European Banking Federation

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Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of almost 5000 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU only.

The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.

EBF response to ESMA Consultation Paper – Considerations of materiality in financial reporting

Key Points

- The concept of materiality is clear.
- Materiality is an entity specific aspect of relevance applied at entity level involving a degree of professional judgment. It cannot be therefore reduced to a set of prescriptive rules.
- Different reporting outcomes could be the result of application to different circumstances.
- It is crucial to avoid excessive and irrelevant disclosures that could reduce readability and understandability of financial reports.
- Should there be a need for further clarification to enhance consistent application at global level, it should be provided by the IASB.

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 the concept of materiality is clear although we acknowledge there may be differences in practical application. It must be taken into account that materiality is applied at entity level and involves a degree of professional judgment taking into account not only entity specific factors but also various macro-economic aspects. Different reporting outcomes could therefore be the result of application to different circumstances surrounding a specific item and not necessarily a result of diverging understanding. The concept of materiality is an entity specific aspect of relevance and cannot be reduced to a set of prescriptive rules. If necessary, the principle behind materiality could be articulated more clearly to increase consistency in application and comparability at global level.

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

No. The concept of materiality is part of global accounting standards as described in the IFRS Conceptual Framework. While we believe this consultation is useful and complements other initiatives in this area, it should only serve as an input to any possible future work of the IASB on the subject, if proven necessary.

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.

We do not believe the different wording would lead to different practical application of the concept. The difference in application would rather arise from different individual circumstances.

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 both paragraph 13 and 16 refer to the same users.

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 believe that in practice, such difference in wording would not lead to lower materiality threshold.

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?

Auditors should review the accounts against the accounting framework which the audited company applies including how materiality is defined under that particular accounting framework. If the judgment of the auditor is not aligned with that of the preparer, it should be reflected in the audit opinion.

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.

Both quantitative and qualitative factors should be considered when determining materiality. Given that professional judgment is involved in materiality assessment, we do not believe that any kind of list such as the one presented in paragraph 22 of the ESMA paper would be helpful.

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.

Not necessarily. The list includes examples where materiality judgment is sensitive. The items should therefore be considered carefully both in terms of its size and nature. The qualitative factor may be regarded particularly important. For example the entity's shares held by its managers should always be referred, regardless of the amount. Other examples are transactions with related parties, where qualitative factor may be more relevant to the judgment than the size alone.

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.

We agree. The impact of all misstatements and omissions should be considered according to IAS 8. We believe that the guidance in IAS 8 is sufficient.

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.

Preparers should always evaluate whether identified errors, omissions and misstatements should be corrected in their wider context, including considerations in paragraphs 24-27 if relevant.

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.

No. We do not believe that disclosure of judgment could be provided in a useful and meaningful way. We believe that the requirements of IAS 1 to disclose information regarding judgments that the management made in the process of applying the accounting policies should be enough.

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.

Not necessarily. It is possible for a line item to be material, but not necessarily for all the detailed disclosure requirements. The decision on the materiality of a particular note will depend on the nature and extent of the disclosure and should be assessed individually. Should omission of a note be considered a misstatement, there is a risk of introduction of excessive and irrelevant disclosures that could reduce readability and understandability of financial reports.

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.

Materiality of the disclosure will depend on the nature of the disclosure and should be assessed against relevance to the users.

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?

No, we do not believe that the materiality assessment applied to interim financial reports should differ from the materiality assessment applied to annual reports.