Withdrawal of AASB 1031 *Materiality*

Collation of Responses to ED 243

Objective of ED 243

The objective of AASB ED 243 *Withdrawal of AASB 1031* Materiality is to make amendments to Australian Accounting Standards to affect the withdrawal of AASB 1031 *Materiality* and to make the consequential amendments that will arise from the Standard's withdrawal.

Purpose of this collation

The ED posed seven Specific Matters for Comment (SMCs). The purpose of this collation is to give the AASB an overview of the responses to these SMCs.

The AASB received eight comment letters in response to the ED.

The list of respondents is as follows:

Submission 1	Group of 100
Submission 2	KPMG
Submission 3	HoTARAC
Submission 4	ACAG (split into 4A and 4B as indicated above)
Submission 5	PwC
Submission 6	CPA/ICAA
Submission 7	EY
Submission 8	Macquarie University – Department of Accounting and Corporate Governance

The submission from the Australasian Council of Auditors-General (ACAG) (submission No. 4) states that their members had differing views regarding the proposals in the ED. Therefore, for the purposes of this collation, submission No. 4 has been split into two: 4A – are those ACAG members (four members) that are in favour of the proposals and 4B – are those ACAG members (three members) who are not in favour of the ED's proposals. Therefore, each SMC will have a total of nine responses.

Staff have used judgement in classifying and interpreting the comments received in this paper – it is not a substitute for reading the full text of the submissions. A staff analysis and comments follows each SMC with a summary and staff recommendations at the end of this paper.

SMC 1

Whether the proposal to withdraw AASB 1031 is supported?

View	Number
Agree	6
Disagree	3
Total	9

Specific comments regarding the proposal to withdraw AASB 1031 are as follows:

Respondent	View	Comments
1 – Group of 100	Agree	The G100 is pleased to support the withdrawal of AASB 1031 for the reasons stated in ED 243.
2 – KPMG	Agree	KPMG agrees with the AASB proposal to withdraw

Respondent	View	Comments
		AASB 1031 *Materiality,* as it reduces the risk of inadvertent non-compliance with IFRS.
3 – HoTARAC	Disagree	HoTARAC does not support the withdrawal of AASB 1031. HoTARAC believes that the AASB should retain AASB 1031, as the removal of this significant guidance is likely to impact on the reliability of judgements across reporting entities. HoTARAC believes that the implementation of the standard has fulfilled a significant function in the practical and quantitative application of materiality since its introduction in 1986 as AAS 5 *Materiality in Financial Statements.* HoTARAC believes that AASB 1031 is effectively a low maintenance standard which provides significant widespread benefit in the consideration of materiality. When the IFRSs were first incorporated into the Australian Accounting Standards, the Board, as explained in the ED, had decided to retain AASB 1031: "to ensure that the meaning of materiality remained well explained". AASB 1031 assists in facilitating consistent quantitative assessments of materiality across Australian jurisdictions and is a major reference point for preparers and users of financial statements. It significantly supplements the qualitative assessment of materiality while still maintaining the need for professional judgement and accountability. The importance of assessing materiality is a fundamental concept under Relevance in the *Framework for the Preparation and Presentation of Financial Statements* which states: "Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatements." Withdrawal of AASB 1031 would remove the indicative quantitative thresholds which clarify whether an item or aggregate of items is material (refer paragraphs 12 – 15), and guidance on the practical application of materiality. HoTARAC does not support the AASB analysis of the removal of the above paragraphs as those: "... that could be omitted without a loss of meaning". BC5 of the ED states that the withdrawal of AASB 1031 is: "... to achieve consistency with its policy of not providing unnecessary local guidance on matters covered by IFRSs". HoTARAC disagrees that the quantitative content of AASB 1031 is unnecessary and is satisfactorily covered within the IFRSs e.g. the IASB *Conceptual Framework for Financial Reporting* (Conceptual Framework), IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting*

Respondent	View	Comments
		Policies, Changes in Accounting Estimates and Errors, whereby somewhat limited quantitative guidance has been provided at a high level. AASB 1031 contains much more comprehensive guidance in paragraph 9-19, and in particular, for the Not-For-Profit sector, paragraph 17-19. In essence, this withdrawal could potentially leave a gap before the completion of the IASB's educational material on materiality is issued. The European Securities and Markets Authority (ESMA) in its initial *Consultation Paper*[1] found: " ... 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." Furthermore, the ESMA in its *Feedback Statement*[2] considered 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." This is further supported by the Financial Reporting Council's (FRC)[3] *Managing Complexity Report.* The FRC noted that there has been an increase to complexity in financial reporting resulting from the accumulation of accounting rules, and accompanying disclosures, since the introduction of IFRS. This led to a call for reductions in and simplification of various requirements. A number of international reviews have called for the rationalisation of disclosures in relation to financial reporting. This report noted in particular also: "the challenge is to find a mechanism that encourages directors and preparers to properly consider whether or not a disclosure is material, rather than the simpler option of including all disclosures." HoTARAC believes that given the diversity in the perspective of preparers of financial statements, and without a reasonably consistent quantitative approach to assessing materiality if AASB 1031 was withdrawn, financial statements will have greater potential to vary significantly within sectors and across entities. HoTARAC recommends that at a minimum, in the interim, AASB 1031 not be withdrawn until the project to address

1 European Securities and Markets Authority, 2011, *Consultation Paper*, Considerations of Materiality in Financial Reporting, p.4

2 European Securities and Markets Authority, 2013, *Feedback Statement*, Considerations of Materiality in Financial Reporting,p.7

3 Australian Government, Financial Reporting Council, 2012, *Managing Complexity in Financial Reporting*, Managing Complexity Task Force, p.10.

