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Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
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Dear Hans

IASB ED/2015/8 *IFRS Practice Statement:*
Application of Materiality to Financial Statements

The Australian Accounting Standards Board (AASB) welcomes the opportunity to provide comments on IASB ED/2015/8 *IFRS Practice Statement: Application of Materiality to Financial Statements* ('the ED'). In formulating its comments, the AASB sought and considered the views of Australian constituents through comment letters and other consultation. The comment letters received are published on the AASB's website.

The AASB is supportive of the IASB undertaking its Disclosure Initiative Project and appreciates the IASB's efforts in issuing the draft Materiality Practice Statement. The AASB believes, overall, the guidance will improve consistency in managements' assessments of materiality and will enhance communication between the entity and other parties such as auditors by providing a common platform for materiality discussions. However, the AASB has identified some areas where the discussion could be extended or clarified.

The AASB supports the proposal to issue this guidance in the form of a non-mandatory Practice Statement. The AASB also supports finalising the Practice Statement in advance of completing other work under the Disclosure Initiative project, as the guidance may encourage some entities to begin undertaking a de-cluttering exercise by providing them with a platform against which to make these decisions.

The AASB's responses to the specific matters for comment in IASB ED/2015/8 are included in the Appendix to this letter. If you have queries regarding any matters in this submission, please contact me or Ahmad Hamidi (ahamidi@aasb.gov.au).

Yours sincerely

K. E. Peach

Kris Peach
Chair and CEO

APPENDIX

AASB comments on IASB ED/2015/8 *IFRS Practice Statement: Application of Materiality to Financial Statements*

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 The AASB agrees with the proposal to issue guidance on applying the concept of materiality in the form of a non-mandatory Practice Statement. Application of the guidance should involve judgement. Although Australia had a domestic materiality Standard until 2014 and some Australian constituents prefer the guidance be issued in a form other than a Practice Statement (to give it more prominence and authority), feedback received on the ED generally suggests that there is concern that mandatory guidance could result in inappropriate disclosures in the long-term, as management might feel constrained in applying judgement to the facts of the case under consideration and instead opt for the safer outcome of including a disclosure with a view to reducing the risk of an unfavourable audit opinion. Moreover, in a mandatory form, less sophisticated preparers might look for prescriptive guidance which might not be there and a 'tick the box approach' might ensue. The AASB thinks issuance as non-mandatory guidance reduces the potential risk of undermining the emphasis on management judgement. It would also be consistent with the expected Disclosure Initiative project approach to disclosures where the focus would be on objectives of Standards and management would have more discretion to exercise judgement in determining the necessary disclosures.

2 Accordingly, the AASB supports issuing the guidance as a separate pronouncement, rather than as application or implementation guidance appended to a specific IFRS. The AASB agrees that this emphasises the fact that materiality is a concept that is pervasive throughout IFRS.

Question 2—Illustrative examples
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.

3 The AASB considers the examples in the draft Practice Statement to be helpful, without being prescriptive. However, the AASB notes that the examples included are relatively straightforward. The AASB thinks the guidance would be more useful to preparers, especially those in smaller entities, if it were to include both straightforward examples, and examples that address more challenging circumstances where the materiality assessment is more subjective. For instance, examples could be included to demonstrate how the materiality assessment is made in relation to:

(a) related party transactions conducted on 'market terms', involving small sums, or pertaining to benefits to staff also available to other employees; and

(b) narrative disclosures, such as the qualitative disclosures about risks arising from financial instruments specified by paragraph 33(b) of IFRS 7 *Financial Instruments: Disclosures*.

4 In addition, the AASB notes paragraph 67 of the Practice Statement refers to other misstatements of information such as describing information ambiguously or obscuring material information. The AASB thinks it would be useful to also include, for instance, an example to show how the materiality of obscured material information is evaluated.

Question 3—Content of the [draft] Practice Statement
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?

5 The AASB is of the view that, overall, the draft Practice Statement will be understandable by, and helpful to, preparers of financial statements. However, certain aspects of the Practice Statement could be improved, to extend the discussion or provide clarity to the guidance or ensure that the discussion is balanced. Subject to our concerns discussed further in this submission, the AASB does not disagree with any paragraphs/sections of the proposed guidance.

6 The AASB notes that the draft Practice Statement forms part of the IASB's Disclosure Initiative project. Accordingly, the guidance in the Practice Statement largely pertains to materiality as it applies to presentation and disclosure, rather than recognition and measurement; for example, the discussion in paragraphs 7 – 10 of the ED (IFRS

definition of materiality) does not explicitly acknowledge that the concept of materiality applies also to recognition and measurement to the same extent as it does to presentation and disclosure, and the illustrative examples included relate to presentation or disclosure, rather than recognition or measurement. The AASB supports the focus of this Practice Statement being with regard to presentation and disclosure, but encourages the IASB to make this clear upfront in the document, for example, within the objective of the Practice Statement (however, see also paragraph 8(c)).

