European Securities and Markets Authority

Feedback Statement

Considerations of materiality in financial reporting

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List of abbreviations and acronyms used in this report

CP	Consultation Paper
EECS	European Enforcers Coordination Sessions
EU	European Union
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IFRS IC	International Financial Reporting Standards Interpretations Committee
ISA	International Standards on Auditing

Summary

In November 2011, European Securities and Markets Authority (ESMA) issued a Consultation Paper entitled *Considerations of Materiality in Financial Reporting* (CP) with the objective of contributing to the consistent application of the concept of materiality in financial reporting. In August 2012 ESMA published a Summary of Responses to the Consultation Paper.

Given the range of views expressed by the respondents to the CP on some matters and in order to further clarify those views, ESMA hosted a public roundtable on materiality in financial reporting in October 2012 where some of the issues raised in the CP were discussed.

This Feedback Statement provides an overview of the views expressed by respondents to the questions in the CP as well as the feedback of participants at the Roundtable and sets out ESMA's response to the issues arising from the consultation process.

- A majority of respondents considered that the concept of materiality is generally well understood, but many respondents expressed the view that there is diversity in application. In particular, user representatives signalled that they see a problem with how materiality is understood and applied. Examples were cited that preparers often do not provide information where IFRS does not explicitly mandate disclosure even though the information might be relevant and material while at the same time providing immaterial information that is not relevant to users.

- Diversity in application was attributed to the exercise of management judgement, the various perspectives of different stakeholder groups as well as challenges to the proper application of the concept of materiality.

- Responses across most stakeholder groups raised concerns about the length of disclosures reaching the point where they could obscure readers' understanding of the entity's financial position and performance. Many respondents to the CP considered that proper application of the materiality concept could address this problem. Participants at the Roundtable suggested that the Disclosure Framework project being undertaken by the IASB might offer a potential solution to address the overload concerns. Participants also suggested that further education about the application of IFRSs in Europe might be required.

- There was widespread agreement among respondents across all stakeholder groups that if further guidance was required in respect of the application of materiality, it should be addressed by the IASB, rather than by ESMA. Several respondents noted that the involvement of the IAASB would also be necessary.

- A majority of respondents expressed the view that there was no evidence of any significant divergence in practice in the assessment of materiality between financial reporting and auditing arising from different terminologies used in their respective standards. However, a number of the user representatives mentioned the need for greater consistency between accounting and auditing standards.

- Most respondents highlighted the role of qualitative as well as quantitative aspects in materiality assessments. Several respondents maintained that the qualitative and quantitative aspects of materiality judgements cannot be separated - doing so could lead to development of a 'tick-box' mentality rather than using of judgement in assessment of materiality. Furthermore, they suggested that as materiality is an aspect of considering relevance, the focus of the debate should be more on the qualitative rather than quantitative factors of materiality judgements.

- The CP provided specific examples of instances where materiality judgements may be particularly sensitive. However, a common theme in the responses was that the provision of lists of items to be considered in materiality judgements was not considered desirable. This was because such a list could not be exhaustive, or alternatively that it was not in line with principle-based standards and defeats the exercise of professional judgement.

- A majority of respondents agreed that the impact of all uncorrected misstatements, including those of continuing applicability arising in earlier periods, should be considered when evaluating whether aggregate misstatements are material.

- Among user representatives, there was some support for the inclusion of an accounting policy disclosure in financial statements in respect of materiality. However, respondents from other stakeholder groups were of the view that any such disclosures would become boilerplate, lacking entity-specific information. A number of user representatives did see merit in the provision of such information outside of financial statements.

- The majority of respondents were of the opinion that the principles to be applied in assessing materiality in interim and annual financial reports should be the same. However, many respondents share the view that that was not the case in practice for several reasons. Therefore, ESMA will address this issue with the IASB.

Next steps:

Based on the responses to the CP and on the basis of the discussion during the public Roundtable, ESMA will provide the IASB and the IAASB with the outcome of this consultation and will encourage them to address the aspects of materiality that are seen to be problematic in practice, notably with regards to the relevance of disclosures and the qualitative assessment of materiality. In that regard, the IASB has recently announced that it will host a public disclosure forum to discuss how to improve the usefulness and clarity of disclosures. The IAASB is also undertaking a project on financial statement disclosures. ESMA will share evidence and engage with both the IASB and IAASB in their work on these projects and encourages both standard-setters to include discussions in this area in their on-going cooperation.

I. Introduction

1. Operating under ESMA, the European Enforcers' Coordination Sessions (EECS) is a forum in which all European national enforcers of financial information meet to exchange views and share experiences of enforcement of IFRS financial statements. A recurring theme of such discussions is the apparent differing views regarding the practical application of the concept of materiality amongst preparers, auditors, possibly users of the financial reports and, in some instances, accounting enforcers.