Respondent	View	Comments
		practical difficulties in applying materiality (as noted in p5 in the ED) under IFRS is completed.
4A – ACAG	Agree	Four member Audit Offices support the withdrawal of AASB 1031 for the reasons expressed by the AASB.
4B – ACAG	Disagree	Three member Audit Offices have expressed an alternative view. The ACAG members that do not support the proposal to withdraw AASB I 031 *Materiality* at this time ('those ACAG members') believe that the current proposal to withdraw the Standard is premature. Those ACAG members believe its withdrawal should be considered at the time of, and in the context of, adopting the IASB's *Conceptual Framework for Financial Reporting* (IASB Framework). Those ACAG members understand that the IASB has significantly amended the materiality discussion in its revisions to the IASB Framework. In paragraph QC11 the IASB has stated that "... 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. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation." The new discussion on materiality is significantly different from that contained in paragraphs 29-30 of the current *Framework for the Preparation and Presentation of Financial Statements* (the Framework). We note the content of the current Framework is consistent with, and complimentary to, AASB 1031. Therefore, those ACAG members believe that the possible withdrawal of AASB 1031 and the incorporation of the updated elements of the IASB Framework for for-profit entities are intrinsically linked and should be considered jointly rather than as separate projects. Although those ACAG members note that the concept of 'materiality' is covered briefly in AASB 101 and AASB 108, albeit in definition form, those ACAG members believe the pre-emptive withdrawal of AASB 1031will leave a vacuum in terms of guidance available for preparers, auditors and users of the financial statements. As a result of an IASB discussion forum earlier this year on financial reporting disclosure, they have committed to "start a project in the second half of 2013 to consider developing educational material or guidance on materiality, working with securities regulators, auditors, preparers and users". This was briefly noted in the 'Reasons for issuing this Exposure Draft' section of ED 243. AASB 1031 currently provides this form of guidance in Australia and

Respondent	View	Comments
		the withdrawal of such guidance prior to replacement guidance having been developed is not supported at this time. We recommend the AASB await the finalisation of the IASB project to provide guidance prior to the withdrawal of AASB 1031. Those ACAG members share the view expressed in paragraph 11 of AASB 1031 that "... the notion of materiality guides the margin of error that is acceptable in the amount attributed to an item or an aggregate of items and the degree of precision required in estimating the amount of an item or an aggregate of items". Accordingly, those ACAG members are of the view that the guidance provided in paragraph 15 provides a common basis for preparers and auditors of financial statements to work with when applying professional judgement in determining whether an item, or aggregate of items, is material. The removal of AASB 1031 will place sole reliance on the conceptual framework, AASB 101 and AASB 108. The financial reporting framework for fair presentation will consequentially be weakened and, in those ACAG members view, more open to subjective application of the materiality concept by preparers. Those ACAG members believe that it is sufficiently clear from the content of paragraph 15 that materiality is a matter of professional judgement and that the application of the 5% and 10% levels specified in paragraphs 15(a) and 15(b) needs to be considered within that overall context. As such, it is already clear items need to be considered in terms of their qualitative materiality as well being considered against the quantitative guidance provided. The inclusion of this quantitative guidance in paragraph 15, in those ACAG members view, adds to the general understanding of the concept, rather than being a prescriptive restriction.
5 – PwC	Agree	We support the Board's proposal to withdraw the standard on the basis that this is consistent with the Board's policy that domestic guidance should not be provided on matters that are covered by International Financial Reporting Standards (IFRS). The issue of materiality is not unique to Australia and we agree that the existing guidance in other standards is adequate.
6 – CPA/ICAA	Agree	Yes, we support the proposal to withdraw AASB 1031 *Materiality* as its removal will minimise the remaining differences from IFRS in relation to for-profit entities.
7 – EY	Disagree	The concept of materiality is key to preparing financial statements under IFRSs. It is therefore of particular relevance to investors and other users of financial statements, as it impacts what information is considered relevant and thus presented in the financial statements. The application of the concept of materiality requires significant

