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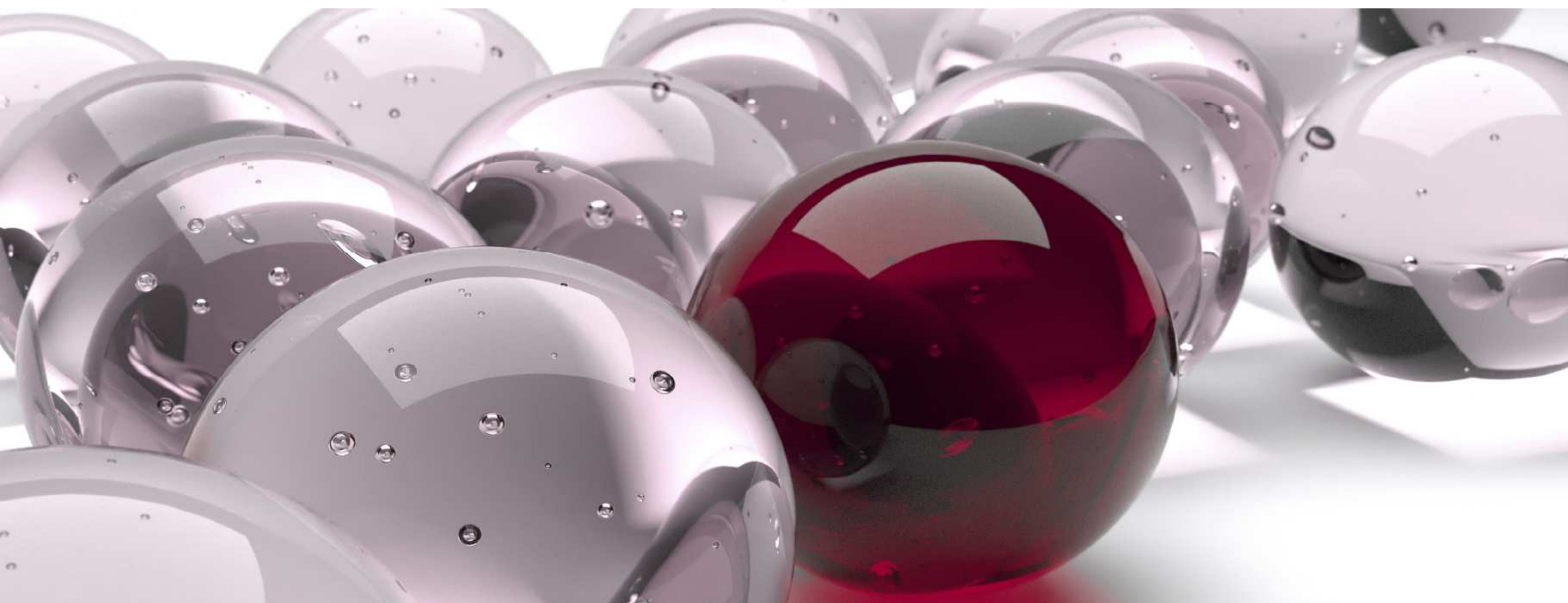

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Editorial

As this issue goes to press, the IASB has just published the final version of the IFRS 16 – *Leases* standard. Originally scheduled for publication in time for Christmas, it turned out to be more of a New Year's gift. Now it is finally here, issuers need to start preparing to recognise operating leases in the balance sheet from 2019 onwards.

The implementation timetable for the new standard will thus coincide with that for IFRS 15. The IASB is currently finalising the proposed amendments for the latter standard, and in this issue we present the Board's decisions and the likely changes from the July 2015 exposure draft.

The Beyond the GAAP editorial team wishes you all the best for 2016, which looks set to be a busy year!

Enjoy your reading!

Michel Barbet-Massin Edouard Fossat

IFRS Highlights

IASB consults on limiting consequences of different effective dates of IFRS 9 and new IFRS 4

As forecast in our September 2015 issue, the IASB has published proposals for two alternative approaches to limit the consequences of the different effective dates of IFRS 9 – *Financial Instruments* and the future IFRS 4 – *Insurance Contracts.*

The Board's proposals were published on 9 December 2015, and readers will remember that the two alternatives are as follows:

- The "overlay" approach, which would only be applicable to financial assets measured at amortised cost under IAS 39 and at fair value through profit or loss under IFRS 9; or
- The "deferral" approach, which would involve deferring application of IFRS 9 and would be applicable to all financial instruments.