2. In November 2011, ESMA issued the CP in an effort to contribute to a consistent application of this important concept in financial reporting. The broad range of respondents and thoughtful comments demonstrate the importance of, and interest in, this initiative.

3. The CP's objective was to seek views on the concept of materiality, and on the basis of answers that would be received, to consider the need for further developments in this area. The comment period closed on 31 March 2012 with 50 responses received from a broad range of stakeholders (a list of the respondents grouped by category is provided in Annex 1 and details of the number of respondents to each question is provided in Annex 2).

4. Given the range of views on some of the issues raised in the CP and in order to further clarify the views, in October 2012 ESMA organised a public roundtable which was attended by participants from 24 institutions, including representatives from IASB, IAASB and EFRAG (overview of categories of respondents to the CP and participants at the Roundtable is provided in Annex 3).

5. The main topics for discussion at the Roundtable included: challenges to the consistent application of materiality, potential role for the materiality concept in tackling disclosure overload, application of materiality in interim financial reporting, assessment of omissions and misstatements and discussion on the need for further guidance from the IASB and IAASB on materiality in financial reporting.

6. This Feedback Statement provides an overview of the key messages from the responses received to the CP and from the discussions at the Roundtable. The views expressed offered valuable insights relevant not only to accounting enforcers, but also to accounting standard-setters, regulators and other stakeholders.

7. ESMA believes that sharing what it has heard will be useful in stimulating further thinking and exploration of this very important concept. It will also provide a basis to begin the process of collaboratively working towards addressing some of the issues raised.

II. Overview of feedback received

A. Understanding, application and guidance in respect of the concept of materiality

8. In the CP, ESMA outlined the provisions of IFRS in respect of the application of the concept of materiality. ESMA asked:

   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?

9. The majority of respondents considered that the concept of materiality is generally well understood, but many respondents expressed the view that there is diversity in application. However, the user representative category was more divided on the issue with two thirds of those responding expressing the view that the materiality concept was not clearly and consistently understood. This key message was repeated during the Roundtable discussions.

10. Respondents attributed this diversity in application to the fact that significant judgement is necessarily involved and that the concept is applied at the entity level. Many respondents pointed out that different judgements and more than one conclusion on similar facts can be valid and do not necessarily represent a lack of consistency. A number of respondents attributed differences arising in either understanding or application to the differing perspectives of the various stakeholder groups.

11. Several participants at the Roundtable pointed out that there is an inherent difficulty in distinguishing between the assessment of materiality within a range of reasonable judgements and breaches of IFRS that might be purported to relate to different application of the materiality concept. Some suggested that further education in respect of the application of IFRS might be required.

12. Failure to properly apply the concept of materiality to note disclosures was a common theme of the responses, with respondents noting reluctance to exercise judgement to exclude information from the financial report leading to the point where length of disclosure could obscure readers' understanding of the entity's financial position and performance. Many respondents noted that when immaterial items are included in the notes, useful and material information could be obscured, making the financial report less relevant.

13. Since disclosure overload was a common theme arising in the responses to the CP, the topic was included for specific discussion at the Roundtable. Several participants noted that since IFRS disclosure requirements do not need to be applied to information that is not material, encouraging behaviour change in respect of the disclosure of immaterial information was necessary. Roundtable participants also suggested that the Disclosure Framework being discussed by the IASB might address some of their concerns. Further potential solutions mentioned included prioritisation of key disclosures as well as developments in technology (e.g., electronic financial statements, XBRL). On the other hand, some highlighted limiting factors for reducing disclosure overload as many non-IFRS requirements are adding to the volume of disclosures in annual reports.

14. User representatives at the Roundtable made the point that preparers often do not provide information where IFRS does not explicitly mandate it, even though the information might be relevant. Consequently, they suggested a broad call for relevance of disclosures in the financial statements as well as more succinct disclosures.

15. In respect of whether more clarification is required, the views of the respondents to the CP were split, with just over half of respondents either silent on, or not supportive of, the development of further guidance and the remaining responses evenly divided between those supporting further guidance on the concept of materiality generally and those supportive of further guidance only in respect of the application of materiality to note disclosures. Consistent with their view that the concept of materiality is not always clearly and consistently understood, a majority of the user representative category mentioned the provision of either additional guidance or greater consistency between accounting and auditing standards. Of those respondents that said that further guidance would be useful, a number clarified that such guidance should be general rather than prescriptive and should be issued by the IASB. This is discussed further in question 2 below.

