



Project:	Materiality Practice Statement	Meeting	AASB December 2017 (M161)
Topic:	Australian Guidance	Agenda Item:	3.1
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		Decision-Making:	Medium
		Project Status:	Draft guidance

Introduction and objective of this paper

- 1 The objective of this paper is to obtain Board decisions in relation to providing materiality guidance based on IFRS Practice Statement 2 *Making Materiality Judgements*.

Attachment

Agenda Paper 3.2 Draft AASB Practice Statement 2

Background

- 2 In the October meeting, the Board concluded that additional work on IFRS Practice Statement 2 *Making Materiality Judgements* is required to make it applicable to all sectors in Australia. Aspects to be considered include:
 - (a) whether to issue an Australian (AASB) version of the IFRS Practice Statement or Australian guidance in another form;
 - (b) the interaction between the IASB guidance and other Australian-specific legislation and guidance;
 - (c) the reference to ‘primary users’; and
 - (d) the inclusion of draft illustrative examples relating to the not-for-profit private and public sectors.
- 3 This paper is structured as follows:
 - (a) summary of staff recommendations; and
 - (b) staff analysis.

Summary of staff recommendations

4 Staff recommend the following:

- (a) the Board should issue an AASB version of Practice Statement 2 rather than publish the IFRS Practice Statement with an Australian addendum;
- (b) there are no conflicts between the IASB guidance and Australian-specific legislation and guidance;
- (c) the definition of ‘primary users’ should be expanded to align with the definition of users in the AASB *Framework for the Preparation and Presentation of Financial Statements* (the *Framework*);
- (d) additional Aus paragraphs and illustrative examples that relate to the not-for-profit private and public sectors should be included in the Practice Statement; and
- (e) the draft AASB Practice Statement should be issued for a short fatal-flaw review period, concluding at the end of January 2018.

Staff analysis

Guidance options

5 Staff considered the following two options regarding providing guidance on making materiality judgements:

	<i>Option 1</i>	<i>Option 2</i>
Approach	Publish IFRS Practice Statement 2 on the AASB website and include an addendum for Australian-specific guidance.	Publish an Australian version of Practice Statement 2 on the AASB website.
Rationale for this approach	<p>The Board adopted this option for IASB Practice Statement [1] <i>Management Commentary</i>.</p> <p>The IFRS Practice Statement is provided on the AASB website via an introductory page that explains that compliance is not required by entities that prepare GPFS in accordance with Australian Accounting Standards.</p> <p>This could provide a precedent approach for Practice Statement 2.</p>	<p>The IASB Practice Statement is for-profit centric and specifically relates to entities that prepare GPFS using IFRS Standards.</p> <p>An Australian version would permit the inclusion of additional examples and editorial changes that would extend the applicability and usefulness of the Practice Statement to include other stakeholders. In particular, the Practice Statement should also be applicable to users and preparers from the not-for-profit private and public sectors.</p>

	<i>Option 1</i>	<i>Option 2</i>
Recommendation	<p>Staff do not recommend this option for the following reasons:</p> <ul style="list-style-type: none"> - Australian guidance already existed in relation to the matters addressed in IFRS Practice Statement 1. This is different to Practice Statement 2 since there is currently no Australian guidance on materiality; - Practice Statement 1 relates to management commentary which does not form part of GPFS, however Practice Statement 2 addresses aspects of preparing GPFS. <p>Hence an alternative approach to the one adopted for IFRS Practice Statement 1 is justifiable.</p>	<p>Staff recommend this option as it would align with the AASB's strategic objective of 'putting stakeholders first always.'</p> <p>An Australian version of the practice statement would enable tailored guidance that:</p> <ul style="list-style-type: none"> - includes references to Australian-specific legislation and standards; - broadens and aligns the definition of 'primary users' to the AASB Framework; - includes additional illustrative examples relating to the not-for-profit private and public sectors.

Staff recommendation

- 6 Staff recommend adopting Option 2, which is to publish an AASB version of Practice Statement 2.