The exposure draft proposes that the deferral approach would only be permissible over the period from the effective date of IFRS 9 (i.e. periods commencing on or after 1 January 2018) to year-end 2020 at the latest. The new standard on insurance contracts is scheduled to come into effect on 31 December 2020, if it is finalised in 2016 as expected. If not, entities which select this option should in any case apply IFRS 9 from 1 January 2021 at the latest.

The comment period for these proposals is open until 8 February 2016 at the latest. The tight deadline is due to the European Union's need for clarity on the issue in the context of adoption of IFRS 9 (see 'European Highlights', below).

The exposure draft is available from the following link: http://www.ifrs.org/Open-to-Comment/Pages/International-Accounting-Standards-Board-Open-to-Comment.aspx

Effective date of amendments to IFRS 10 and IAS 28 postponed indefinitely

On 17 December 2015, the IASB published amendments to the effective date of amendments to IFRS 10 – *Consolidated Financial Statements* and IAS 28 – *Investments in Associates and Joint Ventures,* which addressed the sale or contribution of assets between an investor and an associate or joint venture (for more details, see the study featured in Beyond the GAAP no. 81). The Board decided to defer the amendments pending the findings of its research project on the equity method.

Third meeting of ITG dealing with impairment issues under IFRS 9

The third meeting of the IFRS Transition Resource Group for Impairment of Financial Instruments (ITG) took place on 11 December 2015. This group aims to provide support for issues relating to the implementation of the new IFRS 9 impairment model.

The following topics were discussed:

- Incorporation of forward-looking scenarios such as macroeconomic forecasts when determining "significant increases in credit risk" on financial instruments and when measuring expected credit losses;
- The scope of paragraph 5.5.20 of IFRS 9, which addresses the maximum period to consider when measuring expected credit losses on certain types of instrument such as revolving credit facilities (i.e. should the contractual period or a longer period be taken into account?);
- Measurement expected credit losses for charge cards and similar credit facilities with no stated absolute credit limit;
- Measurement of expected losses for revolving credit facilities;
- Inclusion of collateral and other credit enhancements in the measurement of expected credit losses;
- Inclusion of cash inflows expected from the sale on default of a loan (sale of the asset to a third party) in the measurement of expected credit losses;
- Meaning of "current" effective interest rate (which is the discount rate to be used when measuring expected credit losses for floating-rate financial assets?);
- Assessment of "significant increases" in credit risk for financial instruments with a maturity of less than twelve months ;
- Measurement of the loss allowance for credit-impaired financial assets;
- Presentation of the loss allowance for financial assets measured at amortised cost.

The Agenda Papers on these various issues prepared by the staff of the IASB are available on the IASB's website via the following link: http://www.ifrs.org/Meetings/Pages/ITG-meeting-December-2015.aspx.

The meeting on 11 December was the last of the three meetings planned at the outset. All the issues submitted during 2015 have been debated. No further meetings are scheduled currently. However, the ITG is still in existence and may meet again if required in the future.

Preparers of financial statements may continue to submit implementation issues following the process outlined here: http://www.ifrs.org/About-us/IASB/Advisory-bodies/ITG-Impairment-Financial-Instrument/Pages/Submit-an-issue.aspx

TRG meeting held in November; outlook uncertain for 2016!

On 9 November, the TRG met for the sixth time since its creation to discuss the following issues:

- Options for additional goods and services: in situations where the option is not a separate performance obligation (i.e. when the option does not give the customer a material incentive to acquire additional goods or services), should these additional goods or services be:
  - recognised as a separate contract when the option is exercised? or
  - taken into account from the outset, meaning that the total contract price is treated as variable consideration?
- Pre-production activities (e.g. engineering or design costs incurred prior to production of a complex asset): some stakeholders have raised questions about the accounting treatment of pre-production costs, as IFRS 15 supersedes previous guidance on contract costs set out in IAS 11.

  The key challenge relates to distinguishing these costs from costs incurred in fulfilling a contract: an entity must be able to identify a specific performance obligation relating to pre-production activities in order to recognise these costs. In other words, the question is whether or not the activities transfer a distinct good or service to the customer.
- Licences: questions have been raised about renewal of licences and contractual restrictions:
  - for licences that provide the customer with the right to use the entity's intellectual property over a certain period (for which revenue is recognised at a point in time), should revenue from a renewal of the licence be recognised at the start of the renewal period or when the intellectual property is actually made available to the customer (i.e. potentially before the beginning of the renewal period)?
  - if there are restrictions on the customer's right to use intellectual property, stipulated in a contract that runs over several years, what are the accounting consequences of a subsequent change in these restrictions that gives the customer more leeway in its use of the licence?

