



<b>Project:</b>	<b>Disclosure Initiative</b>	<b>Meeting</b>	AASB December 2015 (M149)
<b>Topic:</b>	<b>Options for Adoption of Materiality Practice Statement in Australia</b>	<b>Agenda Item:</b>	8.1
<b>Contact(s):</b>	Ahmad Hamidi <a href="mailto:ahamidi@asb.gov.au">ahamidi@asb.gov.au</a> (03) 9617 7643	<b>Project Priority:</b> <b>Decision-Making:</b> <b>Project Status:</b>	High High Form tentative views

### Introduction and objective of this paper

- 1 The objective of this paper is to seek the Board's preliminary views as to how the guidance proposed in IASB ED/2015/8 *IFRS Practice Statement: Application of Materiality to Financial Statements* should be adopted in Australia.
- 2 ED/2015/8 will be discussed at the upcoming Accounting Standards Advisory Forum (ASAF) meeting on 8-9 December 2015. At that meeting, IASB staff will be seeking feedback from ASAF members as to their plans for implementing the Materiality Practice Statement in their jurisdictions.
- 3 Staff note that IFRS Practice Statement *Management Commentary* was not issued as an AASB-equivalent pronouncement in Australia; however, a link was made available on the AASB's website to that IFRS Practice Statement. To help inform the AASB member to ASAF and assist staff to develop a draft AASB response to Question 1 of ED/2015/8<sup>1</sup>, staff are seeking the Board's preliminary views as to whether a similar approach should be adopted in respect of the Materiality Practice Statement when issued, or whether AASB should be providing feedback to the IASB that the guidance be issued with an alternative status (that is, as mandatory guidance) or in an alternative form (for example, as an IFRS).

### Link to ED 271 and project summary

ED 271: [http://www.aasb.gov.au/admin/file/content105/c9/ACCED271\\_10-15.pdf](http://www.aasb.gov.au/admin/file/content105/c9/ACCED271_10-15.pdf)

*Project summary:*

[http://www.aasb.gov.au/ADMIN/file/content102/c3/Disclosure\\_Initiative\\_Materiality\\_Practice\\_Statement\\_Project\\_Summary.pdf](http://www.aasb.gov.au/ADMIN/file/content102/c3/Disclosure_Initiative_Materiality_Practice_Statement_Project_Summary.pdf)

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1 Question 1 seeks feedback on whether the guidance in the draft Materiality Practice Statement should be issued as non-mandatory guidance, and whether a Practice Statement is the appropriate form for non-mandatory guidance on Materiality.

## **Disclosure Initiative Project Advisory Panel – feedback**

- 4 At its October 2015 meeting, the Board decided to establish a Project Advisory Panel in relation to the Disclosure Initiative project. The Project Advisory Panel has since been established (see Appendix 1 to this Paper). Staff are presently seeking feedback from Panel members on their preliminary views as to whether the guidance proposed in the draft Materiality Practice Statement should be mandatorily applicable to Australian entities, and will provide a verbal update to Board members at the Board meeting.

### **Summary of staff recommendation**

- 5 Staff recommend that the IFRS Practice Statement be issued as an Australian-equivalent Practice Statement. Staff expect this to eventually supplement any standards-level principles and guidance published by the IASB as part of the Principles of Disclosure project<sup>2</sup>.

### **Background**

#### *IASB rationale for a Practice Statement*

- 6 The purpose of the draft Materiality Practice Statement is to provide guidance to assist management in using judgement about what information is material and therefore should be included in financial statements. It should also help facilitate management's discussions with auditors and regulators about those judgements.
- 7 The IASB has proposed to issue the guidance as a Practice Statement. A Practice Statement is not IFRS and as such its application is not required in order to state compliance with IFRS (that is, it is non-mandatory). The IASB's rationale for issuing the guidance in the form of a Practice Statement is set out in paragraphs BC10 – BC15 of ED/2015/8 (see Appendix 2 to this paper) and was made on concerns that mandatory guidance in a Standard could:
- (a) create conflicts with national legal frameworks and accordingly, may add complexity to the development of the guidance [paragraph BC11]; and
  - (b) appear prescriptive, which could undermine the emphasis on management judgement [paragraph BC13].