Question for Board members

- Q1 Do Board members agree with the staff recommendation to issue an AASB version of Practice Statement 2?

For-profit sector

- 7 The Board recommended in its October 2017 meeting that further work needs to be done to identify potential conflicts with Australian-specific legislation and guidance that entities would need to consider when preparing general purpose financial statements.
- 8 Staff considered the guidance provided in paragraphs 27 and 28 of the Practice Statement, which relates to the interaction with local laws and regulations. Staff consider the guidance in these paragraphs to be clear in that information considered material, in accordance with a financial reporting framework, must still be provided even if local laws and regulations permit otherwise. Similarly, where local laws and regulations require information in the financial statements which is not required in

accordance with Australian Accounting Standards, the information must be provided without obscuring material information.

9 The definition of ‘material’ in the Practice Statement, which does not conflict with AASB 101 *Presentation of Financial Statements* and AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, was also considered against Australian-specific legislation and guidance, including:

- (a) APESB standards and guidance;
- (b) ASX Listing Rule 3.1 (continuous disclosure obligations);
- (c) Australian System of Government Finance Statistics (GFS); and
- (d) Draft Appendix to the Tax Transparency Code.

<i>Legislation / guidance</i>	<i>Definition / reference to ‘materiality’</i>
Practice Statement 2 – Making Materiality Judgements	Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity’s financial report.
APESB Standards	<p>APES 205 <i>Conformity with Accounting Standards</i> does not define ‘materiality’.</p> <p>APES 110 <i>Code of Ethics for Professional Accountants</i> has an Australian Preface that states:</p> <p>“With regard to the use of the words ‘material’ and ‘materiality’ in Sections 290 and 291, it is not possible to provide a definition that covers all circumstances where either word is used. In assessing materiality, a Member in Public Practice or a Firm shall consider both the qualitative and quantitative aspects of the matter under consideration which might have, or be seen to have, an adverse effect on the objectivity of the Member or Firm”</p>
ASX Listing Rules	<p>For example, Listing Rule 3.1 refers to ‘a material effect on the price or value of the entity’s securities’.</p> <p>The test for determining whether information has ‘a material effect on the price or value of the entity’s securities’ is set out in section 677 of the Corporations Act. Under that section, a reasonable person is taken to expect information to have a material effect on the price or value of an entity’s securities if the information “would, or would be likely to, influence persons who commonly invest in securities in deciding</p>

<i>Legislation / guidance</i>	<i>Definition / reference to ‘materiality’</i>
	whether to acquire or dispose of’ those securities.
Australian System of Government Finance Statistics (GFS)	The ABS GFS Manual (2015) does not define ‘materiality’.
Draft Appendix to the Tax Transparency Code	There draft Appendix to the Tax Transparency Code includes the following definition for ‘material’: “Omissions or misstatements of items are material if they could, individually or collectively, influence the decisions that users make regarding their level of understanding of the tax affairs of an entity. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.”

- 10 An example of continuous disclosure obligations has also been added for for-profit entities – see Example AusF.1, following paragraph 26.

Staff recommendation

- 11 Staff consider that the guidance provided in the IFRS Practice Statement does not conflict with Australian-specific legislation and guidance.

Question for Board members

- Q2 Do Board members agree that the Practice Statement does not conflict with Australian-specific legislation and guidance?

Not-for-profit private and public sectors

Primary users of financial statements

- 12 The IFRS Practice Statement is aimed at entities that prepare general purpose financial statements in accordance with IFRS Standards (paragraph IN2). Accordingly the IFRS Practice Statement adopts a for-profit centric definition of the term ‘primary users’. Paragraph 7 refers to primary users as ‘existing and potential investors, lenders and other creditors’.
- 13 The term ‘primary users’ is not defined in the AASB *Framework*. However the AASB *Framework* includes an Australian-specific paragraph that extends the definition of the term ‘users’ to also include users of financial information of a not-for-profit reporting entity. Paragraph AusOB2.1 is as follows:
- “Among the users of financial information about a not-for-profit reporting entity are existing and potential resource providers (such as investors, lenders and other

creditors, donors and taxpayers), recipients of goods and services (such as beneficiaries, for example, members of the community) and parties performing a review or oversight function on behalf of other users (such as advisers and members of parliament). Such users may make resource allocation decisions in relation to not-for-profit entities that differ from those identified in paragraph OB2 ... In relation to not-for-profit entities, where pertinent, all references in this Framework to ‘existing and potential investors, lenders and other creditors’ (and related terms) should be read as a reference to this broader range of users.”