Beyond the GAAP will publish an overview of the discussions as soon as the official staff summary of the meeting is available.

There is also some uncertainty over the future of the TRG, as no date has been set for the next meeting. The IASB and FASB have differing opinions as to whether the TRG should be discontinued or whether it should remain in existence for as long as stakeholders are raising implementation issues. The IASB did not comment on this subject at the December meeting, so for the moment we will just have to wait and see.

European Highlights

EFRAG criticises IASB proposals on interaction between IFRS 9 and the future IFRS 4

On 4 December 2015, following a very short public consultation, EFRAG sent a letter to the European Commission expressing reservations about the IASB's two proposed alternatives for limiting the consequences of the non-alignment of the effective dates of IFRS 9 – *Financial Instruments* and the future IFRS 4 – *Insurance Contracts.* The letter was published ahead of the IASB's publication of its exposure draft (see 'IFRS Highlights', above).

The letter follows EFRAG's endorsement of IFRS 9, although the endorsement advice did suggest that an exception should be made for insurance companies, which should be permitted to defer application.

EFRAG begins by analysing the advantages and disadvantages of the two proposed alternatives, based on the IASB's discussions and summaries of its decisions. It then presents an analysis of which entities would be permitted to apply these options, notably the deferral approach. This analysis suggests that few of the large European entities commonly considered to be 'insurers' would be eligible. EFRAG notes this problem and states that it is currently unable to change its endorsement advice to the European Commission.

EFRAG will need to run its usual due process of public consultation on a draft comment letter, following publication of the IASB's exposure draft on 9 December 2015.

EFRAG's letter to the European Commission can be accessed at the following link:
http://www.efrag.org/Front/n1-1606/Further-information-related-to-the-endorsement-of-IFRS-9.aspx

Two changes in leadership of EFRAG TEG

On 21 December 2015, EFRAG announced the new membership of its Technical Expert Group (TEG) from 1 April 2016.

Françoise Florès, the current TEG chair and EFRAG CEO, will be succeeded by Andrew Watchman, currently Global IFRS Leader at Grant Thornton. His mandate runs for three years. His vice-chair will be Nicklas Grip, who has been a member of the TEG since 2010. Mr Grip succeeds Mike Ashley and will be in post for a two-year term.

The 16-strong TEG will include three French members for a two-year term from 1 April 2016. Christian Chiarasini has been reappointed, while Nicolas de Paillerets rejoins after having previously been a member between 2010 and 2014. Cédric Tonnerre, Technical Director of the French standard-setter (ANC), serves as country liaison.

The full membership of the TEG is as follows:

- Andrew Watchman, auditor, UK – chair and CEO
- Nicklas Grip, banking and financial instruments specialist, Sweden – vice-chair
- Phil Aspin, industry, UK
- Christian Chiarasini, auditor, France
- Geert Ewalts, insurance specialist, Netherlands
- Günther Gebhardt, academic, Germany
- Heinz Hense, industry, Germany
- Søren Kok Olsen, auditor, Denmark
- Nicolas de Paillerets, industry, France
- Serge Pattyn, analyst, Belgium
- Andrew Spooner, auditor, UK
- Ambrogio Virgilio, auditor, Italy

Country liaison:

- Anthony Appleton, Technical Director, Financial Reporting Council (FRC), UK
- Tommaso Fabi, Technical Director, Organismo Italiano di Contabilità (OIC), Italy
- Sven Morich, Technical Director, Accounting Standards Committee of Germany (ASCG), Germany
- Cédric Tonnerre, Technical Director, Autorité des normes comptables (ANC), France

The two EFRAG press releases are available via the following links:

- Appointment of TEG chair: http://www.efrag.org/Front/n2-1618/NEW-EFRAG-TEG-CHAIRMAN-AND-CEO-IN-2016.aspx
- Other TEG members http://www.efrag.org/Front/n1-1623/EFRAG-TEG-ROTATION-2016--appointments-and-reappointments.aspx

Adoption of *Disclosure Initiative* amendments to IAS 1

On 15 December 2015, the European Commission adopted the amendments to IAS 1 – *Presentation of Financial Statements* entitled *Disclosure Initiative.* These amendments were published by the IASB on 18 December 2014. The amendments aim to improve the effectiveness of disclosure and encourage entities to use professional judgement when deciding what information to disclose in their financial statements when applying IAS 1 (for more details, see Beyond the GAAP no. 84).

