



ACT
Government

Chief Minister, Treasury and
Economic Development

Ms Kris Peach
The Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007

Dear Ms Peach

Exposure Draft 271 – IFRS Practice Statement: Application of Materiality to Financial Statements

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on the Exposure Draft 271: *Application of Materiality to Financial Statements*.

HoTARAC welcomes the proposed guidance, but notes that it is difficult to develop guidance on the application of materiality in terms of users' needs, when these users and their needs are currently being identified through the updated conceptual framework project. This is likely to result in the need for further review and amendment when the conceptual framework project is finalised.

HoTARAC also suggests the AASB add examples to the Australian version of the practice statements to assist in application to the not-for-profit sector.

Comments by HoTARAC on the Specific Matters for Comment, including the AASB Specific Matters, in the ED are attached.

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Department of Finance on (02) 6215 3551, email: peter.gibson@finance.gov.au.

Yours sincerely

David Nicol
Chair
Heads of Treasuries Accounting and Reporting Advisory Committee

22 January 2016

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?

- (a) HoTARAC has no objection to issuing the guidance as a non-mandatory practice statement. However, HoTARAC notes that the proposed practice statement aggregates information from a number of sources, including the current conceptual framework. The IASB is currently reviewing its conceptual framework, including identifying the users of financial statements and their needs. The practice statement is likely to need updating as the conceptual framework is progressed and referred to standards evolve. For accounting standards, this occurs through consequential amendments. HoTARAC assumes a similar process is intended to apply to the practice statement.
- (b) HoTARAC agrees a practice statement is the appropriate form of non-mandatory guidance, subject to our comments above on cross-referencing.

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 example(s) would be helpful to entities.

HoTARAC finds the example paragraphs in the practice statement useful, though believes they could be more extensive.

HoTARAC notes that these examples are geared towards the very narrow view of users as short-term investors. HoTARAC recommends this be subject to review as the user group for financial statements is being considered through the conceptual framework project. HoTARAC notes that the recent exposure draft on the conceptual framework clarified the role of probability in the recognition of assets and liabilities. The application of materiality is likely to be critical to the application of these concepts in the financial statements and HoTARAC suggests the guidance on recognition and measurement include examples.

HoTARAC further recommends the inclusion of examples covering some high level issues in the Practice Statement for which no illustrative examples are provided, such as management's stewardship, uncertainties and contingencies, and interim financial reporting. Scenarios to be addressed could include probity and related party transactions as they relate to management's stewardship.

The IASB may also wish to consider an example of situations where additional disclosures are included to meet materiality requirements.

HoTARAC also believes it would be beneficial for the IASB to explain how the concept of materiality interacts with the term 'major' in IFRS 5 *Non-current Assets Held for Sale and*

Discontinued Operations and with the term 'significant' as referred to in IAS 24 *Related Party Disclosures* (paragraph 27) and IAS 34 *Interim Financial Reporting* (paragraph 15B). An example of the circumstances where 'minimum disclosure requirements' can be omitted on the basis of materiality (paragraph 49) would also be useful.

In order for the Practice Statement to be truly helpful to preparers, HoTARAC considers that the document should focus more on grey areas. For instance, the example in 39(b) use a large quantum of loss combined with speculative activity where it is relatively clear foreign exchange losses should be disaggregated. Less clear-cut examples would be more helpful.

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?

- (a) HoTARAC recommends further guidance be provided on how materiality applies to the measurement criteria. For example, some standards require assets to be held at fair value (e.g. IAS 40 *Investment Property*). In some circumstances, where there is no active market or identifiable cash flows for an asset, it may be impossible or extremely complicated and expensive to measure the recoverable amount, particularly under the requirements of IFRS 13 *Fair Value Measurement*. The IASB could consider conditions where materiality be invoked to use an estimate of fair value or to continue to carry the assets at historic cost where this has been used in the past. A possible precedent for this is IAS 34, which allows more latitude in the application of materiality to estimates in interim financial statements (paragraph 60). Could a similar precedent be applied to avoid the need for expensive and time-consuming valuation, where the information is of little value to users? If the IASB consider existing guidance adequate, the inclusion of an example would be useful.
- (b) HoTARAC agrees that the guidance is helpful, subject to other comments. HoTARAC further suggests the following amendments to be made to the guidance:
 - paragraph 30 be modified as 'wide range of primary users' to align with IASB's objective stated in Paragraphs 21 and 22;

- insert the words 'a mere' to the third sentence of paragraph 47 to avoid confusion. The sentence will then read 'Nevertheless, if information is material in the context of the primary financial statements then a mere disclosure in the notes is not sufficient.' Then move this sentence to the end of that paragraph, as the example given at the end of the paragraph seems to tie in with the first two sentences.
 - paragraph 46 states the context in which the concept of materiality is applied is different for the notes compared to the primary financial statements. HoTARAC recommends that IASB include further guidance on how materiality is to be applied in determining what note disclosures are required and the level of disaggregation required.
- (c) HoTARAC has not identified any sections that are unnecessary, noting the proposed practice statement format.
- (d) HoTARAC has not identified any unnecessary sections of the guidance.
- (e) HoTARAC is not aware of any legal requirement the practice statement conflicts with.

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?

HoTARAC notes that the 'Principles of Disclosure' project is reviewing guidance on the structure and content of financial statements. As materiality is an overarching concept, HoTARAC agrees that it is unlikely the completion of this project will affect the content of the practice statement. However, HoTARAC notes that the concept of materiality is strongly related to the notion of user needs and the identification of users through the conceptual framework. Consequently, completion of the conceptual framework project may result in consequential amendments or more fundamental changes if the user group changes significantly.

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.

Paragraph BC5 (a) notes a widespread stakeholder view that the qualitative aspect of materiality is currently overlooked. That said, the document appears to contain little guidance in this area. Whilst touching on fraud (intentional misstatements) as being material by nature, it does not consider areas such as related party transactions and probity.

AASB Specific Matters for Comment

The AASB would particularly value comments on the following:

- 1. 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.*

HoTARAC is not aware of any regulatory issues and these are unlikely to arise given this is proposed to be issued as a practice statement.

HoTARAC notes that application of materiality in the public sector may be different from the private sector due to different funding sources and user information needs. The suggested non-mandatory guidance would allow public sector financial statements preparers to make their own judgement in the application of the practice statement in circumstances unique to the public sector.

HoTARAC suggests the AASB add examples to the Australian version of this statement to assist in application to the not-for-profit sector.

- 2. whether, overall, the proposals would result in financial statements that would be useful to users.*

HoTARAC agrees that this would result in proposals useful to users.

- 3. whether the proposals are in the best interests of the Australian economy.*

HoTARAC provides no comment as to whether the proposals are in the best interests of the Australian economy.

- 4. unless already provided in response to specific matters for comment 1 – 3 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative.*

In HoTARAC's view, the benefits are more concise, readable financial statements. The costs are increased preparatory work to distinguish between material and immaterial transactions.

