European Securities and Market Authority

103 rue de Grenelle
75007 Paris
France

Paris, 30 March 2012

RE: ESMA Consultation Paper – Considerations of materiality in financial reporting

Dear Madam/Sir

We are pleased to comment on the above mentioned Consultation Paper (CP) published by ESMA.

First of all, we welcome ESMA’s initiative to gather different points of view regarding the concept of materiality and its application in financial reporting.

We share the view that there is no common understanding among the different stakeholders of how the concept of materiality should be applied in financial reporting. As auditors, we have experienced that the assessment of materiality made by enforcers (securities regulators, courts...) may differ significantly from the one made by preparers and auditors. That is why we favour the issuance of guidance regarding materiality that would be applied consistently by preparers, auditors and enforcers. In order to meet this objective, this guidance should be issued by an international authority and at least endorsed by the relevant European authorities.

We wish to put emphasis on the qualitative characteristics that this guidance should present in our opinion:

- It should remain principles-based and set the following principle as its primary objective: financial statements should provide information that is useful for primary users for decision-making. Materiality is a significant area where management exercises its judgement. Each situation being unique, any systematic, rules-based approach in that matter would lead in our view to a lack of relevance.
- It should consider that an excess of information in the notes to the financial statements impairs the clarity and the quality of the financial statements.

- It should be based on guidance relating to materiality that already exists and that has proven its relevance, such as IAASB standards on auditing (ISA).

Our answers to the specific questions raised in this Consultation Paper are presented in the appendix 1 attached below.

We would be pleased to discuss our comments with you and are at your disposal should you require further clarifications or additional information.

Yours sincerely

Michel Barbet-Massin  
*Head of Financial Reporting Technical Support*
Appendix 1: detailed answers to the questions raised in the Consultation Paper *Considerations of materiality in financial reporting*

**Question 1: 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?**

Materiality in financial reporting is a concept that requires exercising professional judgement. Since the different stakeholders do not share the same objectives regarding financial statements, we believe that each class of stakeholders has developed its own approach to materiality.

On some aspects of materiality, preparers and auditors share the same understanding which can diverge significantly from that of users or enforcers.

We believe that materiality in financial reporting should remain subject to judgement, taking into account entity specific factors. Therefore it cannot be dealt with by means of a single set of rules applicable by all stakeholders in a uniform manner, irrespective of their role or environment.

Nevertheless, we agree that achieving a shared understanding of the concept of materiality is a real need, and we welcome the initiative taken by ESMA.

**Question 2: Do you think ESMA should issue guidance in this regard?**

As an auditor, Mazars is worried by the huge difference that sometimes appears between how enforcers (security regulators, courts...), preparers and auditors interpret the concept of materiality, especially in the case of a lawsuit or a dispute.

That is why Mazars would welcome the issuance by a recognized authority of guidance on how the concept of materiality should be understood and applied, provided that this guidance applies to all classes of stakeholders.

ESMA could indeed be the issuer of such guidance, although an international body rather than a European one could be seen as preferable.

Whatever the issuer, we believe that it should not start from scratch, but take advantage of what has already been issued on that topic. IFRSs provide definitions of materiality in financial reporting, whereas the IAASB provides guidance on how to apply it. For example, ISA 320 - *Materiality in Planning and Performing Audit* and ISA 450 - *Evaluation of misstatements identified during the audit* provide relevant guidance on how to determine quantitative materiality. International Auditing standards could therefore be a sound basis for developing a shared approach on materiality.
Question 3: 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 believe that both quotes have the same meaning.

We acknowledge that the IASB should ensure that a consistent wording is used throughout IFRSs, but we believe this goal is difficult to achieve. Uniformity is required for definitions only, and there is less need for eliminating slight wording differences in principles-based guidance.

Question 4: 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.

Users of financial statements are clearly defined in the Framework. Some of the categories of users listed in paragraph 16 of the Consultation Paper are not necessarily primary users. When preparing guidance on the application of the concept of materiality in financial reporting, we believe ESMA should focus on the needs of primary users. Enlarging the scope could lead to an excess of disclosures that could impair the clarity and quality of financial statements.

Question 5a: 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 the use of “could” instead of “would” is nothing but a slight semantic difference that should not have any practical implications regarding materiality thresholds.

Question 5b: 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?

The search for guidance that could lead to a shared understanding of how the concept of materiality should be applied in financial reporting may need to uniform the wording. Nevertheless we are not aware of any significant differences between auditors’ and preparers’ assessment of materiality due to those different wordings.
Question 6a: 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.

Question 6b: 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 materiality is a matter of quantitative and qualitative analysis, and that both aspects should be considered together as a whole. In other words, materiality should be assessed in the context of the objective of the financial statements, taking into accounts all facts and circumstances.

Some situations such as those listed in paragraph 22 of the Consultation Paper could lead to assessing materiality regarding some items of the financial statements at a lower level.

Nevertheless, we do not favour the publication of a list of situations in which the materiality thresholds should be lower, or the introduction of any systematic rules such as the one suggested in question 6a. We fear that a too much prescriptive guidance could lead to an automatic approach that would not be compliant with a principles-based set of accounting standards.

Question 7: 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.

Yes, we agree. When determining materiality decisions, preparers and auditors should assess the cumulative impact of prior period misstatements that are of continued applicability. In this respect IAS 8 is clear on how misstatements and omissions on prior periods should be dealt with.

Question 8: 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.

Yes we agree.
Question 9a: Do you believe that an accounting policy disclosing the materiality judgments exercised by preparers should be provided in the financial statements?

Question 9b: If so, please provide an outline of the nature of such disclosures.

Question 9c: In either case, please explain your rationale in this regard.

As stated above, assessing materiality is a matter of judgement that needs to take into account all facts and circumstances and to develop different approaches depending on the considered line items and specific situations. Therefore we do not believe that it is feasible, nor relevant, to disclose the materiality judgements as an accounting policy.

IAS 1 already requires entities to provide information regarding the significant judgements the management has made in producing the financial statements. We believe that this requirement meets the primary users' needs.

Question 10: 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.

No, we do not agree.

Assessing materiality is a matter of judgement, and we do not support a view that will automatically consider the omission of information about a material line item as a misstatement. Judgement must be made on the relevance for users of such a disclosure even if the line item is material.

Such an automatic qualification would lead to a systematic or “checklist” approach of disclosures that is not desirable.

Question 11: 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.

We believe that the same considerations apply. The starting point is to assess whether the disclosure is relevant to the primary users of the financial statements, and whether it could influence the economic decisions made by users.
Question 12: 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 applied to interim financial statements should not differ from the one applied to annual financial statements.

The objective of interim financial statements is different from that of annual financial statements, and that is why IAS 34 is less prescriptive regarding disclosures and permits interim figures to rely more on estimates. Auditing requirements are also different: interim financial statements are generally not audited, but only reviewed by auditors.

Nevertheless, we do not think that less stringent accounting and auditing requirements for interim financial statements should lead to a different approach regarding materiality. Primary users should be able to make decisions on the basis of interim financial statements. The risk of misstatements in interim financial statements is greater than in annual financial statements, considering the greater use of estimates and the lower level of control, but the approach to materiality should be identical.