Commission Regulation (EU) 2015/2406, which was published in the Official Journal of the European Union on 19 December 2015, stipulates that the mandatory effective date for these amendments shall be no later than the commencement date of the first financial year starting on or after 1 January 2016.

The regulation is available here:
http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2015.333.01.0097.01.ENG&toc=OJ:L:2015:333:TOC

Adoption of Annual Improvements to IFRS 2012-2014 Cycle

On 15 December 2015, the European Commission adopted the amendments arising from the 2012-2014 cycle of annual improvements to IFRS, which were published by the IASB on 25 September 2014.

Readers will remember that these amendments address the following standards and topics:

- IFRS 5 – *Non-Current Assets Held for Sale and Discontinued Operations*: changes to a sale plan or distribution plan;
- IFRS 7 – *Financial Instruments: Disclosures*:
  - continuing involvement and servicing contracts;
  - offsetting financial assets and financial liabilities in the interim financial statements;
- IAS 19 – *Employee Benefits*: clarification on determining the discount rate;
- IAS 34 – *Interim Financial Reporting*: disclosures;
- IFRS 1 – *First-time Adoption of International Financial Reporting Standards*.

Commission Regulation (EU) 2015/2343, which was published in the Official Journal of the European Union on 16 December 2015, stipulates that the mandatory effective date for these amendments shall be no later than the commencement date of the first financial year starting on or after 1 January 2016.

The regulation is available here:
http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32015R2343

Adoption of amendments to IAS 27 on use of the equity method in separate financial statements

On 18 December 2015, the European Commission adopted the amendments to IAS 27 – *Separate Financial Statements*, which permit the use of the equity method to account for investments in subsidiaries, joint ventures and associates in in the separate financial statements. These amendments were published by the IASB on 12 August 2014.

Commission Regulation (EU) 2015/2441, which was published in the Official Journal of the European Union on 23 December 2015, stipulates that the mandatory effective date for these amendments shall be no later than the commencement date of the first financial year starting on or after 1 January 2016.

The regulation is available here:
http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2015.336.01.0049.01.ENG&toc=OJ:L:2015:336:TOC

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A Closer Look

Draft interpretation on Uncertainty over Income Tax Treatments (IAS 12)

As we reported in a previous issue (see Beyond the GAAP no. 93), the IFRS Interpretations Committee has published a draft interpretation on the accounting treatment of uncertain income tax positions under IAS 12. Here, we review the key points of the interpretation.

Scope: in what circumstances does the interpretation apply? What is covered?

The draft interpretation covers more than just unresolved disputes with taxation authorities. It applies to any situation where there is uncertainty over the legal acceptability of an income tax treatment: an entity may have to reflect this uncertainty in the accounting of its income tax positions, even if there has not been any control or notification of an income tax rectification.

The interpretation is expected to cover all situations where there is uncertainty, and the impact on both current tax and deferred tax.
However, it will not cover uncertain tax positions which are covered by other standards. The accounting treatment of interest and penalties is also excluded from the scope of the draft interpretation.

In its draft comment letter, EFRAG pointed out that the proposals could result in inconsistency between accounting for income taxes and accounting for other types of tax or levy (notably taxes covered by IAS 37 and its interpretation IFRIC 21).

Recognition & measurement of uncertainties: what is the proposed approach?

The draft interpretation states that an entity shall assume that the taxation authority will examine the amounts declared and will have full knowledge of all information relevant to its investigation (in other words, it assumes a 100% "detection risk").

Starting from this assumption, the entity shall assess whether it is probable that the taxation authority will accept the tax treatment used (or that it is planning to use) in its income tax filings. The uncertainty should only be taken into account in the measurement of income tax if the entity concludes it is not probable that the taxation authority will accept the tax treatment in retained in its income tax filings.

If the entity deems it probable that the taxation authority will reject the tax treatment, the entity shall measure the uncertainty by using the method that it believes will best predict the resolution of the uncertainty: either the most likely amount, or the expected value, which is the weighted average of the range of possible outcomes.

If an uncertain tax treatment has an impact on both current tax and deferred tax, the entity's estimates and judgements must be consistent throughout.

