

ASSIREVI
Associazione Italiana Revisori Contabili

Al Presidente

ESMA
European Securities and Markets Authority
103 rue de Grenelle
75007 Paris
France

26 March 2012

Consultation Paper – Considerations of materiality in financial reporting

Dear Sirs,

ASSIREVI is the association of Italian audit firms. Its member firms represent the majority of the audit firms registered with CONSOB (*Commissione Nazionale per le Società e la Borsa*) and are responsible for the audit of almost all of the companies listed on the Italian stock exchange. ASSIREVI promotes technical research in the field of auditing and accounting and publishes technical guidelines for its members. It collaborates with Governmental bodies, CONSOB, the Italian accounting profession and other bodies in the development of auditing and accounting standards.

Assirevi is pleased to submit its comments on the Consultation Paper “Considerations of materiality in financial reporting” (“CP”) issued by the European Securities and Markets Authority (“ESMA”) in November 2011.

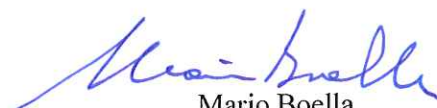
The concept of materiality is a key concept used in preparing financial statements under IFRS and many other GAAPs. We think that the development of guidance to ensure more consistent application of the concept of materiality is a relevant matter to investors and other users of financial statements. Therefore, we agree with ESMA that it is an issue of significant practical relevance.

Given that the concept of materiality and its interpretation is highly relevant to audits of financial statements, we think that the topic should be addressed in a joint effort with global standard setters and other securities regulators worldwide on this topic. In particular, should further guidance and interpretation on such topic be considered necessary, we believe that it would be tackled best in the underlying financial reporting standards by the IASB.

Our detailed comments are set out in the attached document.

Should you wish to discuss our comments, please do not hesitate to contact us.

Yours faithfully,


Mario Boella
Chairman of Assirevi

COMMENTS ON THE ESMA CONSULTATION PAPER

“Considerations of materiality in financial reporting”

(November 2011)

Responses to requests for specific comments

Q1: Do you think that the concept of materiality is clearly and consistently understood and applied in practise by preparers, auditors, users and accounting enforcers or do you feel more clarification is required?

We believe that International Financial Reporting Standards and International Standards on Auditing provide an appropriate and consistent framework for understanding and applying the concept of materiality. The two sets of standards are coordinated, as the International Standard on Auditing 320 “Materiality in planning and performing an audit” (ISA 320) refers to concepts treated in International Financial Reporting Standards and requires that the auditor refers to the frame of reference established in the applicable financial reporting framework for determining materiality in the context of an audit.

In our view the concept of materiality is clearly understood by preparers, auditors, accounting enforcers and users which have an adequate knowledge of the relevant accounting and auditing standards. With reference to the remaining users, although there could be different degrees of understanding , we think that the accounting concept of materiality intended as being “relevant” or “significant” is generally understood. Based on the preceding, we think that no clarifications are required.

Based on the existing international auditing standards the determination of materiality is a matter of professional judgment and is affected by the perception of the financial information needs of users of the financial statements. As a consequence in the practical application of the concept of materiality it is possible that certain differences exist. In such context we do not believe that different judgments necessarily represent a lack of consistency.

Q2: Do you think ESMA should issue guidance in this regard?

As indicated above in our response to Question 1, the existing standards provide an adequate and consistent framework for the determination of materiality and accordingly we think that no guidance is necessary.

However, should the feedback to the consultation evidence the need of further guidance, in our view any additional guidance or interpretations should be provided by the IASB, in its role of global accounting standard setter, and according to its established due process.

We do not recommend ESMA issuing guidance on materiality without coordination with global standard setters and other securities regulators worldwide on this topic.

Q3: In your opinion, are ‘economic decisions made by users’ the same as users making ‘decisions about providing resources to the entity’? Please explain your rationale and if possible provide examples.

The IASB Conceptual Framework for Financial Reporting indicates that financial reports prepared under IFRSs primarily address the information needs of providers of capital to help them in making decision about providing resources to the entity. Other parties, such as regulators and members of the public, may also find general purpose financial reports useful, even if those reports are not primarily directed to these other groups.

As a consequence, in our view, the two phrases are consistent since there would not be a practical difference.