Additionally, the IASB considered that a separate non-mandatory document was preferable to non-mandatory implementation guidance supporting a specific IFRS as it would help emphasise that the concept of materiality is pervasive throughout IFRS [paragraph BC14].

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2 Staff note that 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, in its forthcoming Discussion Paper for its Principles of Disclosure project.

*Previous Australian Accounting Standard: AASB 1031*

- 8 AASB 1031 *Materiality* (1995) was part of Australian GAAP until adoption of IFRS in 2005. AASB 1031 stated its objective as:
- (a) defining materiality;
  - (b) explaining the role of materiality in making judgements in the preparation and presentation of the financial report; and
  - (c) requiring the Standards specified in other Australian Accounting Standards to be applied when information resulting from their application is material.
- 9 In adopting IFRS in 2005, the AASB issued AASB 1031 *Materiality* (July 2004). At the time IFRS were first incorporated into Australian Accounting Standards, the Board decided to retain a revised version of AASB 1031 to help ensure that the meaning of materiality remained well explained, as the *Framework for the Preparation and Presentation of Financial Statements* on issue at that time included only limited guidance on materiality in comparison to AASB 1031. The revised version of AASB 1031(2004) included the same objective as the AASB 1031 under previous Australian GAAP.
- 10 In December 2013, the Board decided to withdraw AASB 1031 to be consistent with its policy of not providing unnecessary local guidance on matters covered by IFRS<sup>3</sup>. As part of the Board's considerations, the Board had noted the IASB's intentions to begin a project on Materiality with a view to developing application guidance or educational material. The Board considered that the withdrawal of AASB 1031 would facilitate the incorporation of any authoritative guidance into the Australian Accounting Standards eventuating from that project.

**Staff analysis of options for adopting the materiality guidance**

- 11 Staff think that there are five options that the Board could consider to adopt the guidance in the draft Materiality Practice Statement. Staff are asking the Board which option they prefer. The Board's tentative view would help inform the AASB member to ASAF and assist staff to develop a draft AASB response to Question 1 of ED/2015/8. The options are as follows:<sup>4</sup>
- (a) do nothing (that is, not issuing the Practice Statement as an AASB pronouncement), but make available a link to the IASB Practice Statement;
  - (b) issue an Australian equivalent Practice Statement;

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3 The withdrawal of AASB 1031 was implemented progressively. It had the status of an interim standard in its revised form as amended in December 2013 until such time references to AASB 1031 in other Standards were removed. AASB 1031 was finally withdrawn in 2014 by being superseded by AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*.

4 Staff note that the Board's view at this time may be different to the Board decision when considering a final IASB pronouncement, as there may be other considerations in departing from the final form of an IASB pronouncement.

- (c) issue the guidance as non-mandatory guidance in the form of application/implementation guidance to an Australian Accounting Standard;
  - (d) issue the guidance as mandatory guidance in the form of a domestic Australian Accounting Standard; or
  - (e) issue any principles on applying materiality included in the guidance as an Australian Accounting Standard.
- 12 Staff do not recommend that the guidance be issued as educational material for the reasons set out in paragraph BC15 of ED/2015/8.

*Option (a): Do nothing, but make available a link to the IASB Practice Statement*

- 13 There is a precedent for this option. The Board did not adopt IFRS Practice Statement *Management Commentary* into the Australian reporting requirements in February 2014 noting the following:
- (a) although the IASB concluded that management commentary is within the scope of financial reporting, the Practice Statement is not an IFRS and consequently entities applying IFRS are not required to comply with the Practice Statement, unless otherwise required in their jurisdiction; and
  - (b) broadly similar guidance on management commentary already exists in Australia, particularly in the private sector.
- 14 Further, this option is similar to the Board's approach to non-integral IFRS material (for example, implementation guidance and illustrative examples), which are not issued as Australian material.
- 15 Staff do not support the 'do nothing' option as:
- (a) currently there is no alternative domestic accounting guidance on applying materiality ;
  - (b) the concept of materiality is pervasive through all Australian Accounting Standards; and
  - (c) the guidance is directly related to financial statements.
- 16 Staff think it is necessary that the guidance is at least acknowledged in AASB literature, especially if it provides some high-level principles on applying materiality.

