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Ref: KLB/da

29 January 2016

Ms Kris Peach
Chair
Australian Accounting Standards Board
Level 14, 530 Collins Street
Melbourne VIC 3000

Dear Ms Peach

SUBMISSION – IFRS PRACTICE STATEMENT:
APPLICATION OF MATERIALITY TO FINANCIAL STATEMENTS (ED 271)

We appreciate the opportunity to provide comment to the Australian Accounting Standards Board (the AASB) on ED 271 *IFRS Practice Statement: Application of Materiality to Financial Statements*.

Pitcher Partners is an association of independent firms operating from all major cities in Australia. Firms in the Pitcher Partners network are full service firms and we are committed to high ethical standards across all areas of our practice. Our clients come from a wide range of industries and include listed and non-listed disclosing entities, large private businesses, family groups, government entities, and small to medium sized enterprises.

We support the IASB's efforts to facilitate more consistent application of the materiality concept. Nevertheless, in its current form we do not support the publication of the guidance as a Practice Statement.

Our detailed responses to the questions contained in ED 271 are attached to this letter.

Please contact either myself or Dean Ardern, Director - Audit & Accounting Technical (03 8610 5434 or dean.ardern@pitcher.com.au), in relation to any of the matters outlined in this submission.

Yours sincerely

K L Byrne	D Ardern
Partner	Director, Audit & Accounting Technical

ED 271 *IFRS Practice Statement: Application of Materiality to Financial Statements*

Specific matters for comment:

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?

Response:

(a) We consider that the guidance set out in the [draft] Practice Statement should be non-mandatory for a number of reasons, including:

(i) it is not currently drafted in manner that would facilitate mandatory application. In comparison to the Application Guidance to IFRS 10: *Consolidated Financial Statements* (which is integral to IFRS 10 and therefore mandatory in jurisdictions in which IFRS 10 is mandatorily applicable), the guidance on materiality lacks definitive criteria management would consider and apply in determining whether, for instance, note disclosures in addition to those required by an applicable standard should be provided; and

(ii) it contains both direct quotations from, and cross-references to, the *Conceptual Framework*. If the application of the guidance was to be made mandatory, the effect of this would presumably be to grant those sections of the *Conceptual Framework* referred to in the guidance the same status as IFRS requirements. This outcome would arguably be inconsistent with paragraph 11 of IAS 8/AASB 108: *Accounting Policies, Changes in Accounting Estimates and Errors* and, in the Australian context, with the current status of the *Framework for the Preparation and Presentation of Financial Statements* (paragraph 2 of the *Framework*).

We note the IASB's reasons in paragraph BC15 for issuing the guidance in the form of a [draft] Practice Statement. Nevertheless, as it is currently drafted, we consider the guidance is more in the nature of education material. Consequently, and for the reasons identified above, we do not support the IASB's proposal:

(iii) in BC15(b) to include the guidance as part of the IFRS Bound Volume. In jurisdictions (such as Australia) where IFRS is mandatory for many types of entities, inclusion of the guidance in the IFRS Bound Volume may be mistakenly interpreted by some preparers and users to mean the guidance has the same standing as IFRS requirements; or

(iv) to permit the relevant authorities in each jurisdiction that has adopted IFRS to determine whether the guidance should mandatorily apply in their jurisdiction. We consider such an approach to be inconsistent with the IASB's efforts to date to develop a 'single set of high quality, understandable, enforceable and globally accepted financial reporting standards…'.

(b) Consistent with the IASB's reasoning in paragraph BC14 of the [draft] Practice Statement, we consider the practice statement format to be an appropriate vehicle for issuing non-mandatory guidance on concepts that are relevant across a number of IFRS. However, as noted above, in its current form we do not support the guidance in the [draft] Practice Statement being issued as non-mandatory guidance.

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 examples(s) would be helpful to entities.

Response:

We consider the illustrative examples provided in the [draft] Practice Statement would be generally helpful to management in understanding of the role of materiality in IFRS. Some of the examples, however, could be drafted in a manner that more clearly articulates how the concept of materiality should be applied to note disclosures. For instance:

(a) Paragraph 39(c) discusses the types of factors management might consider when assessing what information should be disclosed in relation to multiple business combinations occurring during a reporting period that are each individually immaterial but are material collectively. As paragraph B65 of IFRS 3/AASB 3: *Business Combinations* requires some specific aggregated information to be disclosed in such circumstances, it is unclear from the example what other information, if any, management might consider disclosing in relation to these types of business combinations.

(b) Paragraph 43 states, in part, that:

Management considers whether an item is material by considering it relative to individual line items, subtotals and totals on the face of the financial statement, as well as to each overall individual statement.

As it is currently drafted, this could be read by management to mean the materiality of an item recognised in the financial statements can be determined by comparing it to potentially <u>any</u> line item, subtotal or total on the face of the financial statements. In contrast, in practice the quantitative materiality of an item is normally assessed against an appropriate comparable item. For instance, in determining whether an expense item is material on a quantitative basis, the item might be compared to the reported total expenses and/or profit or loss for the period.

(c) Paragraph 47 discusses the differences between judgements about materiality when separately presenting items in the financial statements and judgements about materiality when disclosing information in the notes. To illustrate such differences, paragraph 47 notes, in part, that:

For example, management may decide to present only a single amount for total revenue on the face of the statement of comprehensive income. In the notes management should disaggregate the amount and disclose further information, as appropriate, to enable the primary users to understand the nature, amount, timing and uncertainty of the revenue and related cash flows.

