



Australian Government

**Australian Accounting
Standards Board**

Level 7, 600 Bourke Street
MELBOURNE VIC 3000
Postal Address
PO Box 204
Collins Street West VIC 8007
Telephone: (03) 9617 7600
Facsimile: (03) 9617 7608

3 April 2012

Mr S Maijoor
Chair
European Securities and Markets Authority
103 Rue de Grenelle
75007 Paris
FRANCE

Dear Mr Maijoor

Consultation Paper *Considerations of materiality in financial reporting*

The Australian Accounting Standards Board (AASB) provides the following comments on the above-named Consultation Paper (CP) from its perspective as an accounting standard setter in a jurisdiction that adopts International Financial Reporting Standards (IFRSs). Accordingly, the AASB does not comment on each of the questions asked in the CP or on how the European Securities and Markets Authority (ESMA) should foster supervisory convergence among securities regulators in relation to the application of materiality in IFRS-compliant financial statements. The AASB observes that some of the questions are related to issues other than materiality that are dealt with in the IASB Conceptual Framework, or are more related to practice and enforcement than standard setting (given the principle-based nature of IFRSs).

The AASB is writing to express concern that issuing guidance on some issues raised in the CP could, in effect, re-interpret the wording of IFRSs and the IASB Conceptual Framework, and indeed go beyond matters of materiality. Some examples of the AASB's concerns regarding the CP are in respect of:

- (a) Part III, which discusses the characteristics of primary users and the objective of financial reports, including the nature of primary users' decisions encompassed by that objective. Of particular concern to the AASB is that:
 - (i) Question 3 asks whether 'economic decisions made by users' (a similar phrase is used in the superseded IASB *Framework for the Preparation and Presentation of Financial Statements*) are the same as users making 'decisions about providing resources to the entity' (a phrase used in the current IASB Conceptual Framework). The AASB thinks it would be inappropriate to develop guidance on this issue, as any ESMA guidance would potentially re-interpret the IASB Conceptual Framework. The AASB notes that the answer to Question 3 can be deduced from a comparison of paragraphs OB2 and OB5 of the IASB's Conceptual Framework with paragraphs 12 – 15 of the superseded IASB *Framework*, without the need for additional guidance;
 - (ii) paragraph 16 (to which Question 4 relates) sets out examples of decisions that information provided to primary users of financial statements could be

expected to assist—these include examples that are not identified in the IASB’s Conceptual Framework. Those additional examples are not directly related to materiality, and also potentially re-interpret the IASB’s Conceptual Framework;

- (iii) Question 5(a) asks whether respondents agree with ESMA’s view that the IASB’s use of the word ‘could’ in its definition of ‘material’ (in IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) as opposed to, for example, ‘would’ implies a lower materiality threshold. ESMA’s view seems not to take into account paragraphs BC3.12 – BC3.13 of the Basis for Conclusions on Chapter 3 of the IASB Conceptual Framework, which, regarding the related phrase ‘is capable of’ in relation to relevance, state that:

“... the extent to which a decision is affected by information about a particular economic phenomenon is difficult, if not impossible, to determine, even after the fact.

... In contrast, whether information is *capable* of making a difference in a decision ... can be determined.”

Consistent with these comments of the IASB, it would not be a fruitful exercise to assess the relative effect of using ‘would’ and ‘could’ in the context of materiality. The AASB’s concern is that ESMA’s view might be seen as, in effect, re-interpreting ‘could’ in IAS 1 and IAS 8 and the related phrase ‘is capable of’ in the IASB Conceptual Framework; and

- (iv) Question 5(b), which asks whether including a phrase from Auditing Standards could lead to a different assessment of materiality. The principles required to be applied in preparing financial statements should influence the principles applied in auditing those financial statements, not the obverse. Therefore, it is unclear why any different terminology in Auditing Standards should be a consideration in applying the materiality requirements in IFRSs. Providing guidance on the relationship between IFRSs and Auditing Standards (in relation to materiality) runs the risk of conflating the different requirements of those two sets of Standards, and of, in effect, re-interpreting IFRSs;
- (b) Part VII.I, regarding ‘accounting policies’, includes an argument in paragraph 20 that, when read together with Question 9(a), seems to imply that the requirement in paragraph 122 of IAS 1 to disclose the judgements that management has made in the process of applying the entity’s accounting policies and that have the most significant effect on the amounts recognised in the financial statements could be a reason to require disclosure of judgements made about materiality. However, the AASB thinks disclosures about judgements affecting items that without doubt are material are unrelated to disclosures about materiality judgements. The AASB is therefore concerned that, by implying such a relationship, paragraph 20 and Question 9(a) potentially re-interpret the nature of the disclosures about judgements required by paragraph 122 of IAS 1; and

- (c) Part VII.II, regarding ‘component of line item disclosures’, indicates that particular types of omissions may be considered a misstatement (paragraph 26 and Question 10). The AASB is concerned that calling these ‘misstatements’, rather than ‘omissions’, would re-interpret terminology in IFRSs. It notes that ‘omissions’ and ‘misstatements’ are identified separately in the definition of ‘material’ in IAS 1 and IAS 8.

As further context to the basis for the AASB’s comments above, it is relevant to note that the AASB has recently reassessed the need to retain its domestic Standard AASB 1031 *Materiality*, which contains additional guidance on materiality to that in IFRSs. The AASB decided to issue an exposure draft proposing to withdraw AASB 1031, with the effect that the only guidance on materiality applicable to Australian reporting entities would be that issued by the IASB. This reflects the AASB’s views that the principle-based guidance on materiality in IFRSs and the IASB Conceptual Framework is adequate, and that withdrawing the additional Australian guidance would not be expected to change practice.

If you have queries regarding any matters in this comment letter, please contact me or Jim Paul (jpaul@aasb.gov.au).

Yours sincerely,

A handwritten signature in black ink, reading "K.M. Stevenson". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Kevin M. Stevenson
Chairman and CEO