16. **ESMA's response:** Given that respondents perceived diversity in the application of materiality and that some respondents saw a need for further guidance, ESMA will report this finding to the IASB for its consideration. Furthermore, ESMA would encourage efforts to prioritise the relevance of financial information to users and in that regard welcomes the IASB initiative to improve the usefulness and clarity of disclosures as part of the Disclosure Framework project. ESMA also welcomes the IAASB's financial statement disclosure project and the IAASB's intention to provide input as appropriate to the IASB initiatives related to disclosures. ESMA also considers that a greater focus on education to improve the consistency of understanding and application of the materiality concept in financial reporting would be a useful initiative.

17. Arising from the matters raised in question 1 of the CP, ESMA also asked:

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

18. A large majority of the respondents to the CP across all stakeholder groups considered that ESMA should not issue guidance. They noted that if further guidance on the concept of materiality is deemed to be required, the IASB as the global standard-setter is the appropriate body to develop it. Respondents were concerned that the issue of guidance by ESMA could give rise to an EU variation of IFRS which is not considered desirable in the context of the move towards global standards and would not assist with global consistency in application. Furthermore, such EU-specific guidance could cause difficulties for entities listed both within and outside the EU.

19. Several respondents suggested that the CP is an important contribution and that ESMA should provide the IASB with the outcome of its consultation, raise its concerns with the IASB and contribute to any IASB project relevant to this matter.

20. **ESMA's response:** ESMA does not intend to issue any guidance directed to issuers in respect of materiality. However, while not issuing additional guidance, ESMA will work further within the current financial reporting framework to enhance the understanding and consistent application of materiality under IFRS as a part of the enforcement of financial information. At the same time, ESMA will provide the IASB and the IAASB with details of the outcome of this consultation and will encourage them to address the aspects of materiality that are seen to be problematic in practice, notably in the area of disclosures. In that regard, the IASB's disclosure framework project is relevant and ESMA will share evidence and engage with the IASB in its work on that project.

B. Characteristics of primary users and the objective of financial reports

21. In the CP, ESMA outlined that the definition of materiality in IAS 1 – *Presentation of Financial Statements*, paragraph 7 puts emphasis on whether an item '*could influence the economic decisions that users make*', while the stated objective of general purpose financial reporting in the

Framework is to provide useful information to aid user decision making about '*providing resources to the entity'*. ESMA asked:

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.

22. The responses to this question were mixed; half of the respondents to the question believed that '*economic decisions that users make*' is not the same as users making decisions about '*providing resources to the entity*' and the other half considered that the decisions are the same. The most cited elucidation by those who do not believe the decisions are the same was that decisions about providing resources to the entity is a subset of economic decisions.

23. An analysis of the responses by category follows the same pattern. Five out of seven audit firms believe there is no difference while a majority of user representatives and accounting bodies believe the decisions are not the same.

24. **ESMA's response:** Given that there seems to be a certain degree of diversity in understanding the terms '*economic decisions that users make*' and users making decisions about '*providing resources to the entity*' by a broad range of constituents, ESMA will report this finding to the IASB for its consideration.

25. In the CP, ESMA outlined that there are many stakeholders with an interest in an entity's financial reporting, including past and present employees. ESMA noted that the Framework states that the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors, who are termed the 'primary users'. ESMA provided examples of the kind of decisions that primary users make, such as decisions about whether to buy, hold or sell an entity's equity or whether to provide loans or other forms of credit. ESMA asked:

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

26. A majority of respondents believe that the primary user constituents of general purpose financial reports as defined by the IASB (existing and potential investors, lenders and other creditors) do not include all those users as outlined in paragraph 16 of the CP.

27. Many of those respondents believe that present and past employees are not primary users. Some indicate that employees might have conflicting information needs and desires that cannot be satisfied.

28. An analysis of the responses shows that five out of the six accountancy bodies that responded are of the opinion that the groups are not the same. Furthermore, three out of six user representatives advocate the extension of the primary user group - by stewardship users (two) or credit rating agencies (one).

29. Feedback at the roundtable about the consideration of users in the context of materiality decisions noted that while the primary users are investors and other providers of capital, it is nonetheless important for preparers to keep in mind secondary users in considering what information might be relevant. Furthermore, there is an overlap in information needs between primary and

secondary users and a natural benefit to other users in the provision of information for primary users.

30. **ESMA's response:** While a majority of respondents did not consider that primary users included all of the stakeholders included in the CP for discussion purposes, it is important to note that the feedback at the roundtable highlighted that the information needs of other users were relevant and should also be considered.

31. In the CP, ESMA explained that the assessment of materiality requires consideration as to whether an omission or misstatement '…***could***… *influence the economic decisions that users make…* '. ESMA asked:

    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.