Respondent	View	Comments
		judgement, which is inherently subjective. We believe that preparers, regulators and users hold different views about what material information is, suggesting that potential expectation gap may exist, particularly around financial statement disclosures. The proposed withdrawal of AASB 1031 (ED 243) is based on the AASB's goal to remove unnecessary local guidance on matters appropriately covered by IFRSs, and predicated on the idea that the concepts relating to materiality will be addressed by: • The IASB conceptual framework (including changes proposed in the discussion paper[4]) • International Accounting Standard 1: *Presentation of Financial Statements* (IAS 1) • International Accounting Standard 8: *Accounting Policies, Changes in Accounting Estimates and Errors* (IAS 8) In the discussion paper released by the IASB on the Conceptual Framework for Financial Reporting (Framework)[5], the IASB reaffirmed its stance on the description of materiality[6], though noted that the application of this principle has in certain instances led both to the disclosure of too much irrelevant information and not enough relevant information[7]. Consequently, the IASB is considering providing additional material on the application of materiality to address these issues relating to disclosure. While the proposed changes to the Framework will look to address the materiality issues relating to disclosure, there is no discussion around the types of matters that would be addressed, which currently exist in AASB 1031. For instance: • The nature of an amount affecting materiality[8]; • The quantitative threshold (i.e. 10%/5% of base amount)[9]; or • The difference between materiality in absolute and relative terms[10] We believe AASB 1031 currently assists discussion between preparers, auditors, users and regulators in providing guidance as to the basis of what should and should not be considered material in a financial report. It also provides guidance in other areas of financial reporting,

4 Discussion Paper DP/2013/1: A Review of the Conceptual Framework for Financial Reporting
5 Discussion Paper DP/2013/1: A Review of the Conceptual Framework for Financial Reporting
6 Ibid, Paragraph 7.45
7 Ibid, Paragraph 7.46
8 AASB 1031: *Materiality* – Paragraph 12
9 Ibid, Paragraph 15
10 Ibid, Paragraph 18-19

Respondent	View	Comments
		including application of Prudential Standards, by due diligence committees, for assessment of continuous disclosures and enforceable undertakings. See also our response to question 3 below. Therefore we do not support the withdrawal of AASB 1031 at this time.
8 – Macquarie University	Agree	We support the withdrawal of AASB 1031, as it reduces the risk of inadvertent non-compliance with IFRS.

Staff Analysis re SMC 1

As indicated, six respondents support the proposal to withdraw AASB 1031.

Arguments in support of the proposals were:

- it reduces the risk of inadvertent non-compliance with IFRS;
- it is consistent with the Board's policy that domestic guidance should not be provided on matters covered by IFRSs;
- the issue of materiality is not unique to Australia; and
- removal will minimise the remaining difference from IFRS in relation to for-profit entities.

The three respondents who did not support withdrawal of AASB 1031 argued:

- removal of this significant guidance is likely to impact on the reliability of judgements across reporting entities;
- AASB 1031 is a low maintenance standard which provided benefit and fulfils a significant function in the practical and quantitative application of materiality;
- withdrawal would remove the indicative quantitative thresholds which clarify whether an item or aggregate of items is material;
- that the quantitative content of AASB 1031 is necessary as it is not satisfactorily covered with IFRSs (Conceptual Framework, AASB 101 and AASB 108, which are at a higher level).
- AASB 1031 contains more comprehensive guidance in paragraphs 9-19 and in particular paragraphs 17-19 for not-for-profit entities;
- withdrawal could potentially leave a gap before completion of the IASB's educational material on materiality is issued; and
- the European Securities and Markets Authority (ESMA) noted in its Consultation Paper *Considerations of Materiality in Financial Reporting* that there are apparent differing views regarding the practical application of the concept of materiality amongst preparers, auditors, possibly users and in some instances accounting enforcers. In its associated Feedback Statement ESMA 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.

Staff Comments

To summarise, staff consider that the most prevalent theme emerging from constituent comments is that the majority of respondents support the withdrawal of AASB 1031. Those respondents who do not support the proposals consider that AASB 1031 is useful and until there is appropriate, educational material issued from the IASB the Standard should not be withdrawn. Staff are aware of the comments made in the ESMA feedback statement but also note that respondents to ESMA considered that any guidance on the application of materiality should be addressed by the IASB rather than ESMA. As a result ESMA proposed to provide, to the IASB, the outcome of their consultation and to encourage the IASB to address the aspects of materiality that are seen to be problematic in practice, relevance of disclosures and the qualitative assessment of materiality.[11]

SMC 2

Whether the proposals in this Exposure Draft would result in a change from current practice, including whether the proposal to permit early adoption would result in the omission of disclosures that might otherwise be made, and, if so, why.

Responses to this SMC have been analysed in two parts, (a) whether the withdrawal of AASB 1031 would result in a change to current practice and (b) whether early adoption would result in omission of disclosures that might otherwise be made.

(a) Whether the withdrawal of AASB 1031 would result in a change to current practice.

View	Number
No Change	3
Possible Change	3
No comment	3
Total	**9**

(b) Whether early adoption would result in omission of disclosures that might otherwise be made.