The estimates may be made either for each uncertainty independently, or collectively for a group of tax treatments in the event that the resolution of one uncertainty affects, or is affected by, another uncertain tax treatment. The entity must therefore use judgement to determine the unit of account that it believes will best predict the resolution of the uncertainty.

The draft interpretation also states that an entity must revise its judgements and estimates if the facts and circumstances change subsequently.

Disclosures in the notes: what's new?

The draft interpretation does not introduce any new disclosure requirement and simply refers to existing requirements, in particular:

- IAS 1 on significant estimates and judgements;
- IAS 37 on contingent assets and liabilities.

However, the interpretation stipulates the areas in which an entity must use judgement when accounting for uncertain tax positions under IAS 12. As a result, it is likely that increased disclosures in the notes will be expected on these areas.

What are the transition requirements?

Entities may choose whether to apply this interpretation prospectively, or retrospectively in accordance with IAS 8. If an entity opts for retrospective application it must be in a position to do this without the use of hindsight.

A Closer Look

IASB redeliberates proposed clarifications to IFRS 15

At its December 2015 meeting, the IASB redeliberated the proposed clarifications to IFRS 15 – *Revenue from Contracts with Customers*, in the light of the 74 comment letters received in response to the exposure draft published at the end of July 2015.

The clarifications relate to the following issues:

- Identifying performance obligations;
- Principal versus agent considerations;
- Licensing;
- Transition requirements.

When IFRS 15 was first published in May 2014, it was identical to Topic 606, published simultaneously by the FASB. However, each Board has gone on to discuss proposed clarifications to its document, with a resultant risk of deconvergence. Principal versus agent considerations are the only area where identical proposals have been put forward and redeliberations have been carried out jointly.

The IASB worked on the principle that it would only make changes to the standard (which is mandatory for financial periods commencing on or after 1 January 2018) if:

- clarifications were deemed essential for satisfactory implementation of IFRS 15; or
- the benefits of maintaining convergence were deemed to outweigh the costs involved in post-publication changes to the original document.

In practice, the IASB exposure draft mainly proposed changes or additions to the illustrative examples, with amendments to the body of the standard or the application guidance kept to a minimum.

To the contrary, it became obvious early on that the FASB was taking a different approach, seeming willing to make as many clarifications as required to simplify implementation of Topic 606 as much as possible for US issuers. Thus, the FASB has proposed additional practical expedients (e.g. for identification of performance obligations), as far as possible avoiding complicated and potentially costly analyses that would result in unnecessary changes to existing practices.

At the December meeting, the IASB confirmed the majority of the proposals set out in the July 2015 exposure draft (cf. Beyond the GAAP no. 92). However, changes or clarifications have been made in the areas discussed below.

1. Identifying performance obligations

The IASB eventually decided, with a narrow majority, to follow in the footsteps of the FASB by amending the body of the standard, notably the paragraph which seeks to clarify the meaning of "distinct within the context of the contract" (cf. paragraph 29 of the standard). In practice, this paragraph is useful for determining whether two or more goods or services sold as part of the same contract should be treated separately (when recognising revenue and profit margins).

The IASB and FASB staffs will work together to try to maintain convergence on this major issue. The illustrative examples will also be redrafted in line with the new wording of IFRS 15.

Meanwhile, the IASB did not really address the substantial concerns expressed by commenters regarding the example on the sale of multiple units of complex, highly specialised goods, which are deemed not to be distinct and thus constitute a single performance obligation (Example 10 Case B). However, the staff stated that the fact pattern would be clarified in the final version, to ensure that it is not applied by analogy to situations which are not really comparable.

Key points to remember

IFRS 15 is to be amended in line with Topic 606, to clarify the circumstances in which goods or services are "distinct within the context of the contract". These clarifications will be accompanied by updated illustrative examples.

2. Agent versus principal considerations

Following joint redeliberations, the IASB and FASB confirmed the majority of the proposed amendments relating to agent versus principal considerations. However, the two Boards decided to remove exposure to credit risk from the list of indicators to be used to determine whether an entity controls a particular good or service before it is transferred to the customer (cf. IFRS 15.B37(e)).

The comments received by the two Boards included the fact that this indicator is irrelevant, as agent versus principal considerations only come into play once the contract has gone through step 1, i.e. identification of a contract to be recognised in accordance with IFRS 15. This step requires the entity to consider the likelihood of recovering the consideration to which the entity is entitled (which implies that credit risk exposure is *de facto* limited).