7 The AASB has not identified any unnecessary paragraphs or sections. However, the AASB thinks the guidance could be finalised to be more concise by, where appropriate, referencing an IFRS rather than quoting extracts from it. For example, paragraph 60 could simply state that paragraphs 23 and 25 of IAS 34 *Interim Financial Reporting* explain materiality as it applies to interim financial reporting.[1] Similarly, the AASB would prefer the guidance be simplified by removing repetitive content from the final pronouncement; for example, the content of paragraph 29 is largely repeated in paragraph 56.

Additional content, and paragraphs/sections of concern

8 In addition to our response to Question 2, the AASB encourages the IASB to improve the discussion or make clarifications in the following areas:

(a) the AASB notes that various IFRS employ terminology such as "major", "significant", "key" and "at a minimum". The AASB thinks it would be useful for the Practice Statement to address the interaction between "material" and IFRS terminology that implies materiality. In addition, the AASB thinks the draft Practice Statement should discuss the interaction between the Practice Statement and its focus on qualitative characteristics, and IFRS 8 *Operating Segments*, which specifies certain quantitative thresholds for identifying reportable segments;

(b) paragraphs 25 and 26 describe quantitative factors as being insufficient alone to make the materiality assessment. The AASB thinks the apparent inconsistency with the definition of materiality (which includes the text "or both") should be addressed, and the paragraphs balanced by including also the converse position that consideration of qualitative factors alone might be insufficient and would need to be complemented by consideration of quantitative factors;

(c) the AASB acknowledges that some of its constituents would like for the IASB to specify quantitative thresholds for materiality. The AASB agrees with the statement in paragraph 25 of the ED that it is not appropriate for IFRS to specify a uniform quantitative threshold for materiality. The AASB is concerned that specifying quantitative thresholds could result in possible conflict with existing jurisdictional guidance that may apply to financial statements. The AASB, however, encourages the IASB to extend paragraph 26 to assist entities in determining appropriate quantitative thresholds;

1 In addition, with respect to paragraph 60, the AASB considers it would be more appropriate for the source reference in the first sentence (footnote 19) to be to a paragraph within IAS 34, rather than to the introduction to IAS 34.

(d) the statement in paragraph 46 that when the concept of materiality is applied to the notes "the context in which that concept is applied is different", might be interpreted by some as implying that different levels of materiality are applied to primary financial statements and to the notes. The AASB considers that the guidance should better and more consistently articulate that once information is assessed as being material for separate disclosure at the complete set of financial statements level, it needs to be included in financial statements. The decision about whether separate disclosure is warranted in the primary financial statements, or only in the notes, would be based on the role of the primary financial statements or notes. It may be useful for various paragraphs, for example, paragraphs 29 and 32, to include a cross-reference back to paragraph 11;

(e) paragraph 47 notes that "if information is material in the context of the primary financial statements then disclosure in the notes is not sufficient". It would be useful for the paragraph to include a cross-reference to paragraph 42;

(f) the AASB thinks it would be useful for the discussion in paragraph 36 (to disclose the fact that a particular issue is immaterial to an entity) to be made in the context of a requirement in IFRS, for example, by linking it to the disclosure objective specified by an IFRS;

(g) in practice, some entities correct small prior year errors retrospectively without disclosing that a change has been made to prior period amounts. It would be useful for the discussion in paragraph 74 to address whether retrospective correction means the entity has assessed the prior period error as being material (and that the adjustment should be disclosed), or whether disclosure of the retrospective restatement could be material even where the departure from the IFRS recognition method is determined to be immaterial;

(h) the last sentence of paragraph 9 should be rephrased to avoid giving the impression that there is a free choice between presenting material information in the primary financial statements or in the accompanying notes; for example, "Applying the concept of materiality ensures that financial information that could reasonably be expected to influence decisions that users make on the basis of those financial statements is separately presented in the primary financial statements (sometimes referred to as …) or, <u>where appropriate,</u> separately disclosed in the accompanying notes". It would be useful also for a cross-reference to be made to paragraph 43;