View	Number
No Omission	6
Omission	1
No comment	2
Total	**9**

Specific comments regarding whether there may be a change in current practice (a) or if the proposals would result in the omission of disclosures (b) are as follows:

Respondent	View	Comments
1 – Group of 100	(a) No comment (b) No omission	We do not believe that withdrawal of AASB 1031 would result in the omission of disclosures that might otherwise be made because the application of materiality is well entrenched and is applied by directors and managers in exercising their judgment whether or not to disclose a particular item or group of items.
2 – KPMG	(a) No change (b) No omission	We agree that it is unlikely to change practice regarding the application of materiality in financial reporting.
3 – HoTARAC	(a) Possible change (b) No omission	In BC 7 of the ED, the Board noted that: "... it would not expect the withdrawal to change

[11] European Securities and Markets Authority 2013, *Feedback Statement Considerations of materiality in Financial reporting,* p.4

Respondent	View	Comments
		practice regarding the application of materiality in financial reporting." HoTARAC, however, believes that the basis of application of materiality will change over time, given that there would be greater flexibility in interpretation of materiality without some form of quantitative guidance being available if AASB 1031 were withdrawn, particularly with respect to different contexts. Given the diversity in perspectives of preparers, we believe that without a reasonably consistent quantitative approach to assessing materiality, financial statements have the potential to vary significantly within sectors and across entities. The ESMA in their *Feedback Statement*[12] stated that: "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." The FRC[13] highlighted that where there is a mindset of preparers and auditors of "when in doubt, disclose", the consequences can be: • "an increase in both the number and volume of additional financial and other disclosures presented; • the inclusion of immaterial disclosures, which may detract from material disclosures, and confuse and/or deter proper review of these financial reports by targeted users and corporate stakeholders; and • a lack of understanding by preparers and auditors as to which disclosures are material, with the result that material disclosures may be omitted from financial reports and immaterial disclosures included. …" As staff and management change in entities, and if there is a lack of documentation of treatment of the application of materiality in that sector, reliance on the limited information available within the Conceptual Framework, IAS 1 and IAS 8 will impact on the assessment of materiality and its application in the disclosure process. As a result, there would be a significant degree of subjectivity in assessing materiality. In the longer term, HoTARAC believes this would result in inconsistencies in practice of how materiality is understood and applied. HoTARAC does not believe early adoption would necessarily result in the omission of disclosures that might otherwise be made.

12 European Securities and Markets Authority, *Feedback Statement*, op. cit., p.3.
13 Financial Reporting Council, op cit., p.6.

Respondent	View	Comments
4A – ACAG	No comment	No comments were made
4B – ACAG	(a) Possible change (b) Omission	Those ACAG members believe that the withdrawal of AASB 1031, particularly in the absence of further guidance yet to be developed, may result in some preparers omitting information from the financial statements that would otherwise be included. Further it may result in greater divergent interpretations of materiality amongst preparers, and between preparers and auditors. Differences of this nature are likely to result in disruptions to the financial statement preparation and audit process.
5 – PwC	No comment	No comment made
6 – CPA/ICAA	(a) No change (b) No omission	No, we would not expect the withdrawal of AASB 1031, including the proposal to permit early adoption, to result in any change from current practice.
7 – EY	(a) Possible change (b) No omission	The proposals to withdraw AASB 1031 would potentially result in a less clear and well understood application of materiality than currently exists. It is anticipated that would likely lead to diversity in the application of materiality and undermining of the comparability principle of financial accounting. On 16 August 2012, the European Securities and Markets Authority released a summary of the responses to its consultation paper on materiality[14] in financial reporting released in November of the year before. Some of the major findings from this consultation paper were that[15]: • The majority of respondents considered that the concept of materiality is well understood, but many respondents expressed the view that there is diversity in application; • A majority of responses raised concerns about the length of disclosures reaching a point where the entity's financial and performance may be obscured for the users; • Many respondents highlighted the role of both qualitative and quantitative guidance with respect to materiality; and • There was widespread agreement from respondents that if further guidance were to provided with respect to the application of materiality, this should be addressed by the IASB. This diversity was believed to be caused by the exercise of management judgement, the differing perspectives of different stakeholder groups, and challenges to the proper application of materiality. It would be expected that removal of AASB 1031 may have a similar effect in

14 Consultation Paper ESMA/2011/373: Considerations of materiality in financial reporting (9 November 2011)

15 Summary of Responses ESMA/2012/525: Considerations of materiality in financial reporting (16 August 2012)

Respondent	View	Comments
		Australia. Therefore while it may not lead to omission of disclosures that would otherwise be made in financial statements, the widespread use of AASB 1031 as discussed in question 1 may have other consequences.
8 – Macquarie University	(a) No change (b) No omission	We agree that it is unlikely to change practice regarding the application of materiality in financial reporting.

Staff Analysis re SMC 2(a)

Regarding whether the withdrawal of AASB 1031 would change current practice, out of the six respondents that commented on this SMC, three commented that it is unlikely to change current practice and the other three thought that it is possible that practice regarding materiality may change. Comments made by these respondents include:

- The basis of application of materiality will change over time, given that there would be greater flexibility in interpretation of materiality without some form of quantitative guidance being available;
- Given the diversity in perspectives of preparers, we believe that without a reasonably consistent quantitative approach to assessing materiality, financial statements have the potential to vary significantly with sectors and across entities;
- The Financial Reporting Council noted in its report *Managing Complexity in Financial Reporting* that there is a mindset of preparers and auditors of "when in doubt, disclose" and therefore the consequences could be the inclusion of immaterial disclosures, which may detract from material disclosures, and confuse and/or deter proper review financial reports by targeted users and corporate stakeholders. This point is also noted in ESMA's feedback statement whereby the majority of responses raised concerns about the length of disclosures reaching a point where the entity's financial and performance may be obscured for the users;
- Withdrawal of AASB 1031 would likely lead to diversity in the application of materiality and undermining of the comparability principle of financial accounting, this was supported by ESMA's feedback statement;
- ESMA's feedback statement also noted that, many respondents highlighted the role of both qualitative and quantitative guidance and further there was agreement that if further guidance were to be provided, this should be addressed by the IASB.