These proposed note disclosures, however, are required by paragraph 110 of IFRS 15/AASB 15: *Revenue from Contracts with Customers*. Accordingly, it is unclear what information, if any, management might consider disclosing in relation to revenue from contracts with customers in addition to that required under the Standards.

(d) Paragraph 54(c) states:

if an impairment loss was recorded for an item of plant in the prior year, but not in the current year, then detailed impairment disclosures may not be material in the current year.

If an event or circumstance does not arise in a reporting period, any disclosure requirement relevant to that event or circumstance is arguably not <u>applicable</u> to the entity in the reporting period. In this example, it is unclear what the guidance is attempting to clarify.

We acknowledge application of the materiality concept involves significant judgement that depends on the specific facts and circumstances. Accordingly, any guidance on the application of the concept of materiality cannot (and should not) be expected to address every possible set of circumstances, particularly in the context of principles-based accounting standards. Nevertheless, we consider the guidance would be enhanced by including further discussion and/or examples covering the following matters.

(e) Items that are material by virtue of their nature rather than by their magnitude. We note that paragraph 27 provides some examples in which 'quantitative aspects may not be helpful' in assessing materiality, but the guidance provides no examples that specifically deal with items that are material by virtue of their nature. Such examples might include related party transactions that are made on 'market' terms.

(f) Following on from (e) directly above, items that are not recognised in the financial statements. From our experience, management often experience difficulties in applying the concept of materiality in the context of the disclosure requirements in paragraphs 31-42 of IFRS 7/AASB 7: *Financial Instruments: Disclosures*, particularly in assessing the material risks arising from financial instruments.

(g) Paragraph 51 provides limited guidance on how management might interpret and apply 'disclosure objectives'. Considering disclosure objectives are a common feature of IFRS, including IFRS 3, IFRS 7, IFRS 8: *Operating Segments*, IFRS 12: *Disclosure of Interests in Other Entities*, IFRS 13: *Fair Value measurement*, IFRS 15: *Revenue from Contracts with Customers* and IFRS 16: *Leases*, we would expect that the guidance would consider, for instance, the potential circumstances in which an entity would provide note disclosures in addition to those specifically required by the applicable Standard because the disclosure objective(s) were not met.

Question 3—Content of the [draft] Practice Statement
The [draft] Practice Statement proposes guidance in three main areas: (a) characteristics of materiality; (b) how to apply the concept of materiality in practice when presenting and disclosing information in the financial statements; and (c) how to assess whether omissions and misstatements of information are material to the financial statements. It also contains a short section on applying materiality when applying recognition and measurement requirements. 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?

Response:

(a) Refer to our response to Question 2 above.

(b) We consider the guidance would be understandable by preparers of financial statements who have a reasonable level of business/accounting knowledge. We found the guidance to be accessible and reasonably well structured. Refer to our response to Question 2 for our suggestions regarding the paragraphs/sections we consider to be unclear.

(c) The guidance contains no paragraphs/sections with which we disagree.

(d) We note from paragraphs BC3 and BC5 to the guidance that one of the main concerns of stakeholders identified by the IASB is the lack of guidance in IFRS on how the concept of materiality should be applied to disclosures in the notes to the financial statements. We also note, however, that less than a quarter of the document (paragraphs 45-55) specifically deals with this issue. While we consider that the document provides a useful overview of the concept of materiality as it applies to IFRS, we believe the document would serve these stakeholders, and particularly management, better if it focused specifically on the differences between judgements about materiality when presenting items separately in the primary financial statements as compared to judgements about materiality when disclosing information in the notes. In our view, clear guidance on this matter would greatly assist in 'decluttering' financial statements generally.

The length of the document could also be reduced substantially by:

(i) paraphrasing and including cross-references to guidance and requirements in other standards and in the Conceptual Framework. We note that at least nine paragraphs in the guidance contain direct quotes of material from IFRS sources, some of which are relatively lengthy;

(ii) eliminating any repetition within the material. For instance:

a. paragraphs 30, 31 and 34 appear to cover material dealt with earlier in the document; and

b. the last sentence in paragraph 50 is arguably unnecessary; and

(iii) deleting the last sentence in paragraph 43 of the guidance. This sentence appears to deal with the format of financial statements rather than the concept of materiality.

(e) We do not consider any aspects of the guidance would conflict with any current legal requirements related to materiality as they apply to entities operating within Australia.

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?

Response:

We have no specific comments in relation to the IASB's proposed approach.

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.

Response:

We note the following editorial matters for your consideration.

(a) The term 'presentation' does not appear have been applied consistently throughout the guidance. For instance, the term 'presentation' is used to describe the provision of information in the notes to financial statements in paragraphs 30, 38 and BC5(b) of the guidance.

(b) Paragraph 69 of the guidance states, in part, that:

Consequently, the disclosures in the financial statements should ensure that the primary users are made aware of the <u>subjectivity</u> involved in recognising and measuring such items. (emphasis added)

We would recommend replacing 'subjectivity' with 'judgement'. As it is currently drafted, the sentence could be read to mean note disclosures are based on the preparer's personal feelings and/or views.

We also note that, if adopted, the AASB's proposals in paragraph 18 of the ED 260: *Income of Not-for-Profit Entities* might be viewed as inconsistent with paragraphs 29 and 39(c) of the guidance.