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23 August 2013

The Chairman
The Australian Accounting Standards Board
PO Box 204
Collins Street West
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By email: standards@aasb.gov.au

Dear Sir

ED 243 Withdrawal of AASB 1031 *Materiality*

EY is pleased to submit its response to the AASB Exposure Draft 243 Withdrawal of AASB 1031 *Materiality* (ED 243) issued in June 2013. Our responses to the specific questions are set out in the appendix to this cover letter. We highlight below some of the broader issues underlying our response to the specific questions raised in the ED.

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While, we do have mixed views on whether AASB 1031 should be withdrawn, on balance, we believe that AASB 1031 plays an important role in financial reporting, and do not support its removal until the IASB has completed producing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.

Should you wish to discuss any aspects of our submission, please feel free to contact Lynda Tomkins on (02) 9276 9605.

Yours faithfully

Ernst & Young

Ernst & Young

APPENDIX – Responses to the specific matters for comment in the Exposure Draft – Withdrawal of AASB 1031 Materiality

1. Whether the proposal of withdraw AASB 1031 is supported

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 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[1])
- 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)[2], the IASB reaffirmed its stance on the description of materiality[3], 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[4]. 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[5];
- The quantitative threshold (i.e. 10%/5% of base amount)[6]; or
- The difference between materiality in absolute and relative terms[7]

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, 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.

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

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

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[8] in financial reporting released in November of the year before. Some of the major findings from this consultation paper were that[9]:

- 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 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.

3. Where they 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

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.

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[8] Consultation Paper ESMA/2011/373: Considerations of materiality in financial reporting (9 November 2011)
[9] Summary of Responses ESMA/2012/525: Considerations of materiality in financial reporting (16 August 2012)

4.	Whether, overall, the proposals would result in financial statements that would be useful to users;
5.	Whether the proposals are in the best interests of the Australian economy; and

No. The proposed changes would likely detract the utility of the financial statements to users.

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.

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.