Key points to remember

Exposure to credit risk should no longer be an indicator that an entity is acting as the principal in the transaction.

3. Licensing

At the TRG meeting in November 2015, questions were raised regarding renewal of licences and restrictions in certain contracts.

However, the IASB has decided not to provide any additional clarifications, other than those proposed in the July 2015 exposure draft.

The IASB pointed out that the general model set out in IFRS 15, which covers identification of performance obligations and contract modifications, also applies to licensing contracts. Thus, the application guidance on licensing does not override the general model.

As a result, this is the issue on which the greatest divergence is expected between IFRS 15 and Topic 606. However, in practice, it would be unusual for the two frameworks to result in different accounting outcomes.

Key points to remember

Unlike the FASB, and despite the many questions raised with the TRG regarding this issue, the IASB will not make any further changes to the application guidance on licensing, other than those already set out in the July 2015 exposure draft.

4. Transition requirements

As well as confirming the proposals put forward in the July 2015 exposure draft, the IASB has decided that:

- If an entity has opted for the alternative method as well as the practical expedient on contract modifications (which was introduced in the wake of the July 2015 exposure draft), it may apply this expedient either:
  - at the beginning of the earliest comparative period presented in the financial statements in which IFRS 15 is first applied; or
  - at the date of initial application of IFRS 15.

  The alternative method involves calculating the effect of transition at the date of initial application, i.e. 1 January 2018 in most cases;
- If an entity has opted for the alternative method, it may apply IFRS 15 either to all contracts (a new option introduced by the IASB) or only to contracts that are not completed contracts, as defined in IFRS 15, at the date of initial application (an option included in the May 2014 version of the standard). This should address the practical difficulties discussed by the TRG relating to the definition of a "completed contract" (cf. Beyond the GAAP no. 92).

At its January 2016meeting, the IASB is expected to confirm the transition provisions and effective date of the clarifications decided in December. This meeting should complete the amendments process for IFRS 15, with the next landmark being the 1 January 2018 effective date. Issuers will now finally have a stabilised basis on which to prepare for transition. However, there are still uncertainties regarding the future of the TRG and what will happen to any remaining implementation issues between now and the effective date.

A Closer Look

How should the concept of materiality be applied?

On 28 October last year, the IASB published a draft Practice Statement on the application of materiality to financial statements. The public consultation on the draft is open until 26 February 2016 (see Beyond the GAAP no. 93).

The document is the result of numerous appeals to the IASB to address this subject, including one from ESMA. The European market authority carried out its own public consultation in 2011, as national enforcers had noted differences in practice between companies, auditors, users of financial statements and market regulators (see Beyond the GAAP no. 53).

The Practice Statement falls within the context of the IASB's broader *Disclosure Initiative.* The Board notes that amendments to the Practice Statement may be necessary following completion of the *Disclosure Initiative,* as relevant issues may be addressed in that project.

The current document is not a draft standard. The term 'Practice Statement' has been used to emphasise the pervasiveness of materiality (see point 1, below) and in particular to avoid conflicts with legal requirements on materiality that may exist in some jurisdictions.
IFRS do not generally prohibit entities from providing further information in addition to that required under IFRS in order to meet stricter local legal requirements. If a jurisdiction does not have existing legal requirements, it may decide to adopt the Practice Statement into its national framework.

Readers may remember that the IASB's guidance on management commentaries was also published in the form of a Practice Statement, in 2010 (see 'A Closer Look', Beyond the GAAP no. 40).

Objectives

The IASB's objectives for the Practice Statement are as follows:

- To provide guidance on:
  - the characteristics of materiality;
  - how to apply this concept when presenting information in the financial statements and the notes;
  - how to assess whether omissions and misstatements are material to the financial statements.
- To illustrate the types of factors that should be taken into account when assessing whether information is material.

Definition of materiality under IFRS

Materiality is defined in the current *Conceptual Framework* (QC11) and in IAS 1 – *Presentation of Financial Statements* (IAS 1.7) as follows:

> *"Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor."*

Thus, the exposure draft explains that applying the concept of materiality should:

- Ensure that material information is presented separately in the primary financial statements and/or in the notes to the financial statements;
- Act as a filter to ensure that the financial statements are an understandable and effective summary of the information that the entity holds in its internal records.

