



22 August 2013

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins St West Victoria 8007
AUSTRALIA

Dear Mr Stevenson

AASB Exposure Draft ED 243
Withdrawal of AASB 1031 Materiality

Please find attached the Australasian Council of Auditors-General (ACAG) response to AASB Exposure Draft ED 243 *Withdrawal of AASB 1031 Materiality*.

The Australian members of ACAG have differing views regarding the proposals contained in ED 243.

Four member Audit Offices support the withdrawal of AASB 1031 for the reasons expressed by the AASB.

Three member Audit Offices have expressed an alternative view. Those member offices believe the proposal to withdraw AASB 103 is premature and they do not support the withdrawal of the standard at this time. The attachment to this letter outlines the alternative view of these Audit Offices.

The opportunity to comment is appreciated and I trust you will find the comments useful.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Simon O'Neill', is written over a horizontal line.

Simon O'Neill
Chairman
ACAG Financial Reporting and Auditing Committee

General Comment

The three member Audit Offices who do not support the withdrawal of AASB 1031 at this time, consider that the withdrawal should be assessed as part of the process of adopting the IASB Framework for Financial Reporting following the completion of further work by the IASB in developing guidance regarding materiality.

Those offices acknowledge guidance in relation to materiality will remain in the AASB Conceptual Framework, AASB 101 Presentation of Financial Statements, and AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors, however they believe this guidance is limited and the withdrawal of AASB 1031 prior to additional guidance being developed could lead to greater divergence in practice.

Specific Matters for Comment

1. Whether the proposal to withdraw AASB 1031 is supported

The ACAG members that do not support the proposal to withdraw AASB 1031 *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 1031 will 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 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.

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?

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.

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;**

Those ACAG members provide no further comment on this matter.

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

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. Whether the proposals are in the best interest of the Australian economy?

Those ACAG members provide no further comment on this matter.

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.

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.

Other Matters

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 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.