

16 February 2016

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**Comment on Exposure Draft, IFRS Practice Statement:**  
**Application of Materiality to Financial Statements**

The Accounting Standards Board of Japan (“ASBJ” or “we”) welcomes the opportunity to provide comments on the International Accounting Standards Board’s (“IASB”) Exposure Draft (“ED”) of IFRS Practice Statement: *Application of Materiality to Financial Statements* that the IASB published as part of its Disclosure Initiative. We support the IASB’s initiative, because we believe that it will help address various concerns that have been expressed by market participants and will help improve the quality of an entity’s financial information prepared in accordance with IFRSs.

However, through discussions with our constituents, we have learned that many of them do not find the proposed guidance very useful, because they find that most of the descriptions in the ED are merely a repetition of the existing accounting requirements or codification of the current practices. Typically, they are of the view that many of the descriptions in the ED do not provide useful guidance that could address the challenges they are actually facing in their financial reporting practices where such practices have been sufficiently developed, while they view that the proposed guidance may be helpful to ‘educate’ others about what the application of materiality concept to financial statements is all about as it enables them to see the relevant guidance at a glance. Based on the feedback, we believe that the incremental benefits from the ED for the betterment of financial reporting practices is relatively limited, especially in jurisdictions where financial reporting practices have been developed, and rigorous auditing, supervision and enforcement practices have been in place.

Given our overall assessment of the ED that the proposed document would not be helpful to address real-life practical challenges, we do not support the IASB’s proposal to issue the guidance in the form of a Practice Statement. Instead, in order to better reflect the nature of

the document, we recommend that the proposed document be issued in a form of 'educational material', except that some of the descriptions in the ED (which we find that the IASB expects financial statements preparers and auditors to comply with) should be migrated into IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* or a planned general disclosure standard as part of the authoritative guidance. This way, we believe that the nature of the proposed document would become much clearer and easier to understand.

In addition, we do not believe it necessary for the IASB to issue the proposed document in accordance with an accelerated timetable when considering our assessment regarding its limited effect on current financial reporting practices. In our view, the document would be more helpful, if it is finalised after considering other relevant work of the Disclosure Initiative. Consequently, we recommend the IASB not to issue the proposed document before finalisation of other relevant work of the Disclosure Initiative. In our view, that would minimise the risks of changing the document multiple times in a relatively short period of time.

We are hoping that the completion of the IASB's work that would help improve an entity's judgment with regard to whether and how to implement disclosure requirements in parallel with the work on a review of disclosure requirements themselves (including clear articulation of disclosure objectives in individual standards) will more effectively bring about a positive impact on the communicative value of financial reporting for users of financial statements.

For our comments on specific questions in the ED, please refer to the Appendices to this letter.

We hope our comments will contribute to the IASB's deliberation.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Atsushi Kogasaka', written in a cursive style.

Atsushi Kogasaka  
Vice-Chairman of the Accounting Standards Board of Japan  
Chairman of the Technical Committee: ASAF of the ASBJ

### Comments on Specific Questions 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?

1. As for the form of the document, we do not believe that the proposed document should be issued in the form of a Practice Statement; instead we believe that it should be issued in the form of the educational material for the following reasons:
  - (a) As stated in the covering letter, we do not believe the form of a Practice Statement reflects the nature of the document. In our view, the form of educational material would better reflect the nature and supposed usage of the document.
  - (b) The nature of the document is significantly different from the IASB’s only existing Practice Statement *Management Commentary* which was issued to assist management in presenting information that is disclosed outside the financial statements. Given that management commentary does not constitute part of the financial statements, the disclosure requirements of management commentary are often prescribed by the securities regulators and are not subject to the requirements of IFRSs, whereas the contents of the proposed document deal with information contained in the financial statements.
  - (c) To the extent of our knowledge, there would be possibly no or very few jurisdictions that will adopt the document as mandatory guidance in individual jurisdictions, even if the proposed document is issued in the form of a Practice Statement.
  - (d) Even if the proposed document is published in the form of an educational material, the IASB is not prohibited from carrying out public consultation so as to obtain inputs from a wide range of stakeholders. Thus, we do not think that the need for public consultation should determine an appropriate format of the document.
2. In addition, as stated in the covering letter, we find some descriptions in the ED appear to

represent the contents that the IASB expects financial statements preparers and auditors to comply with. Hence, we propose that the relevant part of the document should be migrated into IAS 8 or a planned general disclosure standard as part of the authoritative guidance of IFRSs following the normal standard-setting due process, while leaving other parts as the non-authoritative educational material by making a clear link with accounting and disclosure requirements in relevant Standards.

