "The objective of this [draft] IFRS Practice Statement Application of Materiality to Financial Statements (the '[draft] Practice Statement') is to assist ~~management~~ in applying the concept of materiality to general purpose financial statements prepared in accordance with International Financial Reporting Standards (IFRS)." We agree with the statement in paragraph BC20 that the Practice Statement does not directly cover materiality considerations made by auditors <u>for any other purposes</u> and that statement should remain in the BC.

(ii) **Scope (paragraphs 2-3) and Recognition and measurement (paragraphs 61-66) –** According to paragraph 2, the Practice Statement is intended to be applied in preparing general purpose financial statements in accordance with IFRS. Preparation of financial statements includes application of both recognition and measurement requirements and disclosure and presentation requirements. Although the Practice Statement acknowledges that the concept of materiality is also applied in measurement and recognition, it only addresses it generally (paragraphs 61-62), while it addresses presentation and disclosure in a much detailed manner. As stated in the introduction to this letter, our opinion is that the Practice Statement should include equal prominence sections of measurement and recognition and disclosure and presentation. The section of measurement and recognition should include guidelines for the application of materiality in measurement and recognition, for example, how an entity can determine if the application of a Standard to a specific transaction is material or not.

(iii) **Immaterial information (paragraphs 34-36)** - Paragraph 35 states that "IFRS does not prohibit entities from disclosing immaterial information. Nevertheless, it requires them to consider whether disclosure of immaterial information results in material information being obscured" and paragraph 34 states that "Providing immaterial information in the financial statements may obscure material information and consequently mean that the financial statements are less understandable." In our opinion, it is important that the IASB will state clearly that an entity shall not disclose immaterial information whenever it results in material information being obscured.

(iv) **Aggregating and disaggregating information (paragraphs 37-39) and primary financial statements versus the notes (paragraphs 40-45, 47-48)** - These paragraphs provide notable guidelines for the presentation of financial statements. In our opinion, these guidelines form an integral part of IAS 1 or of the *Conceptual Framework for Financial Reportin*g (paragraph 41), and should be included in these documents rather than in the Practice Statement. We believe that paragraph 46 is the only paragraph that should remain in the Practice Statement.

(v) **Reviewing note disclosures at each reporting date (paragraphs 54-55)** - These paragraphs indeed provide notable guidelines for the presentation of financial statements that relate to comparative information. In our opinion, these guidelines form an integral part of IAS 1, and therefore should be included in IAS 1 rather than in the Practice Statement.

(vi) **Complete set of financial statements (paragraphs 57-58) –** In our opinion, the drafting of the last sentence in paragraph 57 could lead to a misunderstanding. Paragraph 31 of IAS 1 (quoted in paragraph 49 of the Practice Statement) states that "… an entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance." The last sentence in paragraph 57 states that "Nevertheless, public availability of information does not relieve the entity of the obligation to disclose information that is specifically required by IFRS in the financial statements if that information is material." We believe that the word "specifically" should be omitted in order to ensure that public availability of information does not relieve the entity of the obligation to disclose any information required by IFRS (by a specific disclosure requirement or by a general disclosure requirement). If the IASB accepts this omission, the word "specifically" should also be omitted from the last sentence in paragraph 58.

(vii) **Interim reporting (paragraph 60) –** In our opinion, paragraphs 23 and 25 of IAS 34 are important to the application of materiality in interim financial reporting. Yet, we believe that a reference to these paragraphs would be sufficient and it is unnecessary to quote them.

(viii) **Practical expedients (paragraphs 63-66)** - In our opinion, the section of practical expedients does not include substantive expedients in the application of recognition and measurement requirements, but relates to the way bookkeeping is conducted. Therefore, we believe that paragraphs 63-66 should not be included.

(ix) Paragraph 69 – The drafting of the first sentence in paragraph 69 is unclear. It states "In assessing whether misstatements are material, management should take into account how precisely transactions can be measured." We agree that management should consider the precision of measurement of transactions. Yet, this sentence might imply that this is the only factor management should consider in assessing materiality. In our opinion, a better drafting could be "In assessing whether misstatements are material, management should take into account, among other factors and circumstances, how precisely transactions can be measured."

(x) Paragraph 77 – We are aware that this comment is actually to paragraph 41 of IAS 8 but since it was quoted in the Practice Statement, we decided to include it. Paragraph 41 of IAS 8 states that "…Financial statements do not comply with IFRSs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows…". We believe that errors made intentionally to achieve a particular presentation are **qualitatively material**, even if they are **quantitatively immaterial**. In our opinion, the Board should redraft paragraph 41 of IAS 8 to make this clear.

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?

In our opinion, since all of the Practice Statement is based on the definition of materiality, it is recommended that the IASB first finalises the discussion on the definition of materiality in its Principles of Disclosure project. We believe that any change to the definition of materiality would lead to more than minor changes to the Practice Statement and it is not advisable to amend any document issued by the IASB shortly after its issuance. However, if the IASB expects finalisation of the Principles of Disclosure project only in a few years, we believe that there is no justification to postpone the publication of the Practice Statement.

We appreciate the opportunity to provide our comments.

Sincerely,

Dov Sapir, CPA, Chairman

Israel Accounting Standards Board