32. Most respondents to this question agreed that, in isolation, '*could*' and '*would*' do have different meanings. Use of the word '*would*' generally indicates a greater degree of certainty than the conditional '*could*'. For this reason, a few preparers indicated that they may not be able to judge explicitly what influences a user in his economic decision making and, therefore, that they prefer the expression '*could*'.

33. The vast majority of respondents, however, thought that the distinction between the two words exists only in semantics. In practice, they would not expect the usage of the two terms to give rise to any difference. Respondents noted that if it did, there would be many more modified audit reports in the IFRS financial statements.

34. A small number of respondents thought it might be helpful if the terms could be clarified, but only in terms of the semantics as they did not see that any alignment would make any difference in practice.

35. A small number of respondents highlighted references in the IASB Framework which discussed materiality in terms of being that which '*is capable of influencing the economic decision making of a user*' and which embraces, and is consistent with, the common understanding of '*could*'. Looking to the context in which the term is discussed, they advise against further interpretation.

36. **ESMA's response:** Given that the vast majority of respondents did not see any difference arising in practice, nor did they see that alignment of the terms would make any difference in practice, ESMA does not see a need to pursue this matter further.

37. In the CP ESMA noted that while the financial reporting assessment of materiality requires consideration of whether an omission or misstatement '… ***could*** … *influence the economic decisions that users make…* ', the auditing standards use the expression '***could reasonably be expected to*** *influence the economic decisions of users*'. ESMA asked:

    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?

38. The majority of respondents felt that the terminology used gives rise to similar assessments and that specific reference to '*reasonably be expected to*' would make no difference. Many pointed out that there is no evidence of significant divergence in practice, nor that the arguably different

definitions in IFRS and ISAs give rise to different assessments.

39. Several respondents referred to text within IAS 1 supporting the definition of materiality. IAS 1, paragraph 7 concludes that the assessment of materiality needs to take into account how users could '*reasonably be expected to be influenced*' by information when making economic decisions. The phrase from ISA 320 is, therefore, already embraced by the definition and guidance given within IAS 1 and no alignment is necessary.

40. **ESMA's response**: While no significant divergence in practice was observed by respondents, ESMA notes that, as reported in the feedback to Question 1, several user representatives referred to the need for greater consistency between accounting and auditing standards. Therefore, ESMA will report this finding to the IASB and IAASB for their consideration. However, it is important to acknowledge that IAASB auditing standards apply to a range of reporting frameworks, not just IFRS and this may account for the perceived inconsistency reported by user representatives.

C. Attributes of the information

41. In the CP, ESMA noted that materiality has qualitative as well as quantitative aspects. It was suggested that when considering a quantitative threshold in assessing materiality, the individual line in the primary statement to which the item belongs should also be assessed when determining the materiality. In order to gain the respondents' views of the basis on which the quantitative analysis of materiality is established ESMA asked:

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.

42. The vast majority of respondents focused on the need for the determination of materiality to be based on both quantitative and qualitative characteristics. With only one exception, all respondents highlighted the fact that materiality is not a simple quantitative figure and that the qualitative aspects must take account of the specific facts and circumstances surrounding each item. It was noted that this requires professional judgement based on all relevant information. Several respondents believed that the guidance provided by the IASB is sufficient in this regard.

43. Because of the range of facts, circumstances and requirements that must be considered, many respondents argued that different materiality thresholds are applied all the time.

44. Several respondents maintained that separating qualitative and quantitative aspects would drive a 'tick box' mentality to the determination of something which must, by definition, be decided by application of professional judgement.

45. Several respondents pointed to the US Securities and Exchange Commission's Staff Accounting Bulletin: No. 99, Materiality suggesting that it provides some helpful guidance.

46. Two respondents answered the specific question that was asked, in terms of the quantitative assessment of materiality, believing that the matter was only material if the line item was also material to those financial statements.

47. **ESMA's response**: It is noted that only two respondents addressed the specific question asked, with most respondents focusing instead on the fact that materiality should not be determined solely by simple quantitative comparisons, as both auditing and accounting standards stipulate. ESMA always shared this view and does not support a 'tick-box' approach to materiality assessment.

48. In the CP, ESMA provided a list of examples where materiality judgements are usually particularly sensitive and thus where the adjudged materiality threshold may be lower. ESMA asked:

Q6b: Do you agree that each of the examples provided in paragraph 21 a – e of the Consultation Paper[1] constitute instances where the materiality threshold may be lower? Are there other instances which might be cited as examples? Please explain your rationale.

49. A number of respondents, spread across the range of categories, but with the specific exception of preparer and user representative bodies, argued that it was not appropriate to try and give a list of items where more judgement might be needed than in other cases.