<b>Question 2—Illustrative examples</b>
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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 those example(s) would be helpful to entities.
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3. As stated in the covering letter, we do not believe that examples in the proposed document would be sufficiently helpful to address the practical challenges that preparers and auditors are actually facing in their financial reporting practices where such practices have been sufficiently developed. For example, although we agree with the examples shown in paragraph 27 of the ED, we do not necessarily find that the proposed examples are helpful to address the practical challenges because we believe that preparers and auditors have already understood these examples correctly.
4. In general, we think that the proposed document mostly covers relevant areas relating to the application of materiality to financial statements, and there are not many areas that should be added to the document. In addition, we have received feedback from our constituents that the proposed document could be used as a ‘checklist’ if the IASB tries to add a number of examples to the document such that the document covers areas comprehensively. Hence, we suggest that the IASB take a cautious approach when considering whether to add additional examples.
5. Having said that, in light of the initial focus of the project (that is, in our understanding, to improve the disclosure practices in the financial statements), we think that it might be helpful if the IASB considers expanding discussions relating to the application of the materiality concept to disclosures in financial statements. For example, it might be helpful if the IASB expands on paragraph 46 of the ED that relates to whether, and if so, how the concept of materiality can be applied differently to the primary financial statements and notes to financial statements.
6. For specific comments on illustrative examples, please see paragraph 9 of this letter.

### **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? 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 those example(s) would be helpful to entities.

(a) **Additional contents should be included**

7. Except for the suggestion stated in paragraph 5 of this letter, we do not think that there are many additional contents that should be included in the proposed document.

**(b) Understandability and helpfulness of the proposed guidance**

8. As a whole, we think that the descriptions in the document are sufficiently clear preparers of financial statements who have a reasonable level of business or accounting knowledge and IFRS. However, as stated in the covering letter, we do not believe that the contents of the documents are sufficiently helpful for preparers in addressing the real-life practical challenges that they are actually facing in their financial reporting practices.

**(c) Paragraphs or sections that should be amended**

9. We believe that descriptions in the proposed document should be amended for the following respects:

**Paragraph 39 (a) of the ED**

Paragraph 39 (a) of the ED explains that combining a large number of similar leases for disclosure purposes may not lead to a loss of material information, while it also states that separate information about a subset of the leases may be material if they have significantly different characteristics from others. Given that such judgement is quite complicated in practice, we feel that it would be more desirable if the level of detail of disclosures is specified at the Standard level in this case. Hence, we prefer removing the example or replacing the example with a different example.

**Paragraphs 45-48 of the ED**

Paragraph 46 of the ED states that although the concept of materiality does not change when applied to the notes, the context in which that concept is applied is different. However, the ED does not provide robust descriptions about what factors affect the difference in judgments other than stating that the objective of the primary financial statements and notes to financial statements are different. In light of addressing the recent disclosure-related problems (that many describe as ‘disclosure-overload’), it would be helpful if the IASB further explains what factors could affect the judgments possibly supplemented by additional illustrative examples.

**Paragraph 57 of the ED**

Paragraph 57 of the ED states that the assessment of whether and how information should be disclosed in the financial statements may depend on the availability of other information from publicly accessible resources, while it also states that public availability of information does not relieve the entity of the obligation to disclose material information that is specifically required by IFRSs in the financial statements. We think that the paragraph is at the least confusing, because descriptions in the paragraph seem conflicting with each other. Specifically, we do not think that the assessment of whether and how

information should be disclosed in the financial statements will change on the basis of the availability of other information from publicly accessible resources, as consideration of other publicly available sources would blur the scope of responsibilities of both management and auditors for the financial statements.

**Paragraph 59 of the ED**

Paragraph 59 of the ED states that the context and objectives in which the concept of materiality is applied to interim financial reporting are different from that applied to annual financial reporting. However, the ED does not provide robust descriptions about how they are different (for example, whether and how a quantitative benchmark against which the materiality should be assessed is different between interim financial reporting and annual financial reporting). Hence, it would be helpful if the IASB provides additional descriptions about the nature of such differences.