(i) paragraph 23 states that information is material if it confirms trends that could reasonably be expected to reinforce decisions made by the primary users. It is arguable that all information has an element of confirmatory value. Accordingly, the AASB thinks the paragraph should articulate what sort of confirmatory trend information could reinforce decisions made by the primary users. For example, information may be material where it confirms trends that relate to user evaluation of the key drivers of financial position or financial performance of an entity. For example, information about contractual commitments for intangible assets may be material to a company for which continual research and development investment is important;

(j) paragraph 54 clarifies that information that was material to the prior period may not necessarily be material to the same extent in the current reporting period. The AASB encourages the IASB to also address the converse scenario, that is, the extent to which comparative information may need to be included if the current period disclosure is material to an understanding of the financial statements. For example, an entity may determine that a reconciliation of plant and equipment is material for inclusion in the current period financial statements. However, a similar reconciliation had not been disclosed in the prior period because the balances were immaterial. The AASB thinks guidance in this respect would provide useful clarification to preparers as to whether it is necessary to develop such comparative information;

(k) paragraph 28(c) refers to 'rare or unusual' transactions. The AASB notes that not all rare or unusual transactions will be material for separate disclosure, nor may the accounting standards specify that such transactions need to be separately disclosed from other transactions, and thinks it may be useful for the Practice Statement to acknowledge this. Further, rather than using the terminology 'rare or unusual', the AASB would prefer these transactions be characterised instead as those that are not frequently undertaken in the ordinary course of the entity's business;

(l) another example that could be included in paragraph 28 of where the materiality assessment may be more sensitive is where an entity's financial performance has changed from profit in one year to a loss in another year;

(m) the discussion in paragraph 79 could be extended to clarify that a discount rate that is at one end of a range of possible discount rates is not an 'inappropriate discount rate';

(n) the first sentence of paragraph 27(a) could be reworded to clarify that an accounting policy needs to be disclosed when the underlying economic phenomena is material to user understanding of the financial statements. The AASB is concerned that the wording of the example in the paragraph could be read as suggesting that disclosure of accounting policies that are straightforward (for example, that property, plant and equipment is depreciated over its useful life) and which may consequently appear 'boilerplate' could be immaterial for disclosure. The AASB thinks that the example could be more clearly worded to communicate that accounting policies that are not relevant to explaining the entity's financial performance or financial position are likely to be immaterial for disclosure, and to cross-reference to the discussion on obscuring material information; and

(o) it may be useful for the discussion in paragraphs 40 – 44 relating to primary financial statements to also address whether presentation of only a current/non-current distinction in the balance sheet (with further disaggregation in the notes) provides users with sufficient material information.

Conflict with legal requirements related to materiality

9 The AASB is not aware of any legal requirements in Australia that would be in conflict with the proposed guidance. Based on its outreach, the AASB does not expect

the guidance, if finalised in the form of a non-mandatory Practice Statement, to cause conflict with the Australian *Corporations Act 2001*, which specifies the reporting requirements for Australian companies.

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?

10 The AASB supports the proposal to issue the Practice Statement before the finalisation of the IASB's Principles of Disclosure Project. The AASB thinks deferring the issuance of guidance until the completion of the Principles of Disclosure project would deprive entities from useful guidance in the meantime. The AASB also thinks that the earlier issuance of guidance may encourage some entities to begin undertaking a de-cluttering exercise by providing them with a platform against which to make these decisions.

11 The AASB is of the view that the guidance should be updated following the completion of the Principles of Disclosure project should the results of that project require any consequential amendments to the guidance. In addition, as the Practice Statement cross-references to the Conceptual Framework, the AASB thinks that the Practice Statement should similarly be updated for any consequential changes that are necessary once a revised Conceptual Framework is finalised. Alternatively, the AASB would support the issue of the Materiality Practice Statement being subsequent to the issue of a revised Conceptual Framework, having regard to the stated expected timing of finalisation of both publications.

Question 5—Any other comments
Do you have any other comments on the [draft] Practice Statement? As mentioned in Question 4, a discussion about the definition of materiality will be included in the Discussion Paper in the Principles of Disclosure project, so the IASB is not asking for comments on the definition at this time.

12 In addition to the above, the AASB makes the following comments:

(a) The wording of the definition of 'materiality' is slightly different in IAS 1 and IAS 8 compared to the Conceptual Framework. This should be acknowledged by the Practice Statement;

(b) Paragraph 39(b) might be interpreted as allowing presentation of 'extraordinary items' in the primary financial statements;

(c) In respect of the example in paragraph 39(c), it would be useful to clarify that providing information about the acquisitions in aggregate may only be suitable when the small businesses to be aggregated share similar characteristics; and

(d) Paragraph 47, last sentence, states that "the management should disaggregate the amount…". The use of 'would' in place of 'should' is preferred.