ACCOUNTING STANDARDS BOARD

GUIDELINE ON THE APPLICATION OF MATERIALITY TO FINANCIAL STATEMENTS

Issued by the
Accounting Standards Board

April 2019

Acknowledgement

The Guideline on *The Application of Materiality to Financial Statements* includes extracts of the IFRS Practice Statement on *Making Materiality Judgements* (IFRS Practice Statement 2) issued by the International Accounting Standards Board (IASB). The IASB has issued a comprehensive body of IFRS® Accounting Standards and IFRIC® Interpretations. Extracts of the IFRS Practice Statement 2 are reproduced in this Guideline with the permission of the IASB.

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Authority of this Guideline

In accordance with section 89 of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), the Accounting Standards Board's functions include the preparation and publication of directives and guidelines on the Standards of GRAP. While Standards of GRAP set out the recognition, measurement, presentation and disclosure requirements for financial reporting in the public sector, guidelines clarify existing principles in the Standards of GRAP. Guidelines do not replace or amend any of these principles.

1. INTRODUCTION

1.1 Financial statements are the principal means of communicating financial information about an entity to the users of those financial statements. To meet the objective of financial reporting, information provided in the financial statements needs to be relevant to the users for accountability and decision-making purposes.

1.2 Preparers of financial statements are continually making decisions about what information to include in the financial statements. They need to identify information necessary to meet the objective of financial reporting by making appropriate judgements and decisions about materiality.

1.3 The concept of materiality means that only information that is relevant to the users should be in the financial statements. The determination of materiality is not a simple concept - it involves the exercise of professional judgement. Determining materiality, particularly the application of judgement, has been highlighted by preparers to be one of the most significant challenges when preparing financial statements. As a result, entities often apply the individual requirements of the Standards of GRAP rather than focusing on what is material. As a result, unnecessary complexity is being created in the application of the Standards, and the users are provided with information that obscures their focus from key issues.

Objective of this Guideline

1.4 The objective of this Guideline is to provide guidance that will assist entities to apply the concept of materiality when preparing financial statements in accordance with Standards of GRAP. This Guideline aims to assist entities in achieving the overall financial reporting objective.

1.5 This Guideline outlines a process that may be considered by entities when applying materiality to the preparation of financial statements. The process was developed based on concepts outlined in Discussion Paper 9 on *Materiality – Reducing Complexity and Improving Reporting*, while also clarifying existing principles from the *Conceptual Framework for General Purpose Financial Reporting*[1] and other applicable Standards of GRAP.

1.6 This Guideline includes examples and case studies to illustrate how an entity may apply the principles in this Guideline, based on specific facts presented.

Scope of this Guideline

1.7 This Guideline addresses the application of materiality to the preparation of financial statements. It considers materiality decisions about the recognition, measurement,

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[1] In June 2017, the Board replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for General Purpose Financial Reporting.*

presentation and disclosure of information in an entity's financial statements. While this Guideline applies primarily to materiality in the context of financial statements, the guidance may be relevant to other information included in general purpose financial reports (GPFRs). GPFRs encompass a more comprehensive scope of financial reporting which comprises the financial statements and information that enhances, complements and supplements the financial statements.

1.8 While assurance providers may use similar principles as preparers when applying materiality, the manner in which judgement is applied by assurance providers and preparers will result in differences in their materiality assessments. It is therefore inappropriate for entities to rely on the same materiality considerations and assessments used by assurance providers in making decisions about materiality when preparing financial statements.

1.9 This Guideline is not a substitute for existing legislative requirements or frameworks on materiality and related topics issued by other organisations.

2. DEFINITION AND CHARACTERISTICS OF MATERIALITY

Definition of materiality

2.1 The term "material" is defined in the Standard of GRAP on *Presentation of Financial Statements* (GRAP 1) as follows:

> *Omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature or size of the omission or misstatement judged in the surrounding circumstances. The nature or size of the information item, or a combination of both, could be the determining factor*[2]*.*

2.2 The *Conceptual Framework for General Purpose Financial Reporting*[1] describes materiality as an entity-specific aspect of relevance. Relevance is one of the six qualitative characteristics that make information useful to users and support the achievement of the objectives of financial reporting.