50. They argued that a specific list defeats the exercise of professional judgement and undermines the argument that materiality is to be determined by consideration of attendant facts and circumstances and the application of judgement. Lists were considered to be unhelpful as they have a tendency to drive 'tick-box' compliance and detract from the need for consideration on a case by case basis.

51. User representative bodies were more inclined to agree that the items listed would require a lower materiality level but also agreed that the list may not be exhaustive. A majority of the preparers and preparers' representative bodies answering the question agreed that the list provided 'may' provide examples of instances where the threshold may be lower but emphasised that this would depend on the context and specific facts and circumstances attending. They argued that a qualitative consideration is always required.

52. It was observed that as materiality is an entity-specific aspect of relevance, the focus of the debate should be more on the qualitative rather than quantitative factors of materiality judgements.

53. **ESMA's response:** ESMA acknowledges that the provided list was for example purposes only, and therefore not exhaustive. ESMA remains of the view that the examples provided are situations where materiality judgements are usually particularly sensitive, although whether such examples would be considered material in practice will of course depend on the circumstances of the individual entity concerned.

D. Errors, omissions, misstatements and aggregation

54. In the CP, under the subtitle 'Errors, omissions and misstatements and aggregation' ESMA listed some general situations where the assessment of materiality requires particular consideration, namely uncorrected immaterial errors, aggregation of individually immaterial misstatements or omission, netting of misstatements, and effects of accumulated misstatements. Based on descriptions of those situations ESMA asked:

[1] (a) breaches of legal and/or regulatory requirements;
(b) transactions with related parties, including key management personnel's compensation;
(c) an unusual or non-recurring transactions(s)/balance(s);
(d) an error that results in a reversal of a trend – for example, a loss being turned into a profit or *vice versa*; and
(e) an error that impacts on ratios or other metrics used to evaluate, for example, compliance with debt covenants.

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.

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 of the Consultation Paper in determining materiality? Please explain your views in this regard and provide practical examples, if applicable.

55. A majority of respondents, among all respondent categories, agreed that preparers of financial statements should assess the impact of all misstatements and omissions, including those that arose in earlier periods. Some respondents stated that guidance in IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* is sufficient for assessing these issues, including prior period's misstatements. In their responses, some user representative bodies underlined that misstatements and omissions, even historic ones, are of particular importance since they raise questions not just about current reported numbers but about confidence in the future performance of the business.

56. However, many respondents raised the concern that a kind of checklist is presented in the referred paragraphs, which is not in line with principle-based standards. Some respondents added that no clearly trivial items should be included.

57. During the roundtable, several participants noted that IAS 8, paragraph 8 relating to immaterial departures from IFRSs to achieve a particular presentation was applicable to faithful representation as well as materiality. At the same time, it was noted that auditing standards provide good guidance on aggregation of misstatements in most circumstances.

58. **ESMA's response:** As there is no significant finding arising in respect of this question, ESMA does not see a need to pursue this matter further.

E. Accounting policy disclosure on materiality judgements

59. In the CP, ESMA explained that materiality disclosures could be seen as being part of the IAS 1, paragraph 122 requirements with respect to the judgements made by management which have a significant effect on the amounts recognised in the financial statements. ESMA asked:

Q9a: Do you believe that an accounting policy disclosing the materiality judgements 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.

60. Most respondents indicated that they were not in favour of the inclusion of an accounting policy disclosing materiality judgements in the financial statements. In presenting the rationale for that, respondents indicated that there was a significant risk that such disclosures would become boilerplate (e.g. repeating the definition of materiality from the standard) and therefore, would not provide relevant entity-specific information to users. Alternatively, if such a requirement was to provide entity-specific information, it should be very detailed, but in such case it would become highly complex and difficult for preparers to draw the line and to articulate all judgements made

with respect to different quantitative and qualitative consideration applied to the various items in the accounts.

61. Respondents from all categories made reference to IAS 1, paragraph 122 with respect to disclosures of management judgements which have the most significant effect on the amounts recognised in the financial statements, indicating that materiality disclosures are covered by the above mentioned requirements.

62. Three user representatives indicated that such information would be useful for their purpose. Having expressed a view in favour of presenting materiality disclosures, they indicated that such information was important for users in order to assess the key judgements made by the management, but suggested to include it either as part of the notes to the financial statements or outside of financial statements.

63. **ESMA's response**: ESMA acknowledges that a boilerplate accounting policy with respect to materiality would not provide any benefit to the users of the financial statements. However, given that a number of user representatives indicated that such information would be useful and that such information has the potential to provide additional assurance on management judgements in the preparation of financial statements, ESMA sees merit in the consideration of the inclusion of such information outside of financial statements.