Q4: Is it your understanding that the primary user constituency of general purpose financial reports as defined by the IASB in paragraph 13 includes those users as outlined in paragraph 16 above? Please explain your rationale and if possible provide further examples.

We believe that financial reports prepared under IFRSs primarily should address the information needs of providers of capital. Consequently, a definition of materiality that focuses on economic decisions of users that provide or could provide resources is appropriate for financial reporting purposes. However, we do not believe that present and past employees, as mentioned in paragraph 16(c) of the consultation paper, can be included amongst the primary users as envisaged by the IASB.

As highlighted in the Conceptual Framework (par. OB6 and OB8), it is opportune to remember that the above mentioned individual primary users have different, and possibly conflicting, information needs and desires. As a consequence, although the financial statements should try to address the information needs of providers of capital, they cannot satisfy all their needs, thus leading to be focused only on their common information needs.

Q5a: Do you agree that the IASB’s use of the word ‘could’ as opposed to, for example, ‘would’ implies a lower materiality threshold? Please explain your rationale in this regard.

We do not believe that the use of the word “could” as opposed to “would” should lead to any difference in practice.

Q5b: In your opinion, could the inclusion of the expression ‘reasonably be expected to’ as per the Auditing Standards, lead to a different assessment of materiality for auditing purposes than that used for financial reporting purposes. Have you seen any instances of this in practice?

We believe that the objective of the financial statements prepared in accordance with IFRS needs to be the same both for the company’s management and its auditor.

Indeed, in accordance with IAS 1.15 such objective is to achieve a fair presentation. Based on the ISAs requirements (ISA 700.14), when the financial statements are prepared in accordance with a fair presentation framework (as for IFRS), the evaluation required to the auditor is to assess

whether the financial statements give a fair presentation.

Consequently, materiality, that represents a reference to reach the same objective, should be basically assessed with same criteria and considering the same factors by both the preparer and the auditor.

Indeed, the reference to “reasonably be expected to” is not only found in the auditing standards; the definition of the term “material” in paragraph 7 of IAS 1 explains that “... the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions”.

Q6a: Do you agree that the quantitative analysis of the materiality of an item should not be determined solely by a simple quantitative comparison to primary statement totals such as profit for the period or statement of financial position totals and that the individual line item in the primary statement to which the item is included should be assessed when determining the materiality of the item in question? Please explain your rationale in this regard.

We agree that materiality should not be based only on a mechanical calculation but instead should involve judgement in light of the surrounding facts and circumstances. In making such assessment, both quantitative and qualitative factors would need to be considered, and the size or nature of an item, or a combination of both, could be the determining factor.

On the one hand, even though the opening and closing balances of the deferred tax liabilities are regarded as material to the financial report of an entity, it does not necessarily follow that all the related disclosures (for example the movement table) must be material. On the other hand, even though the balance of provisions for claims may not be significant to the financial report of an entity the omission of related disclosures could be considered material.

Q6b: Do you agree that each of the examples provided in paragraph 21 a – e above constitute instances where the quantitative materiality threshold may be lower? Are there other instances which might be cited as examples? Please explain your rationale.

We believe that the examples in paragraph 22 a –e may constitute instances in which the materiality threshold may be lower. However, whether an item is material to an entity’s financial report ultimately would be judged in light of all surrounding circumstances. In particular, an item that is material to an entity need not be material to another entity.

Therefore, we consider that a principle-based approach to assessing materiality is appropriate and it is neither possible nor appropriate to provide an exhaustive list that predetermines what could be material.

In addition, please refer to the previous answer.

Q7: Do you agree that preparers of financial reports should assess the impact of all misstatements and omissions, including those that arose in earlier periods and are of continued applicability in the current period, in determining materiality decisions. Please explain your views in this regard.

Considering the definition of materiality included in IAS 1 par. 7 “Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions users make on the basis of the financial statements”, in our view it is important for the preparers the assessment of the effect of individual omissions or errors as well as the cumulative effects of all omissions and errors on the financial statements taken as a whole, including the misstatements arising from the disclosures.

Errors and omissions occurred in earlier periods, if not amended, might still have effects on current period and therefore should be included and considered in determining materiality decisions.

Q8: Do you agree that preparers of financial reports should assess the impact of all misstatements and omissions as referred to in paragraphs 23 to 26 above in determining materiality? Please explain your views in this regard and provide practical examples, if applicable.