2.3 Consistent with GRAP 1, the *Conceptual Framework for General Purpose Financial Reporting*[1] provides a description of materiality:

> *Information is material if its omission or misstatement could influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's GPFRs prepared for that reporting period. Materiality depends on both the nature and amount of the item judged in the particular circumstances of each entity. GPFRs may encompass qualitative and quantitative information about service delivery achievements during the reporting period, and expectations about service delivery and financial outcomes in the future. Consequently, it is not possible to specify a uniform quantitative threshold at which a particular type of information becomes material*[3]*.*

Characteristics of materiality

2.4 Since materiality is an entity-specific concept, its application may result in different outcomes based on an entity's circumstances. Its assessment therefore requires entities to apply judgement. An entity needs to apply judgement to determine how information could reasonably be expected to influence the discharge of accountability by an entity or decisions that the users make on the basis of those financial statements.

2.5 Therefore assessing materiality involves judgement about:

(a) How information could reasonably be expected to influence the discharge of accountability by an entity or decisions that the users make on the basis of those

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[2] See paragraph .05 of GRAP 1.

[3] See paragraph 3.12 of the Conceptual Framework.

financial statements.

(b) How the nature or size or both, of the information could reasonably be expected to influence users' decisions.

How information could reasonably be expected to influence the discharge of accountability by an entity or decisions that the users make on the basis of those financial statements

2.6 The assessment of materiality is concerned about applying judgement in considering whether to include or exclude information in the financial statements. An entity is required to apply judgement to assess whether information provided could reasonably be expected to influence the discharge of accountability by an entity or decisions that users make. Therefore, the assessment is not whether the information is likely to change the decisions of users but instead whether the information could reasonably be expected to influence those decisions in the light of the financial statements.

2.7 Understanding whether an omission or misstatement could influence decisions of users, and be material, requires consideration of the characteristics of those users of financial statements[4]. The users of financial statements are assumed to have a reasonable knowledge of government, its activities, accounting and a willingness to study the information with reasonable diligence. Therefore, the materiality assessment needs to take into account how users with such characteristics could reasonably be expected to be influenced in assessing accountability and making decisions. Furthermore, the assessment requires consideration and an understanding of the common information needs of users. Since the needs of the users vary, an entity applies judgement to determine whether certain needs should be met in the financial statements as discussed in section 4.

How the nature or size or both, of the information could reasonably be expected to influence users' decisions

2.8 Materiality depends on the nature or size or both, of an item that is judged in the particular circumstances of an entity. The concept of materiality has been interpreted by some as only involving the absolute or relative size of information.

2.9 An entity considers whether an item is material by considering the nature or size or both, of the item judged in the particular circumstances of an entity at the time of reporting. An entity's assessment of materiality should also consider the interactions between the nature and size of the item in light of the entity's circumstances. As such, materiality assessments are not only concerned about the quantitative assessment.

[4] See paragraph .06 of GRAP 1.

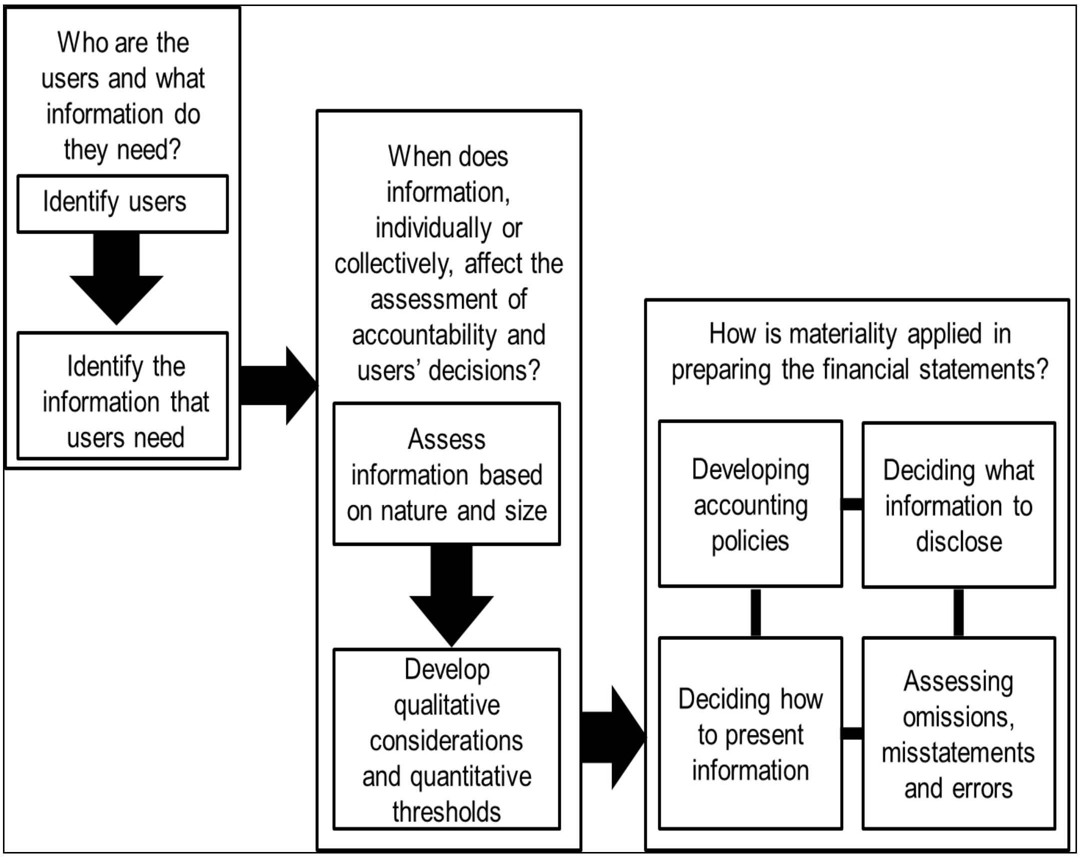
2.10 The assessment of materiality should consider both qualitative and quantitative factors as well as the relevant circumstances. Section 5 discusses the interactions between qualitative and quantitative factors.