**Paragraphs 63 to 66 of the ED**

Paragraphs 63 to 66 of the ED explain practical expedients in recognition and measurement that management can consider in developing its internal record-keeping procedures. However, considering the term ‘practical expedients’ is often used to explain that the Standard permits simplified accounting treatments for cost-benefit reasons (for example, scope exceptions set out in IFRS 16 *Leases*), we think that it would be desirable if the IASB explains the difference between the two types of practical expedients in the proposed document.

**(d) Unnecessary paragraphs or sections**

10. Other than specific comments in the previous paragraph, we do not find particular paragraphs or sections of the ED that are clearly unnecessary for the purpose of educating stakeholders about what the application of materiality concept to financial statements is all about. Nevertheless, consistent with what we stated in the covering letter, we suggest that some of the descriptions in the ED (with which the IASB expects financial statements preparers and auditors to comply) be migrated into IAS 8 or a planned general disclosure standard as part of the authoritative guidance, such that the nature of the proposed document would be much clearer and easier to understand. In this regard, we suggest that the IASB consider migrating some descriptions that represent management’s actions into the authoritative parts of IFRSs. Please see specific comments in Appendix-II of this letter.

**(e) Aspects of the guidance that will conflict with legal requirements**

11. We do not find aspects of the ED that will conflict with the legislative requirement relating

to materiality in Japan

**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?

12. For the following reasons, we do not support the IASB's plan to issue the proposed document before the finalisation of other relevant work of the Disclosure Initiative (including the Principles of Disclosure project):
- (a) Different from the IASB's assessment, we think that the contents of the proposed document will be influenced significantly by its subsequent discussions planned as part of the Principal of Disclosure projects. For example, we think that the contents will be significantly influenced by the subsequent IASB's decision on (a) whether the definition of materiality in the *Conceptual Framework* or the Standard should be amended as well as (b) whether, and if so, how a disclosure objective should be set forth in each Standard. In addition, if the IASB decides to substantially restructure the format of disclosure requirements to emphasise the importance of the management judgement, we think that the contents of the proposed document should be amended accordingly to reflect the increased importance regarding the application of the concept of materiality.
  - (b) If the IASB decides to incorporate some descriptions in the ED into the authoritative part of IFRSs, we think that the IASB should carefully consider whether they should be included in IAS 8 or a planned general disclosure standard. Accordingly, it would



seem logical for the IASB to wait until it decides whether, and if so, how to develop a general disclosure standard.

(c) Based on our assessment on the nature of the proposed document stated in the covering letter, we do not think that issuance of the proposed document is urgently called for in practice. Hence, we do not think it necessary to finalise the document in accordance with an accelerated timetable. Instead, coordinating the work with other relevant work of the Disclosure Initiative would avoid the risks of confusing stakeholders, because it would safeguard against changing the document multiple times in a relatively short period of time.

13. For these reasons, we believe that the IASB should not issue the document before the finalisation of other relevant work of the Disclosure Initiative. We are hoping that the completion of the IASB's work that would help improve an entity's judgment with regard to whether and how to implement disclosure requirements in parallel with the work on a review of disclosure requirements themselves (including clear articulation of disclosure objectives in individual standards) will more effectively bring about a positive impact on the communicative value of financial reporting for users of financial statements.

## **Appendix-II**

### **Descriptions that IASB should consider migrating into authoritative parts of IFRSs**

As stated in paragraph 2 of this letter, we believe that the IASB should consider migrating selected descriptions in the ED (with certain modifications thereto) into the authoritative parts of IFRSs. As an example, we identified the following paragraphs for the IASB to further consider, because: (i) these descriptions do not necessarily exist explicitly in the existing IFRSs, (ii) they are relevant to specific management actions and (iii) attaching authoritative status thereto are expected to contribute to improving the quality financial information prepared in accordance with IFRSs.

### **Presentation and disclosure in the financial statements**

- Paragraph 30: Judgements on whether information is material should be made within the context of the primary objective of financial statements and by considering the complete set of financial statements.
- Paragraph 32: Management should assess whether information is material within the context of the different parts of the financial statements; for example,
  - (a) Whether and how information should be presented separately in the primary financial statements;
  - (b) Whether and how information should be included in the notes; and
  - (c) Whether the assessment above changes after reviewing the complete set of financial statements.

### **Primary financial statements versus the notes**

- Paragraph 43: When presenting line items, management should assess which items serve as useful signposts to link the face of the statements with the detail in the notes to help the primary users navigate through the financial statements.