The key aspects of materiality are then explained in the four substantive chapters of the document, which we will address below:

1. General characteristics of materiality
2. Presentation and disclosure in the financial statements
3. Recognition and measurement
4. Omissions and misstatements.

1. General characteristics of materiality

The exposure draft identifies five general characteristics of materiality.

Pervasiveness

First of all, the concept of materiality is pervasive, as it applies to the complete set of primary financial statements, as well as the notes to the financial statements. This was noted in the December 2014 amendments to IAS 1.

Use of judgement

The second characteristic is that the assessment of materiality requires judgement. When applying judgement, management should consider the entity's specific circumstances and environment, while also bearing in mind how the information will be used by the users of financial statements. The situation should be re-assessed at each year-end.

Users should be taken into account

The exposure draft devotes quite a lot of space to the third aspect of materiality, which relates to the users of financial statements and the decisions they will make.

As stated in IAS 1, the users of financial statements "are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence". Thus, the users to be taken into account are deemed to be typical and rational users, representative of a broad range of users. Management is not required to meet the specific needs of a particular user that would have little or no relevance to other users.

In order to determine what information is material to the users of financial statements, it is first necessary to identify their needs. The IASB notes that these considerations are already taken into account when developing standards, particularly in the requirements for presentation and disclosure. Thus, the requirements set out in IFRS provide an appropriate basis for management to carry out this assessment. Entities may also take into account questions raised by users on the publication of financial statements, the practices of other entities in the same market segment, and market responses to information issued by the entity.

Finally, the exposure draft reminds readers that, as stated in the Conceptual Framework, information is useful if it has predictive value and/or confirmatory value.

Moreover, if information is material, then the cost of providing it should not be a factor in the decision on whether to provide the information.

Qualitative and quantitative assessment

The fourth characteristic of materiality is that it should be assessed both qualitatively and quantitatively. Quantitative thresholds used by the entity may be useful tools, but they are not sufficient. The assessment should take into account both the size and the nature of an item, event or circumstance, the uncertainties and contingencies to which the entity is exposed, and the sensitivity of particular assumptions. The IASB also notes that it cannot set quantitative thresholds, as it cannot predict what will be material in a particular situation. When assessing whether information is material, entities should thus consider other disclosure requirements (in particular, information required by the market regulator), their business plan and the economic environment.

It should be noted that the AMF's *Guide to the Relevance, Consistency and Readability of Financial Statements* recommends a similar approach (see Beyond the GAAP no. 93).

Individual and collective assessment

The final characteristic is that materiality should be assessed both individually and collectively. This section notes that even if information is not material in isolation, it may be material when aggregated with other immaterial information.

An example of this is multiple acquisitions of relatively small businesses, which become material when taken collectively. This could be in terms of revenue, profits, debt levels or the structure of the group.

Key points to remember

The assessment of materiality:

- Applies to the complete set of financial statements, including the notes;
- Requires judgement;
- Should consider the users of the financial statements and their needs;
- Involves both quantitative and qualitative factors; and
- Should be carried out on both an individual and a collective basis.

2. Presentation and disclosure in the financial statements

The assessment of materiality needs to be carried out within the context of the objectives of financial statements, which are to provide information on the entity's financial position, financial performance and cash flows that is useful to a broad range of users in making economic decisions.

Thus, the assessment of materiality allows management to determine not only whether or not information should be included in the annual or interim financial statements (even if this information is specifically required by an IFRS), but also where it should be presented, and if it needs to be presented separately.

After carrying out this assessment, the entity should review its conclusions by looking at the complete set of financial statements, to see whether any changes are needed in order to make the information clearer or more prominent.

When deciding whether to present the information in the primary financial statements or the notes, management should consider the objectives of the various financial statements. The main objective of the notes is to supplement and explain the information contained in the primary financial statements. However, another objective of the notes is to present information that is necessary to meet the general objectives of financial statements, but that is not included in the primary financial statements (e.g. contingent liabilities). The notes may also present information that is not required under IFRS but that may influence decisions made by the users of financial statements.

As regards immaterial information, the exposure draft restates the fact that entities are not prohibited from publishing such information; however, they should ensure that material information is not lost in a sea of immaterial information. However, in some cases it may be relevant to state that a particular item is not material. Here, the IASB borrows a favourite example from the AMF: it may be

useful to state that the entity does not hold securities of issuers that are in dire economic straits.