3. ROLE OF MATERIALITY IN THE FINANCIAL STATEMENTS

3.1 Applying materiality is pervasive to the preparation of financial statements. Materiality is a key consideration in deciding how to apply the Standards of GRAP when preparing the financial statements. Information is material if its omission or misstatement has the potential to influence the decisions of users or affect the discharge of accountability by the entity.

3.2 Applying materiality in the preparation of financial statements requires entities to make key assessments and decisions. These assessments and decisions are discussed in detail from section 4 to section 6 of this Guideline, and provide guidance on how an entity could assess whether information is material for the purposes of preparation of the financial statements.

Diagram 1: Key assessments and decisions in considering materiality



3.3 The materiality assessments and decisions outlined in diagram 1 should be considered throughout the financial reporting cycle, and not only when financial statements are prepared. For instance, even though financial statements are prepared after the end of the reporting period and final materiality decisions are made at that point, an entity should consider these assessments and decisions throughout the reporting period. This will ensure that relevant information is available on a timely basis and will also inform the level of aggregation and disaggregation. Entities may also consider these assessments and decisions when a new entity is reporting for the first time, or when an existing entity adopts a new Standard of GRAP.

3.4 Materiality assessments and decisions are made at a specific point in time, taking into account the relevant facts and circumstances that are present at that time. Where there are significant changes to those facts and circumstances, it may be appropriate for an entity to modify its assessments and decisions. An entity considers the requirements in GRAP 3 for selecting and changing accounting policies to ensure that material items are accounted for in accordance with the Standards of GRAP.

3.5 When making these assessments and decisions, entities will need to apply judgement. Such judgement requires full consideration of the information involved and an understanding of how that information could reasonably be expected to be used by users of financial statements.

3.6 While preparers of financial statements can apply materiality assessments discussed in this Guideline, the key judgements relating to these assessments and decisions about materiality should be made by those who have all the facts and circumstances of the entity, for example, management together with its relevant governance structures.

3.7 GRAP 1[5] requires entities to disclose the judgements made by management in the process of applying an entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements. This could also include disclosures about the judgements applied in management's assessment of materiality. These disclosures may include management's overall materiality considerations and not necessarily the materiality thresholds developed. Such considerations, if disclosed, will enable the users of the financial statements to understand the approach followed by management in making assessments of, and decisions about, materiality. In particular, the users of financial statements will understand how management applied judgement in deciding whether information is material on the basis of management's knowledge of the entity and in the context of the requirements of the Standards of GRAP. It may also be appropriate for management to document, for its own purposes, the principles, processes and policies with regard to materiality and main decisions taken.

Example 1 – Disclosing the judgements applied in assessing materiality

Background

Entity A is a regulatory entity. It is fully funded by a transfer payment from a national Department. The entity has a transactional bank account and no other financial instruments.

[5] See paragraph .132 of GRAP 1.

The operations of the entity are not asset intensive and the only assets are furniture and office equipment used to perform its administrative duties.

The majority of its expenses relate to compensation paid to employees (80%). The remaining expenses comprise depreciation (5%), office rental (10%) and other expenses (5%).

Application

Notes to annual financial statements

Significant accounting policies

The significant accounting policies applied in the preparation and presentation of these financial statements are set out below. These policies were consistently applied for the years presented.

The entity has considered all the relevant accounting policies in the preparation of its financial statements. These include revenue from non-exchange transactions, operating leases, employee benefits, financial instruments and property, plant and equipment. While the entity has applied all these accounting policies in the preparation of its financial statements, it concluded that it will not provide all the disclosures on financial instruments, operating leases and property, plant and equipment in the financial statements as these are not considered material. In addition, these accounting policies are not included in the financial statements, and these have been published on the entity's website.