F. Note disclosures and materiality

64. In the CP, ESMA outlined that components of line items are a sub-category of the notes to the financial statements and stated that an assessment of the materiality of component line item disclosures is generally connected to the assessment of the materiality of the line item in the financial statements. ESMA further stated that omitting required notes giving additional information about a material line item may be considered a misstatement. ESMA asked:

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.

65. The majority of the respondents disagreed or strongly disagreed that omitting required notes containing additional information about a material line item necessarily constitutes a misstatement. Some respondents, although agreeing with the thrust of ESMA`s argument, are of the opinion that the judgement of preparers and auditors is required in order to ensure that accounts are not overburdened by information which is only of minimal relevance. Consequently, those respondents share the view that a failure to provide a disclosure about an immaterial item would not be capable of representing a material misstatement.

66. Many respondents emphasised that the assessment as to whether the omission of a required note represents a material misstatement requires a case-by-case judgement. According to many of those respondents, the judgement shall consider whether the omission would change the economic decisions of the users. Furthermore, several respondents are of the opinion that all quantitative and qualitative factors have to be considered when assessing the materiality of the omission. Some respondents expressed their concern that ESMA seems to favour an approach which would lead to a 'checklist' or 'tick-box' mentality.

67. Only three respondents explicitly agreed that omitting required notes giving additional information about a material line item in the financial statements constitutes a misstatement. All

of them are user representative bodies.

68. **ESMA's response**: While ESMA believes that omitting required notes giving additional information about material line items in the financial statements may represent a misstatement, ESMA would like to clarify for respondents that it would not favour a rules-based approach that might lead to a checklist mentality. ESMA would expect preparers and auditors to exercise judgement on the materiality of each component of the notes so that disclosures relevant to the users are presented in a helpful manner.

69. In the CP, ESMA outlined examples of supplementary information included in the notes to the financial statements. It was noted that a number of notes do not relate directly to the financial statement items but are nonetheless of significance for the overall assessment of the financial statements of a reporting entity. ESMA asked:

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.

70. Overall, the vast majority of respondents agree with (a): when determining the materiality applying to notes which do not relate directly to financial statement items the same considerations shall apply as when determining the materiality of financial statement items. According to more than 10 respondents, the critical consideration in that regard is the relevance of a note to a user, i.e. whether the provision of a note could cause a user to make a different economic decision.

71. However, several respondents share the view that while in principle the same considerations should apply irrespective of whether a note relates to financial statement items or not, in fact there are differences in practice. Audit firms in particular believe that, in practice, qualitative aspects are relatively more important than quantitative aspects in these cases.

72. Some respondents emphasised that a note should only be provided if it is deemed to contain material information in order to avoid information overload and the use of disclosure requirements in accounting standards as a checklist.

73. **ESMA's Response**: ESMA agrees with the majority view that the same considerations for materiality assessment should apply and encourages preparers and auditors to exercise judgement about materiality in a manner that would consider the relevance of the information to the users. In the context of the current economic and financial crisis, preparers may need to consider new and/or different factors to identify relevant information to enable users to understand the entity's financial position and performance.

G. Interim financial reporting and materiality

74. In the CP, ESMA explained that in accordance with IAS 34 – *Interim Financial Reporting,* paragraph 23 the materiality assessment for interim financial reporting purposes shall be assessed in relation to the interim period financial data. ESMA asked:

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?

75. The views on this question were uniformly distributed amongst the different categories of respondents. The majority of the respondents were of the opinion that the principles for the materiality assessment in interim financial statements should be the same or are the same as in annual financial reports.

76. However, many respondents believe that, although in theory the materiality assessment should be the same, in practice it is not. The most commonly used explanation for existing differences was that interim measurements may rely on estimates to a greater extent. Many respondents also emphasised that the purpose of interim financial reports is different to annual reports as they intend to provide an update on the latest complete set of annual financial statements. Only a few respondents clearly stated that this leads, in practice, to higher materiality thresholds compared to annual financial statements. Some other respondents put emphasis on the fact that materiality is determined in relation to interim period financial data without indicating whether this leads to lower materiality thresholds or not.

77. The relevance of interim reports was reinforced by roundtable participants across several stakeholder categories. Some participants commented that while there is, of necessity, an increased use of estimates in interims this does not equate to an increase in a quantitative materiality threshold. In fact, given that users often focus on the 'trend' of results as well as the fact that the results are for a half-year only, thresholds could instead be lower. Several participants warned against putting too much emphasis solely on quantitative considerations. The overriding consideration was whether users' economic decision-making could be affected, and such assessments often necessitate attributing significant emphasis to qualitative factors.