- 14 The *Framework* also includes paragraph AusOB3.1 which elaborates on the factors that users in the not-for-profit sector would consider when making resource allocation decisions. Paragraph AusOB3.1 is as follows:

“In respect of not-for-profit entities, users (such as certain existing and potential resource providers) are generally not concerned with obtaining a financial return on an investment in the entity. Rather, they are concerned with the ability of the entity to achieve its objectives (whether financial or nonfinancial), which in turn may depend, at least in part, on the entity’s prospects for future net cash inflows. Users will, for example, be interested in the capability of the entity’s resources to provide goods and services in the future. Accordingly, in relation to not-for-profit entities, where pertinent, references in this *Framework* to ‘assessing prospects for future net cash inflows’ (and related terms) should be read in the context of the common information needs of users of general purpose financial reports of not-for-profit entities described in this paragraph.”

- 15 The IPSASB Conceptual Framework, *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (2014), defines ‘primary users’ of GPFs as ‘service recipients and their representatives and resource providers and their representatives’ (paragraph 2.4).

Illustrative examples

- 16 The IFRS Practice Statement has illustrative examples scattered throughout the Statement from paragraphs 9 to 85 about how the materiality concept would be applied in practice. These examples are for-profit centric, however constituents from the not-for-profit sector have confirmed the applicability and relevance of these examples to not-for-profit private and public sector entities as well.
- 17 Notwithstanding the above, staff have included a number of additional examples relevant for not-for-profit entities as well as additional paragraphs to clarify materiality considerations for not-for-profit entities. These are marked up with track changes in the draft AASB Practice Statement (Agenda Paper 3.2). For example, additional Aus paragraphs and/or examples address the following:
 - primary users of financial statements of not-for-profit entities and their decisions, including reference to service potential of assets, based on the AASB and the IPSASB conceptual frameworks;
 - key management personnel related party transactions, based on the Board’s recent Agenda Decision (April 2017); and

- the potential breach of grant agreements (treated similarly to information about breaches of loan covenants), referring to AASB 1058 *Income of Not-for-Profit Entities*.

Staff recommendations

- 18 Staff recommend that the draft additional paragraphs and illustrative examples be included in the proposed guidance to:
- (a) align with the ‘transaction neutrality’ approach of the Board by extending the guidance to address not-for-profit entities;
 - (b) identify a broader group of stakeholders, specifically not-for-profit financial statement users, in addition to the ‘primary users’ noted by the IASB; and
 - (c) identify and illustrate some specific resource allocation decisions made by users of financial statements of not-for-profit entities.

Questions for Board members

- Q3 Do Board members agree that the additional draft illustrative examples as marked up in agenda paper 3.2 should be included in the AASB Practice Statement?
- Q4 Do Board members agree that the additional draft Aus paragraphs should be included?

Next steps

- 19 The draft AASB Practice Statement is presented as a version for fatal-flaw review. Rather than proceeding to issue an AASB Statement directly, staff recommend that the draft Statement be approved for publication for fatal-flaw comments for a period of approximately 45 days, say to the end of January 2018. This will give the opportunity for not-for-profit entities to comment on the additions to the IFRS Statement, as well as for-profit entities.
- 20 A limited consultation period at this stage is justified on the grounds that the Statement is not a mandatory pronouncement.

Question for Board members

- Q5 Do Board members agree to issue the draft AASB Practice Statement for a fatal-flaw comment period, concluding at the end of January 2018?