Staff Analysis re SMC 2(b)

Regarding whether early adoption of the proposals would result in omission of disclosures, six of the seven respondents who answered this SMC did not think the proposals would lead to any omissions. One respondent commented that the application of materiality is well entrenched and is applied by directors and managers in exercising their judgement whether or not to disclose a particular item or group of items. Some respondents were more concerned that withdrawal of AASB 1031 would lead to more disclosures that may reduce the usability of financial statements.

Staff comments

As indicated in the respondent comments above, the majority of respondents did not consider withdrawal of AASB 1031 would change existing practice or result in the omission of disclosures that might otherwise be made. However, some respondents are concerned that once the Standard is withdrawn the lack of guidance will create diversity in practice, particularly because the quantitative aspect of materiality will be removed. Staff are of the view that the findings of ESMA may not translate directly into the Australian environment because Europe does not have the guidance provided in AASB 1031 and are therefore wholly reliant on the existing guidance in IFRSs. Further, staff consider that the experience gained from 10 years of IFRSs in Australia will help ensure that any potential diversity in practice does not occur. This is supported by the respondent comment above that the application of materiality is well entrenched.

In regards to any omissions of disclosures, some respondent are concerned not with the omission of disclosure, but with the potential increase in disclosures that could eventuate if AASB 1031 is withdrawn. Staff note that this is one aspect of materiality that the IASB intends to address in a short-term project on changes to IAS 1 *Presentation of Financial Statements* (See Agenda paper 16.2). At their September 2013 meeting, the IASB tentatively decided to include wording into the materiality guidance in IAS 1 to highlight that disclosing immaterial information could obscure user information.

SMC 3

Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

(a) Not-for-profit entities; and

(b) *Public sector entities, including GAAP/GFS implications*.

View	**Number**
Not aware of anything	2
APES implications	1
No comment	6
Total	**9**

Specific comments made in regards to any regulatory issues are as follows:

Respondent	**View**	**Comments**
1 – Group of 100	No comment	No comment made
2 – KPMG	No comment	No comment made
3 – HoTARAC	Not aware of anything	HoTARAC is not aware of any regulatory issues that may affect implementation of the proposals. However, as highlighted in the ED's Attachment to the Basis for Conclusions table, paragraph 14 is directly relevant to not-for-profit entities given that they “are primarily concerned with achievement of objectives other than the generation of profit. .. “. Reference is also made to guidance in paragraphs 17 - 19 as being “. .. more appropriate to consider”. Withdrawal of the standard would therefore remove the specific guidance on materiality for not-for-profit entities.
4A – ACAG	No comment	No comments made
4B – ACAG	No comment	Those ACAG members provide no further comments on this matter

Respondent	View	Comments
5 – PwC	No comment	No comment made
6 – CPA/ICAA	No aware of anything	No, we are not aware of any regulatory issues or other issues that would arise from the withdrawal of AASB 1031.
7 – EY	APES implications	Yes. In our view, the AASB needs to discuss the interaction of AASB 1031 and APES 350 *Participation by Members in Public Practice in Due Diligence Committees in connection with a Public Document* with the Accounting Professional & Ethical Standards Board. Under APES 350, an assurance practitioner who participates in a due diligence committee (DDC) is required to comply with applicable Auditing and Assurance Standards when his role includes the provision of a materiality guidance letter to the client and its DDC. The form of the materiality guidance letter included in APES 350 specifically references AASB 1031 with respect to the definition and the determination of materiality. In our view, ED 243 *Withdrawal of AASB 1031* Materiality fails to consider the materiality guidance gap which may be created in the Australian environment with respect to an assurance practitioner's role in a DDC process.
8 – Macquarie University	No comment	No comment made

Staff Analysis

The majority of respondents did not comment on this SMC; however, one respondent commented that withdrawal of AASB 1031 could have implications in relation to APES 350 *Participation by Members in Public Practice in Due Diligence Committees in connection with a Public Document* as it makes specific reference to AASB 1031. Another respondent also commented that paragraphs 14 and 17-19 of AASB 1031 are directly relevant to not-for-profit (NFP) entities and therefore its removal would also remove the specific guidance on materiality for NFP entities.