*Option (b): Issue an Australian-equivalent Practice Statement*

- 17 Alternatively, the Board could consider issuing an Australian equivalent Practice Statement for the following reasons:
- (a) this would be consistent with the IASB's proposed non-mandatory approach;
  - (b) the potential risk of undermining the emphasis on management judgement does not arise (paragraph BC13 of ED/2015/8);

- (c) would 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; and
- (d) staff expect the Principles of Disclosure project consider amendment to IFRS in respect of materiality.

18 Staff considered the following arguments against this alternative:

- (a) a Practice Statement is not as effective or prominent as a Standard, considering the established history of an Australian Accounting Standard on materiality;
- (b) being non-mandatory, it would not be subject to regulatory oversight; and
- (c) it may not significantly improve consistency in understanding the type of information that is likely to be material to primary users in an Australian context.

*Option (c): issue the guidance as non-mandatory guidance in the form of application guidance/implementation guidance to an Australian Accounting Standard*

19 The reasons in support of adopting this option are similar to Option (b) because of its non-mandatory nature. Additionally this option would give more prominence to the guidance.

20 However, staff note that the IASB decided against issuing the guidance as non-mandatory implementation guidance supporting a specific IFRS on considering that its location in a separate document would help emphasise that the concept of materiality is pervasive throughout IFRS (see paragraph BC14 of ED/2015/8)

*Option (d): Issue the guidance as mandatory guidance in the form of a domestic Australian Accounting Standard*

21 The Board could consider issuing the guidance as a domestic Australian Accounting Standard. Staff considered the following arguments in support of this alternative:

- (a) is consistent with long-standing Australian practice of having an Accounting Standard on Materiality;
- (b) to reflect that the Board considers the application of the guidance to be important in the preparation of general purpose financial statements;
- (c) the guidance may improve consistency in understanding the type of information that is likely to be material to primary users in an Australian context;
- (d) auditors would be required to express an opinion on compliance with the guidance (as required to express an opinion on compliance with Australian Accounting Standards); and

- (e) it would facilitate ASIC's oversight of financial reporting by enabling ASIC to require entities to comply with the guidance. In the absence of a Standard on Materiality, ASIC would not be able to enforce compliance with the guidance.
- 22 Staff considered the following arguments against this alternative:
- (a) the potential risk of undermining management's exercise of judgement in applying materiality to financial statements. Staff note that this is only a concern and that staff are not aware that AASB 1031 had been an impediment to management applying their judgement in the past; and
  - (b) potentially ascribing more authority to the guidance than the IASB.
- 23 Staff do not support this option. Staff think this option would lead to an accounting standard which is not principle-based unless the content is modified to focus on principles for application of materiality. This option might also pre-empt later standard-level requirements that are expected to arise from the Principles of Disclosure project.

*Option (e): Issue any principles on applying materiality included in the guidance as an Australian Accounting Standard*

- 24 Similar arguments as for Option (d) apply to this option. However, this option is consistent with the nature of an accounting standard which is to address principles rather than detailed requirements.
- 25 It could be argued that having a principled-based standard on Materiality would not be consistent with the IASB's approach of providing detailed guidance to assist management in making materiality judgements. To achieve the same objective as the IASB guidance, the Australian Accounting Standard created under this option might need to be supplemented with more detailed application guidance.
- 26 Staff think that because issuing standards under Options (d) and (e) might pre-empt later standard level materiality requirements expected to arise under the Principles of Disclosure project and would involve additional costs of modification, these options are less attractive.

#### Staff recommendation

- 27 On balance, staff support the present status and form of the guidance and recommend the IFRS Practice Statement on Materiality be issued as an Australian equivalent Practice Statement (Option (b)), if finalised by the IASB in this manner. Staff support this approach for the reasons given by the IASB, but given the topic, consider that the guidance should be issued as a AASB pronouncement and not just a link to the IASB pronouncement as in option (a). Staff expect that this guidance would supplement any standards-level principles and guidance promulgated by the IASB as part of the Principles of Disclosure project.