The definition of materiality refers to omissions and misstatements that individually or taken together may be material. This suggests that an omission or a misstatement is first considered on its own to determine whether it is material. If material, the omission or misstatement will normally be corrected in the financial statements (as required by IAS 8.41). This will prevent that individually material omissions/misstatements are compensated by other smaller misstatements and therefore not corrected.

Accordingly, we agree that once individual materiality has been considered all (identified but uncorrected immaterial) misstatements and omissions should be considered together as part of an overall consideration to determine whether the financial statements as a whole are fairly presented.

Q9a: Do you believe that an accounting policy disclosing the materiality judgments exercised by preparers should be provided in the financial statements?

Q9b: If so, please provide an outline of the nature of such disclosures.

Q9c: In either case, please explain your rationale in this regard.

According to IAS 1, significant accounting policies and critical accounting judgments should be disclosed in the financial statements. We are concerned that a meaningful policy on the materiality judgments made in preparing the financial statements may turn out to be quite lengthy, as it would be difficult to determine where to draw the line for items to be included. In addition, there is a risk that such a policy creates another expectation gap, in particular as it relates to disclosures.

Any attempt to reduce the size of this policy and its potential to mislead, carries the risk of resulting in another very generic (boilerplate) accounting policy, therefore reducing its usefulness.

Q10: Do you agree that omitting required notes giving additional information about a material line item in the financial statements constitutes a misstatement? Please explain your rationale in this regard.

Although we agree that omissions of required notes about a material line item in the financial statements may constitute a misstatement in certain circumstances, we strongly disagree that such omissions of notes always represent a misstatement. We use the term “misstatement” to include omissions of a disclosure as defined by ISA 450.4(a).^{1 2}

The definitions of materiality in IAS 1 and IAS 8 – as well as the auditing guidance in ISA 450 - make it clear that the omission of required notes must be evaluated individually to determine whether it is material. That means the omission of a disclosure which relates to a material line item in the financial statements is in itself not necessarily material.

For purposes of that assessment IAS 1.30 and 31 distinguish clearly between the presentation of items and specific disclosures required by IFRSs. IAS 1.31 states that: “An entity need not provide a specific disclosure required by an IFRS if the information is not material.”

If all omissions of required notes were considered material misstatements just because these notes relate to material financial statement line items, this would in our view heavily reduce the ability to apply judgment provided by IAS 1.31, which explicitly refers to “specific disclosures” required by an IFRS. In assessing materiality of disclosures, consideration should be given to the element of a disclosure requirement, rather than all the disclosures required by one standard, and the relevance of the “information” provided by that specific element. Consequently, a specific piece of information required by an IFRS is not disclosed if it is immaterial, even the disclosure requirement relates to a material line item presented. This would also be more consistent with the disclosure principles that should guide preparers in determining the appropriate level of disclosure for a particular item.

Q11: Do you believe that in determining the materiality applying to notes which do not relate directly to financial statement items but are nonetheless of significance for the overall assessment of the financial statements of a reporting entity:

- a) the same considerations apply as in determining the materiality applying to items which relate directly to financial statement items; or**
- b) different considerations apply; and**
- c) if different considerations apply, please outline those different considerations.**

No, we believe the same considerations apply as for other disclosure items discussed above, ie the omission or misstatement of notes providing supplementary information is evaluated considering the amounts involved as well as the surrounding facts and circumstances. However, considerations of size may be less relevant for such items.

¹ ISA 450 ‘Evaluation of Misstatements identified during the Audit’, paragraph 4:” (a) Misstatement - A difference between the amount, ..., disclosure of a reported financial statement item and the amount, ..., or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. ...”. According to the additional guidance in paragraph A1 of ISA 450, that definition would also cover the omission of a disclosure (A1(b)).

² AS 1.7 (“material”) and IAS 8.5 (“material”) distinguish between misstatements and omissions of disclosure.

Q12: In your opinion, how would the materiality assessment as it applies to interim financial reports differ from the materiality assessment as it applies to annual financial reports?

We believe that the materiality assessment, based on a principle-based approach, as it applies to interim financial reports does not differ from the materiality assessment as it applies to annual financial reports.

However, materiality for interim reports shall be determined, as provided by IAS 34.23, in relation to interim period financial data, thus leading to further considerations other than those made with reference to the annual financial reports.

Milan, 26 March 2012