Staff Comments

With reference to the comment on APES 350, staff have spoken with APES technical staff and they have indicated that they do not think withdrawal of AASB 1031 will be an issue in relation to APES 350 – APESB staff indicated that APES 350 could be amended to make the necessary changes to acknowledge the withdrawal of AASB 1031. Staff also spoke to the technical staff of the AUASB to ascertain if the proposals had any implications for them. AUASB staff noted that ASA 320 *Materiality in Planning and Performing an Audit* includes a footnote that makes reference to AASB 1031. This footnote will need to be amended but AUASB staff indicated that this amendment would not cause any particular issues.

With regards to the comment on the potential loss of not-for-profit specific guidance, staff agree with the conclusion drawn in the Attachment to the Basis for Conclusions that accompanied ED 243 that principles-based standards do not need benchmarking to assess materiality.

SMC 4
Whether, overall, the proposals would result in financial statements that would be useful to users;

View	Number
No change in usefulness	1
Reduce usefulness	3
No comment	5
Total	**9**

Specific comments in regards to whether the financial statements would be useful to users are as follows:

Respondent	View	Comments
1 – Group of 100	No comment	No comment made
2 – KPMG	No comment	No comment made
3 – HoTARAC	Reduce usefulness	HoTARAC believes that the withdrawal of AASB 1031 will result in a significant degree of subjectivity in assessing materiality and in the longer term, result in reduced consistency and reliability in financial reporting and hence, will reduce the usefulness of financial statements for users. HoTARAC considers that the proposals would result in different interpretations of the inclusion of immaterial items or exclusion of material items within financial statements. Accordingly, these differences in interpretation would impact on the usefulness of financial statements to users. This may result in the manipulation of operating results which would not be in the best interests of stakeholders. While both qualitative and quantitative aspects are required in the assessment of materiality, without appropriate quantitative guidance, there is a reasonable concern that materiality may be applied on different quantitative bases across entities and sectors.
4A – ACAG	No comment	No comment made
4B – ACAG	Reduce usefulness	Those ACAG members believe that the withdrawal of AASB 1031, particularly in the absence of further guidance yet to be developed, has the potential to introduce further subjectivity in the preparation of financial statements.
5 – PwC	No comment	No comment made
6 – CPA/ICAA	No change in usefulness	As we would not expect the withdrawal of AASB 1031 to change current practice we anticipate the usefulness of financial statements to users to be unaffected.
7 – EY	Reduce usefulness	No. The proposed changes would likely detract the utility of the financial statements to users.
8 – Macquarie University	No comment	No comment made

Staff Analysis

Of the four respondents who provided comments to this SMC one stated that the usefulness of financial statements would not change, whilst the other three suggested it would reduce financial statement usefulness.

Arguments made include:

- It will result in a significant degree of subjectivity in assessing materiality, which will result in reduced consistency and reliability hence reducing the usefulness;
- Withdrawal of AASB 1031, particularly in the absence of further guidance yet to be developed, has the potential to introduce further subjectivity in the preparation of financial statements;
- Would result in different interpretations of the inclusion of immaterial items or exclusion of material items in financial statements, this may result in the manipulation of operating results which would not be in the best interests of stakeholders; and
- Without appropriate quantitative guidance, materiality may be applied on difference quantitative bases across entities and sectors.

Staff Comment

Staff note that in ED 243 in paragraph BC7 the Board expressed the view that it does not expect practice regarding the application of materiality to change as the proposals do not change the level of disclosures required by standards.

SMC 5

Whether the proposals are in the best interests of the Australian economy;

View	**Number**
Yes – In the best interests of the Australian economy	2
No – Not best interests of the Australian economy	1
No comment	6
Total	**9**

Specific comments as to whether the proposals are in the best interests of the Australian economy are as follows:

Respondent	**View**	**Comments**
1 – Group of 100	Yes	From a G100 perspective the proposals which reflect the adoption of application guidance or educational material developed by the IASB for use internationally are in the best long term interests of the Australian economy.
2 – KPMG	No comment	No comment made
3 – HoTARAC	No	HoTARAC considers that the proposals are not in the best interests of the Australian economy for all of the reasons detailed above, particularly in regard to a probable lack of consistency and reliability in financial reporting for stakeholders.
4A – ACAG	No comment	No comment made
4B – ACAG	No comment	Those ACAG members provide no further comment on this matter
5 – PwC	No comment	No comment made
6 – CPA/ICAA	Yes	Yes, we believe the proposals are in the best interests of the Australian economy as they will remove any perceived non-compliance with IFRS for the for-profit sector from the perspective of the international community.

Respondent	View	Comments
7 – EY	No comment	No comment made
8 – Macquarie University	No comment	No comment made

Staff Analysis

Only one respondent specifically commented that the proposals were not in the best interests of the Australian economy, citing the probable lack of consistency and reliability in financial reporting for stakeholders.

Staff Comments

Given that there was only one comment in the negative staff conclude that the majority of respondents agree that the proposals are in the best interests of the Australian economy.

SMC 6
Unless already provided in response to specific matters for comment 1 – 5 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative.