**Question for Board members:**

Do Board members agree with the staff recommendation in paragraph 27? If not, which of the options in paragraph 11 above do you consider as appropriate for adoption of the guidance in the draft Materiality Practice Statement?

## **Appendix 1: Disclosure Initiative Project Advisory Panel**

### **List of Panel Members**

<b>Name</b>	<b>Organisation</b>
<b>Dean Arden</b>	Pitcher Partners
<b>Diana D'Ambra</b>	Australian Shareholders Association
<b>Karen Foo</b>	Department of Treasury and Finance – Victoria
<b>Kerry Hicks</b>	Australian Charities and Not-for-profits Commission
<b>Sanjay Khushu</b>	Telstra
<b>Julie Locke</b>	KPMG
<b>Doug Niven</b>	Australian Securities and Investments Commission
<b>Adam Sofoulis</b>	Wesfarmers
<b>Rachel Vagg</b>	Queensland Audit Office

### **List of AASB members on the Panel**

<b>Name</b>	<b>Organisation</b>
<b>Regina Fikkers</b>	AASB member PricewaterhouseCoopers
<b>Andrew Kearnan</b>	AASB member Corporate adviser
<b>Megan Wilson</b>	AASB member Non Executive Director Ernst and Young





## **Appendix 2: Extracts from ED/2015/8**

### **Why we are considering issuing guidance in the form of a Practice Statement**

- BC10 This [draft] Practice Statement sets out non-mandatory guidance with the aim of assisting management to use judgement in applying the concept of materiality when preparing financial statements. Entities applying IFRS are not required to comply with the Practice Statement, but the relevant authorities in their jurisdiction may require that they do so. Nevertheless the IASB thinks that this [draft] Practice Statement will help to promote a greater understanding of the role of materiality in IFRS and how it should be applied in preparing financial statements. This will help to improve the usefulness and understandability of financial statements across entities and jurisdictions.
- BC11 The IASB proposes to provide guidance on the application of materiality in the form of a non-mandatory Practice Statement, rather than as mandatory guidance in a Standard. The IASB noted that if it issued mandatory guidance in a Standard, concerns about creating conflicts with national legal frameworks could add complexity when developing the guidance. Nevertheless the IASB noted that even though some jurisdictions have legal or regulatory requirements about materiality, this should not necessarily result in a conflict with the guidance in this [draft] Practice Statement (provided that those local requirements do not prevent an entity from applying requirements in IFRS if the effect of doing so would be material). For example, many companies file with the US SEC as foreign registrants using financial statements that are prepared in accordance with IFRS. The IASB is not aware of any difficulties to these registrants caused by differences between the definition of materiality in IFRS and the definition developed by the U.S. Supreme Court.
- BC12 The IASB also noted that IFRS would not prohibit an entity from providing additional information in order to meet local requirements in a jurisdiction. Furthermore, local requirements may help establish the type of information that is likely to be material to the primary users within that jurisdiction.
- BC13 The IASB also noted that issuing mandatory guidance in a Standard could risk appearing prescriptive, which could undermine the emphasis on management applying their judgement in the application of materiality. Nevertheless, the IASB noted that jurisdictions could choose to adopt the Practice Statement into their national framework.
- BC14 The IASB also observed that issuing guidance as a separate non-mandatory document, rather than as non-mandatory implementation guidance supporting a specific Standard, such as IAS 1, would help to emphasise that the concept of materiality is pervasive throughout IFRS.
- BC15 The IASB also decided that a Practice Statement was preferable to education material for the following reasons:
- (a) it will be subject to full due process, including public consultation. This consultation step enables the IASB to obtain input from a wide range of stakeholders on the proposed content of the Practice Statement; and
  - (b) it will be more accessible and formal than education material, because it would become part of the IFRS Bound Volume. Furthermore, the Practice Statement would constitute a formal document that a jurisdiction could choose to mandate.