CFA Society United Kingdom

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IASB
30 Cannon Street
London
EC4M 6XH

commentletters@ifrs.org

**Response to the IASB consultation on Exposure Draft ED/2015/8: Application of Materiality to Financial Statements**

The CFA Society of the UK (CFA UK) represents about 11,000 investment professionals working across the financial sector including asset managers, buy-side analysts, sell-side analysts and credit rating analysts, among others. For advocacy purposes in the field of financial reporting, these members are represented by the Financial Reporting and Analysis Committee (FRAC). The FRAC welcomes the opportunity to respond to the IASB's consultation on the application of materiality to financial statements.

The FRAC supports the IASB initiative to present additional guidance on the definition of materiality and endorses the IASB's approach to doing so. The proposed guidance puts the onus on management to use its judgement in determining the relevant elements to present and the best way to present them. The Committee believes that this approach is preferable to that of the FASB, which only considers information that changes the overall mix of information to be material. We believe this latter approach risks leading to a sharp decline in disclosure, whereas the proposed IASB approach could ideally lead to financial statements becoming clearer and more comprehensive.

We welcome the framing of the guidance by a consideration of the primary users of financial statements and their information needs. This is the right context for decisions about materiality, and we believe that the discussion is appropriate and helpful. We aspire to a preparer (and auditor) understanding of materiality that does not necessarily lead to more, nor to less, disclosure, but to better disclosure – disclosure that delivers a clearer understanding of the underlying performance drivers of the reporting company.

More specifically, we would also like to comment on three of the questions posed in the Exposure Draft:

**Question 1** - *Should the guidance be issued as non-mandatory guidance?*

Yes, the FRAC believes it should be issued as non-mandatory guidance. On balance, this appears to be a better approach than a more prescriptive one, which risks leading to a more box-ticking type of exercise. We support the philosophy underpinning the draft, which requires genuine thought from preparers about the users of their financial statements. It also reasonably implies that managers and boards are best positioned to make decisions about materiality, and have a responsibility to do so. Furthermore, we agree that such an approach results in the reinforcement of the notion of materiality being pervasive across all aspects of the financial statements.

**Question 3a)** - *Should additional content be included in the Practice Statement?*

The Committee agrees with the spirit of the IASB proposal that a purely quantitative materiality threshold would not be the most productive approach, and favours management having to use its judgement about the relevance of the information to be presented. Nonetheless, there is a view that, in some cases, a quantitative guideline could be useful in prompting additional disclosures on aspects of the financial statements that are of particular interest to investors. Below are some such instances that we would like to highlight:

- Whilst financial statements are not primarily directed at regulating bodies, the influence of the latter can have a significant impact on the value of firms. With increased regulatory oversight in the financial sector for example, investors would benefit from preparers giving particular consideration to the materiality of the different regulatory requirements, ratios and covenants that can significantly affect the way the firm conducts its business. More specific materiality triggers for items mentioned in paragraph 28a could thus be useful in leading preparers towards more precise and thorough disclosures of these items;

- Disclosure of additional information relating to cash-generating units, as well as to stakes in other firms, would shed light on an area that many investors feel often suffers from too little disaggregation. Suggesting a relatively low threshold for more detailed disclosure of these elements would often help assessment of the individual issues and prospects of each entity, which would be of particular relevance for companies with a high number of such units;

- We appreciate the stated advantages of clear primary financial statements. We would, however, suggest that more defined materiality guidance could be useful in making turnover-related Notes include more information pertinent to investors' decisions. This guidance could be defined as a specific level of turnover reliance on certain geographies or product lines, and represent an illustration of the point made in paragraph 47. Similar thinking might be applied to the disaggregation of costs;

- Investors would benefit from particular attention being given to some aspects that prima facie might not appear so important in financial terms, but have nonetheless become increasingly relevant to a wide range of users of financial statements, such as executive pay, post-employment benefits and share-based incentives. Paragraph 53 specifically refers to these particular elements, but a more precise materiality definition in this area could lead to a valuable higher level of disclosure.

More generally, it would, in our view, be interesting to have a statement to the effect that investors are not looking for formulaic disclosure, but instead for financial reports that best reflect all the relevant financial information about the company. Investors also value clear structure above any prescribed length or content, and find useful the de-cluttering of

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financial statements through giving less prominence to information less relevant to investment decisions. For example, the description of 'accounting policies used' might be one boilerplate disclosure that could be added as an illustration to the point made in paragraph 35 about elements to be usually excluded from notes to the financial statements, unless there are specific items of relevance.

**Question 3b)** – *Is the guidance helpful to preparers of financial statements?*

The FRAC believes that the guidance, together with the current materiality definition, will be useful in making managers and boards think about the needs of users when putting together financial statements. In order to help them further in making specific decisions about materiality of any individual element, we would suggest that a useful test could be to think about a situation where unpublished information was divulged in a non-public setting (perhaps as a result of requests from individual analysts or investors) and whether this could potentially be interpreted as being in breach of selective disclosure or inside information rules. If this were the case, then this information might be considered as having passed the threshold of materiality. In a similar way, considering whether information is of such importance that it needs to be known and understood by the non-executive directors of the company would offer an important indication of its materiality.

Yours sincerely,

Marietta Miemietz
Co-chair, Financial Reporting and Analysis Committee
CFA Society of the UK

Paul Lee
Co-chair, Financial Reporting and Analysis Committee
CFA Society of the UK

CFA Society United Kingdom

Will Goodhart,
Chief Executive
CFA Society of the UK

About CFA UK and CFA Institute

The CFA Society of the UK (CFA UK) represents the interests of more than 10,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

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