TO DISCLOSE OR NOT TO DISCLOSE? MATERIALITY IS THE QUESTION

In last month's newsletter, we looked at the first step by the International Accounting Standards Board (IASB) and the Australian Accounting Standards Board (AASB) to 'declutter' financial statements by amending AASB 101 *Presentation of Financial Statements*.

This month we will look at a useful checklist for decluttering your 30 June 2015 financial statements.

The main theme of this 'decluttering' initiative is to apply materiality to all disclosures.

The amendments clarify various aspects of AASB 101, including:

- Line items in the statement of financial position and statement of profit or loss and other comprehensive income can be disaggregated if relevant to an understanding of the entity's financial position and performance
- Additional subtotals are allowed in profit or loss if they are made up of items recognised in accordance with IFRSs (e.g. EBITDA allowed but 'profit before abnormal items' are not). These subtotals must not be more prominent than IFRSs subtotals, and
- Notes can be shown in order of relevance to users (including grouping items together such as all financial instruments), rather than in the order that they appear on the primary financial statements.

However, the main theme of this 'decluttering' initiative is that materiality should be applied to all disclosures in the financial statements.

> 'Entities are not required to disclose immaterial information in their financial statements. Just because a standard contains a list of disclosures does not mean that an entity must always make each of those disclosures in its financial statements. Judgement is required to determine whether the relevant line item is material and also whether the specified disclosure is material.'

SOURCE: AASB MEDIA RELEASE (2 FEBRUARY 2015), QUOTE BY KRIS PEACH, CHAIR OF THE AASB

Effective date for 'decluttering' amendments

The amendments are effective for annual periods beginning on or after 1 January 2016 with early application permitted. As the changes relate to presentation only, the disclosures usually required when applying a new Accounting Standard or voluntarily changing accounting policies do not apply (AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*). However, directors will still be required to pass a resolution as required by s334(5) of the *Corporations Act 2001*, regarding early adoption of this amendment to AASB 101.

Specific disclosures only required if material

AASB 101, paragraph 31 has only ever required disclosures to be included if they are material.

> **AASB 101, paragraph 31**
> 'An entity need not provide a specific disclosure required by an Australian Accounting Standard if the information is not material.'

Usually preparers and auditors try and stick to the requirements of Accounting Standards as closely as possible. We therefore find ourselves in the curious situation whereby the Accounting Standards say one thing (don't disclose if not material), but preparers and auditors have done the opposite (disclosure, disclosure and more disclosure). This largely arises from the potential costs involved in debating what is actually material.

Why disclosure overload?

Several reports have been issued by various bodies over the years (G100's *Less is More*, Australian Financial Reporting Council's *Managing Complexity in Financial Reporting*, UK's Financial Reporting Council's *Louder than Words* and *Cutting Clutter*), raising concerns that the disclosure overload in practice is distracting users from information that is relevant for decision-making.

AASB Staff Paper *To Disclose or Not to Disclose: Materiality is the Question* (February 2014) quotes some of the reasons cited in these papers for the 'kitchen sink' disclosures (a term used in the UK's *Louder than Words* paper), which include:

- Aversion to risk by directors, preparers and auditors in response to a more litigious environment and fear that regulator will challenge omission
- Time pressures - Easier to leave in all disclosures from last year rather than removing if no longer material
- Takes longer to decide what is material than to prepare the disclosure
- Avoids lengthy debates with auditors
- Lack of confidence to judge whether disclosures are material or not
- Follow the leader – 'XYZ Limited includes it so we had better include it too'.

Are reasons for overload justified?

'No' says the AASB Staff Paper *To Disclose or Not to Disclose: Materiality is the Question*. Written in February 2014, and pre-dating the exposure drafts to effect the changes to AASB 101, the Staff Paper negates the above reasons/excuses as follows:

REASONS/EXCUSES	STAFF PAPER COMMENTS
Aversion to risk by directors, preparers and auditors and fear of regulator challenge	ASIC is stating in Media Releases on feedback from its financial reporting surveillance that 'ASIC does not pursue immaterial disclosure that may add unnecessary clutter to financial reports.'
Time pressures - Easier to leave in all disclosures from last year rather than removing if no longer material	Financial statements do not meet the objective of general purpose financial reporting because they are too cluttered to provide information to users to make decisions about resource allocation.
Takes longer to decide what is material than to prepare the disclosure	
Avoids lengthy debates with auditors	Debates with auditors are inevitable on a range of issues. If an item is immaterial, debate should not be lengthy.
Lack of confidence to judge whether disclosures are material or not	Judgement is required in a variety of areas in financial reporting, so lack of confidence to determine material disclosures is not a justification for not making a decision.
Follow the leader – 'XYZ Limited includes it so we had better include it too'.	'Two wrongs don't make a right.' What is relevant for one entity may not be relevant for another.

Start decluttering now – Checklist for decluttering

The *AASB Staff Paper* includes a checklist of things **not to do** when compiling your next set of financial statements. We recommend that you start this process for your 30 June 2015 financial statements.

Do not include every disclosure from a model set of financial statements.	☐
Do not blindly copy what other similar entities have disclosed.	☐
Do not simply repeat disclosures from last year's financial statements without evaluating whether they are still material and relevant. Examples: • Share-based payments – Carrying forward valuation assumptions even if instruments have vested • Remuneration report – Including details of performance conditions for bonus arrangements that have vested.	☐
Do not include accounting policies for transactions and balances you don't have. Examples: • Hedging policy if you don't hedge • Share-based payments if you don't make any • Complex financial instruments if you don't have any • Foreign currency translation.	☐
Do not fear ASIC as they have stated that they do not pursue immaterial disclosures.	☐