View	Number
Possible cost/benefit implications	3
Benefits outweigh costs	1
No comment	5
Total	**9**

Specific comments regarding the cost/benefit implications of the proposals are as follows:

Respondent	View	Comments
1 – Group of 100	No comment	No comment made
2 – KPMG	No comment	No comment made
3 – HoTARAC	Possible cost/benefit implications	HoTARAC believes there may be more difficulty for preparers in assessing the consistent application of materiality in the preparation of financial statements. The time taken to determine materiality and assess consistency is also considered to contribute to outweighing the benefits of the removal of the standard.
4A – ACAG	No comment	No comment made
4B – ACAG	Possible cost/benefit implications	Paragraph BC5 of ED 243 states that "The Board decided to propose the withdrawal of AASB 1031 to achieve consistency with its policy of not providing unnecessary local guidance on matters covered by IFRSs". We are concerned that little or no diligence is evident in ED 243 to substantiate the costs and benefits of the withdrawal of AASB 1031. Given that AASB 1031 has been effective since July 2004, entities and auditors have potentially become heavily reliant on this standard. We believe that the AASB should consult further to determine if materiality is adequately addressed in the forthcoming AASB Framework or whether AASB 1031 should be retained in some form due to the limited guidance available in AASBs 101 and 108.

Respondent	View	Comments
5 – PwC	No comment	No comment made
6 – CPA/ICAA	Benefits outweigh costs	We believe the benefits of the proposal significantly outweigh their costs. At the time IFRSs were first incorporated in to the Australian Accounting Standards the Board decided to retain a revised version of AASB 1031. This was retained to help ensure that the meaning of materiality was appropriately defined and remained well explained as the IASB conceptual framework at the time included only limited guidance. We believe the reasons for its retention no longer exist as Australian has had nearly a decade of experience with IFRS. Further, while we do not believe that AASB 1031 has in anyway affected the application of the Australian Accounting Standards that are the adopted IFRS; its removal will eradicate any contrary perception.
7 – EY	Possible cost/benefit implications	As noted in the question 1 above, the proposal to remove AASB 1031 offers a limited benefit (in the reduction of Australian specific standards), while potentially incurring a cost in the form of increased diversity of application of the standards as a whole.
8 – Macquarie University	No comment	No comment made

Staff Analysis

Of those who responded to this SMC, one respondent believes that the benefits of withdrawing AASB 1031 outweigh any cost. They consider that retention of AASB 1031 is no longer necessary because Australia has had nearly a decade of experience of IFRS and, although they don't consider that AASB 1031 has affected the adoption of IFRSs in Australia, its removal will remove any perception that Australia is not IFRS compliant.

In contrast, three respondents believe there may be cost/ benefit implications. Some of their arguments include:

- The difficulty and time taken to determine materiality to achieve consistency may outweigh the benefits;
- Entities and auditors have become reliant on the standard;
- Concern that little or no diligence has been done to substantiate the costs and benefits of withdrawing AASB 1031; and
- Withdrawal offers little benefit but has to potential to incur cost in the form of increased diversity of application of the standards as a whole.

Staff Comments

In response to the comment regarding auditor reliance, staff consider that an auditor's reliance on AASB 1031 is not a valid reason to retain the Standard.

Regarding the comment relating to the lack of due diligence to substantiate the costs and benefits, staff acknowledge that the Board did not explicitly address costs versus benefits in the ED. However, as noted in paragraph BC7, the Board considered that withdrawing the Standard would have no impact on practice. Staff therefore are of the view that the expected costs would be minimal. In terms of benefits, staff agree with the respondent comment above that withdrawing AASB 1031 will bring Australian Accounting Standards closer to IFRSs and will help eliminate any perception that Australia is not IFRS compliant. This is also consistent with the Board's policy of not providing unnecessary local guidance on matters covered by IFRSs.

SMC 7

Other comments

Other comments on the proposals are as follows:

Respondent	Comments
1 – Group of 100	Approaches to addressing issues relating to the volume, complexity and detail of disclosures in accounting standards and other regulatory requirements emphasize the importance of providing information to users of financial reports that is both relevant and material while at the same time avoiding disclosures of immaterial items. These responses rely heavily on the application of materiality and directors and managers exercising their professional judgment in relation to the disclosures made. It is suggested that given the extent of judgment required it is preferable that the application of materiality is best achieved through the issue of guidance rather than in an accounting standard.
2 – KPMG	Internationally, KPMG has supported the provision of additional guidance regarding the application of materiality, specifically in relation to disclosures, in-line with the IASB Discussion Paper (DP/2013/1) *A Review of the Conceptual Framework for Financial Reporting.*
3 – HoTARAC	*Recommendations if AASB 1031 was withdrawn* HoTARAC recommends that: • since the IFRSs are principles-based, HoTARAC would support the provision of supplementary guidance of the significant components of AASB 1031, in particular paragraphs 12 to 19 within, say, the *Framework for the Preparation and Presentation of Financial Statements;* and • a AASB review of materiality practice be undertaken after three years, if AASB 1031 was withdrawn. *Observation* HoTARAC queries why Interpretation 21 *Levies* (AUS 14.4) has been excluded from Appendix A of the ED. HoTARAC also encourages AASB to include into its work plan a review of similar but not standardised terminology used across various standards, involving the rationalisation of the terms “major”, “significant”, “key” and “main” (as alluded to in BC 9 of the ED).
4A – ACAG	No comment made
4B – ACAG	In the context of the views expressed above we would not support the AASB's adoption of paragraph QC11 of the IASB Framework in its current form. We recommend the existing guidance provided in paragraphs 29 and 30 of the existing Framework be substantially retained. In addition, we do not consider the interim approach outlined in BC17 to only apply changes to the Framework in relation to for-profit entities is consistent with the Board's approach regarding sector neutral standard