Regarding aggregation, the exposure draft quotes a few paragraphs of IAS 1, drawing attention to the following principles:

- A line item that is not sufficiently material to warrant separate presentation in the financial statements does not need to be presented separately even if required under IFRS; however, it may warrant separate presentation in the notes;
- Items presented in the primary financial statements only require disaggregation in the notes if information about their components is material.

As well as considering the nature of the components and their amounts (relative to the individual line item, the sub-totals and total), the entity should also take into account the extent to which the components are similar when deciding whether they should disaggregate them.

For example, if a line item in the statement of financial position comprises a large number of similar contracts, none of which are individually material, this line item would not require disaggregation in the notes. In contrast, if one of a number of exchange losses is material, as it occurred within the context of an atypical transaction, the entity may need to present a specific disclosure on this exchange loss.

The exposure draft states that disclosures in the notes should be reviewed at each year-end, to check whether information provided previously is still relevant. In some cases a summarised version may suffice, while in others the information could be removed altogether.

The IASB notes that users of financial statements also use other information sources. However, the exposure draft emphasises that the existence of other sources does not relieve the entity of its obligation to present material information required by IFRS in its financial statements.

Key points to remember

Entities should base their assessment of materiality on the objectives of the financial statements as a whole and those of each statement. This will enable them to determine:

- Whether or not information should be included (irrespective of whether it is required under IFRS);
- Whether it should be presented in the primary financial statements and/or the notes;
- The appropriate level of aggregation for various items of information, in both the primary financial statements and the notes.

The complete set of financial statements should be reviewed at the end of the process to check that information is presented and disclosed appropriately. Disclosures in the notes should be reviewed at each year-end.

3. Recognition and measurement

This short chapter reminds readers that materiality is not only relevant to presentation and disclosure, but also to the recognition and measurement of items presented in the financial statements.

The exposure draft includes a reminder of the principle set out in IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors*, which stipulates that financial statements that include deliberate errors, even if they are immaterial, are not compliant with IFRS. However, an entity may still use practical expedients.

One such expedient would be a relatively low quantitative threshold, below which items would be recognised as expenses rather than capitalised as assets. However, such practices should be reviewed regularly to check that their overall impact is still immaterial.

Key points to remember

Entities are permitted to use practical expedients for recognition and measurement as long as their overall impact is not material.

4. Omissions and misstatements

The exposure draft uses the broad term "misstatements" to include:

- omissions, i.e. exclusion of relevant data or information;
- errors, arising from a failure to use, or misuse of, reliable information that was available or that could reasonably have been obtained and taken into account (including arithmetical mistakes, mistakes in applying accounting policies, oversights, misinterpretations of facts, or fraud);
- other misstatements, such as ambiguous descriptions of information, or obscuring material information.

Management should assess whether or not misstatements are material, as follows:

- initially on an individual basis, then collectively. If a misstatement is material individually, it may not be offset by other misstatements;
- with relation to the individual line item(s), sub-totals and totals in the financial statements;
- taking into account the precision of the measure (e.g. cash flows compared with Level 3 fair value estimates).

If possible, current period misstatements and prior period errors should be corrected, even if they are immaterial, as required by IAS 8. If the misstatements and errors are deliberate and are intended to mislead the users of financial statements, they are considered to be material even if they only relate to small amounts. In this situation, the financial statements do not comply with IFRS.

Key points to remember

A misstatement is material when it is deliberately intended to influence the decisions made by the users of the financial statements.

Misstatements (as opposed to practical expedients – see point 3) should be corrected if possible, whether or not they are material.

Conclusion

The points covered in this 'Practice Statement' do indeed simply restate current practice: in other words, there is nothing really new. However, this draft document is still useful, in that it combines points from different standards into a single document, and provides illustrative examples.

The consultation responses and subsequent practice will show whether it is possible for all the stakeholders in the financial reporting chain to agree on what information is 'material', and thus move away from the checklist approach which has been criticised from all sides.

Events and FAQ

Frequently asked questions

IFRS

- Contribution to an associate (or a joint venture)
- Earn-out clause conditional on continued employment with a graded vesting mechanism
- When should a capital gain be recognised for a lease in which the lessor has the option to sell?
- Practical implementation of the rule in IAS 36 which states that an impairment loss shall not be reversed due to the unwinding of the discount over time.

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Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

IFRS		EFRAG	
IASB	Committee	Board	TEG
15-19 February	22-23 March	11 February	27-28 January
14-18 March	10-11 May	8 March	24-26 February
18-22 April	12-13 July	13 April	22-24 March

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