78. **ESMA's Response**: ESMA will report the findings in this regard to the IASB and, consistent with its response to the IASB Agenda Consultation, will encourage the IASB to clarify the principles of preparation of interim financial statements. Even though there are objective differences in preparation of annual and interim financial statements, e.g. due to higher use of estimates or the intention to provide an update on the latest complete set of annual financial statements, the underlying principles of the application of materiality in preparation of interim financial statements should be the same as for annual financial statements.

Annex I – List of respondents

This Feedback Statement aims to highlight the main messages stemming from the responses to the CP as well as provide an overview of the feedback provided by participants at the roundtable. The comment letters are available on ESMA's website.

	Name of the respondent grouped by category
	Preparers
1	Barclays plc
2	BP plc.
3	Deutsche Bank AG
4	HSBC Holdings plc
5	SAP AG
6	Standard Chartered Bank
	Accounting Bodies
7	ASSIREVI
8	FAR - the Institute for the Accountancy Profession in Sweden
9	Federation of European Accountants (FEE)
10	Institute of Chartered Accountants in England and Wales (ICAEW)
11	Institut der Wirtschaftspruefer in Deutschland e. V. (IDW)
12	Instituto de Contabilidad y Auditoria de Cuentas (ICAC) Spain
13	The Dutch Professional Accountancy Association (NBA)
14	The Institute of Chartered Accountants of Scotland
15	The Joint Accounting Bodies, Australia
	Preparer representative bodies
16	ACTEO
17	Association for Financial Markets in Europe
18	Insurance Europe
19	Business Europe
20	Confederation of Swedish Enterprise
21	European Banking Federation
22	German Banking Industry Committee
23	The Hundred Group
24	The Quoted Companies Alliance
	User representative bodies
25	Association of British Insurers
26	Corporate Reporting Users' Forum (CRUF)
27	Eumedion
28	Hermes Equity Ownership Services
29	The Credit Rating Agency Observatory (CRAO)
30	CFA UK
	Academics
31	European Accounting Association
32	National centre for accounting and auditing - Ukraine
33	University of Southern Denmark (SDU)
	Regulators and Public bodies
34	European Financial Reporting Advisory Group (EFRAG)
35	SIX Exchange Regulation
36	Swedish Financial Reporting Board

	Name of the respondent grouped by category
	Individuals
37	Chris Barnard
	Standard-Setters
38	Austrian Financial Reporting and Auditing Committee (AFRAC)
39	Accounting Standards Committee of Germany (ASCG) DRSC e.V.
40	Dutch Accounting Standards Board
41	Norsk Regnskapsstiftelse (The Norwegian Accounting Standards Board), Oslo
42	UK Accounting Standards Board
43	Australian Accounting Standards Board (AASB)
	Auditors
44	Deloitte Touche Tohmatsu Limited
45	Ernst & Young Global Limited
46	Grant Thornton International Ltd
47	KPMG IFRG Limited
48	MAZARS
49	PricewaterhouseCoopers LLP
50	BDO

Annex 2 – Number of respondents by question

The table below lists the number of respondents to each question.

As noted above, there were 50 respondents to the CP. However, a number of respondents did not answer all of the questions posed, while others provided only general comments.

Where a respondent's general comments clearly address the substance of a particular question, they are included below as having responded to that question.

Question Number	No. of Respondents
Q1	45
Q2	47
Q3	36
Q4	36
Q5a	38
Q5b	30
Q6a	23
Q6b	36
Q7	38
Q8	38
Q9a-c	39
Q10	40
Q11a-c	37
Q12	36

Annex 3 – Overview of respondents by category

The charts below analyse the number of respondents to the CP and roundtable participants by category.