Respondent	Comments
	setting processes. As the Framework underpins the standards, it would seem conceptually unsupported to adopt two versions of a Framework to support a single, in many cases, version of the standards.
5 – PwC	No comment made
6 – CPA/ICAA	No comment made
7 – EY	It is our view that AASB 1031 offers guidance on a central tenet to accounting which is not sufficiently addressed through the current suite of IFRSs. It is unknown at this point what will be included in the proposed changes to the Framework. Accordingly, we believe removal of AASB 1031 at this point would leave a vacuum, and we have concerns as to the implications of this. In saying this, we do note that: • We support the reduction of local variances to the IFRSs; and • The application of the materiality standard is narrow, and in its current form does not necessarily provide assistance relating to the materiality of disclosures – which is considered to be the primary issue identified where additional guidance is required. While, we do have mixed views on whether AASB 1031 should be withdrawn, on balance, we believe that AASB 1031 plays an important role in financial reporting, and do not support its removal until the IASB has completed producing its own guidance.
8 – Macquarie University	We note that AASB 1031 as with other former Australian accounting standards will remain as historical but non-mandatory guidance as indeed other materiality references available on the internet, are used by those interested in considering materiality issues. We also note that the IASB's work on its Conceptual Framework may provide further non-mandatory guidance on the application of materiality in practice. We encourage the AASB to work to ensure that International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board, are issued in Australia without any significant change, apart from regulatory references if needed, so that Australian for profit reporting entities can remain compliant with best practice global accounting standards (IFRS), but not be burdened by un-necessary compliance costs that other overseas entities do not have to bear.

Staff Analysis

Staff note that two respondents who are in favour of withdrawing AASB 1031 still consider that additional guidance on materiality is warranted. Two other respondents (who are not in favour of the proposals in ED 243) also support supplementary guidance if AASB 1031 is withdrawn.

One respondent commented that they did not agree with the interim approach in paragraph BC17 that was to introduce the new chapters of the IASB *Conceptual Framework* into a revised AASB *Conceptual Framework for Financial Reporting* only for for-profit entities. They argued that this was not consistent with the Board's approach to sector neutral standard setting. Staff note that at the September 2013 AASB meeting, the Board agreed that the new Conceptual Framework chapters would now be applicable to for-profit and not-for-profit entities therefore this concern should be allayed.

A further respondent noted that even if AASB 1031 were withdrawn it would still remain as historical, but non-mandatory, guidance.

Staff comments

Staff consider that the overriding theme from SMC 7 is that respondents consider some guidance would still be necessary following the withdrawal of AASB 1031.

The arguments put forward in ED 243 for withdrawing AASB 1031 were that:

- The new Conceptual Framework chapters contains guidance on materiality; and
- The AASB were aware of the IASB's plans to develop either application guidance or educational material on materiality.

As discussed in Agenda paper 16.2 of this meeting, the IASB have now announced what they are proposing which is in the short-term to amend IAS 1 *Presentation of Financial Statements* to add additional guidance to clarify that:

- the concept of materiality should be applied to the specific disclosure requirements set out in a standard or interpretation;
- materiality should be assessed for both the primary financial statements and the notes to the those statements; and
- disclosing immaterial information could obscure useful information.

The IASB plan to issue an exposure draft in Q1 2014, and an IFRS in Q4 2014 (subject to comments received and deliberations).

In the long-term, the IASB is proposing a research project on materiality with a paper to be brought to the IASB in Q1 2014. The outcome of this project will depend on the findings of the research.

Staff recommendations

<u>Withdrawal of AASB 1031</u>

Having considered the comments received from respondents to ED 243, staff recommend the withdrawal of AASB 1031 for the reasons given by the Board in the Basis for Conclusions.

Q1: Does the Board agree with the above staff recommendation?

<u>Timing of withdrawal</u>

If the Board agrees with the staff recommendation above, staff are seeking direction from the Board as to the timing of the withdrawal of AASB 1031 considering the current IASB project addressing materiality.

Staff have identified three options for withdrawal:

(a) as soon as possible (i.e. do not wait for the outcome of the IASB project);

(b) defer withdrawal until the IASB completes its short-term project on IAS 1 (expected Q4 2014); or

(c) defer withdrawal until the IASB completes its long-term project on materiality (no expected date for completion is available at the time of writing this paper).

Having considered the comments received from respondents, although staff continue to be of the view that withdrawing AASB 1031 would not change current practice, staff are of the view that waiting for completion of the IASB's short-term project may alleviate some of the concerns articulated by respondents to ED 243. On balance, therefore, staff recommend option (b).

Q2:	**Does the Board agree with the above staff recommendation?**