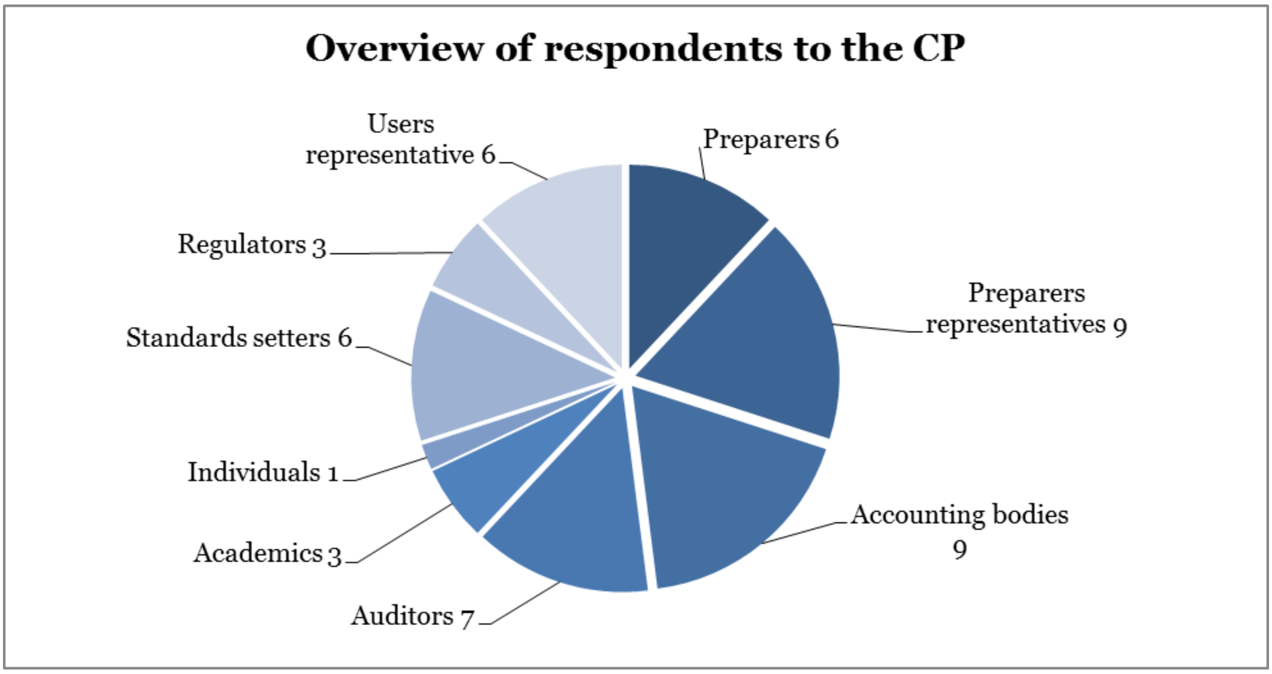

Figure 1: Overview of respondents per category

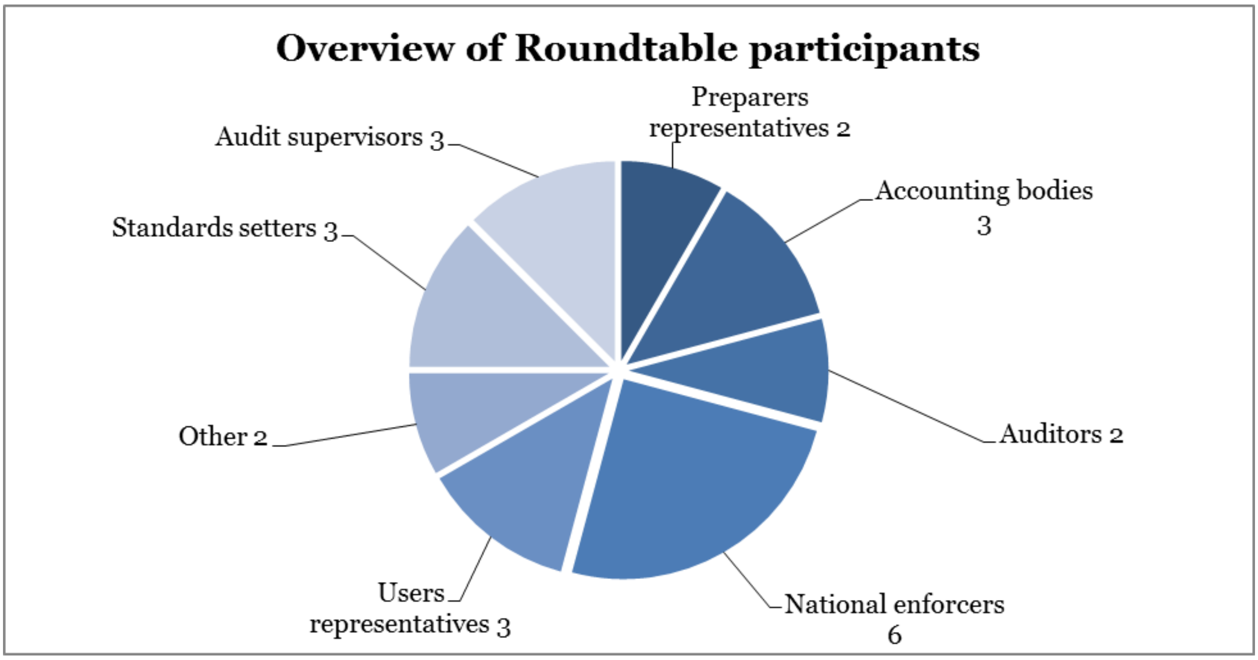

Figure 2: Overview of organisations participating at the Roundtable per category