The entity assessed that, as it is a regulatory entity, the revenue from non-exchange transactions and employee benefits are material to its operations and are its significant accounting policies.

Revenue

The transfer from the National Treasury is recognised when it is probable that future economic benefits will flow to the entity and when the amount can be reliably measured. This is at the commencement of the financial year. Revenue is recognised to the extent that there is no further obligation arising from the receipt of the transfer payment. The obligations are satisfied as expenditure is incurred to execute the entity's activities.

The amount of the transfer payment received and not used, is recognised as a liability. An application is made in the new financial year to retain the unused amount. When consent is obtained to use the funds, it is derecognised as a liability and recognised as revenue.

Employee benefits

Short-term employee benefits

The cost of short-term employee benefits is recognised in the period in which the service is rendered.

Provision for employee benefits

Provision for employee entitlement to annual leave represents the present obligation the entity has to pay as a result of employees' services provided up to the reporting date. A provision is recognised as the entity is uncertain about the timing of the obligation.

The provision is calculated at undiscounted amounts based on salary rates effective at the reporting date.

Post-retirement employee benefits

The entity contributes to a retirement annuity fund on behalf of its employees and is not liable for any actuarial loss sustained by the fund. Accordingly, no provision has been made for any such losses. As the contributions made are those of the employees from guaranteed remuneration, the contributions paid are expensed as remuneration.

4. IDENTIFYING THE USERS OF FINANCIAL STATEMENTS AND THEIR INFORMATION NEEDS

Introduction

4.1 Financial reporting involves making decisions about the information to be included in the financial statements and how it should be presented. As a consequence, entities need to understand who the users are of its financial statements and what information they need.

4.2 While it can be said that all information is relevant to an entity's users, providing all information in the financial statements will not assist users in making appropriate decisions. It is likely to impair the relevance of the information provided. Materiality should therefore be applied in deciding what information is considered most relevant to users.

4.3 Determining what information is material requires consideration of:

(a) Who are the users of the entity's financial statements?

(b) What information do the users need to hold an entity accountable and make appropriate decisions?

Identifying the entity's users

4.4 The application of materiality requires an entity to consider the impact information could reasonably be expected to have on the users of its financial statements.

4.5 Entities raise resources from resource providers for use in the provision of services to citizens and other service recipients. These entities are accountable to those that depend on them to use resources to deliver necessary services, as well as those that provide them with the resources that enable the delivery of those services. The *Conceptual Framework for General Purpose Financial Reporting*[1] identifies the primary users of GPFRs as service recipients and their representatives ("service recipients") and resource providers and their representatives ("resource providers")[6]. The representatives of service recipients and resource providers are also considered primary users of the financial statements as they have been elected to hold entities accountable and make decisions in their capacity as representatives of the interests of service recipients and resource providers.

4.6 Although the *Conceptual Framework for General Purpose Financial Reporting*[1] broadly identifies the groups of users for which GPFRs of public sector entities are intended, an entity needs to identify the primary users that are relevant to its financial statements. For example:

[6] See paragraph 2.4 of the Conceptual Framework.

(a) Resource providers

- Taxpayers.
- Citizens.
- Funders and financial supporters such as lenders, creditors and donors.
- Suppliers, service providers, creditors and senior management and other employees.

(b) Service recipients

- Citizens.

(c) Representatives of resource providers and service recipients

- Parliament, legislatures, municipal councils and other governance and oversight structures.
- National and provincial treasuries.

4.7 Other parties may also use the information in the financial statements. For example, analysts, the media, financial advisors, public interest and lobby groups and others may find the information provided by the financial statements relevant for their own purposes. Organisations that have the authority to require information to be tailored to meet their own specific information needs may also use the information provided by the financial statements for their own purposes. For example, regulatory and oversight bodies, subcommittees of Parliament, the legislatures, municipal councils or other relevant authorities, an entity's management, rating agencies and, in some cases, lending institutions and providers of development and other assistance. While these other parties may find the information provided by the financial statements relevant, they are not the primary users of those financial statements.[7]

4.8 Therefore, the identification of an entity's relevant users will be made based on the knowledge and understanding of the entity's:

(a) service recipients i.e. what services the entity provides and who are the beneficiaries of those services; and

(b) resource providers i.e. what resources the entity receives and who are the providers of those resources.

4.9 The *Conceptual Framework for General Purpose Financial Reporting*[1] assumes that the users of GPFRs have a reasonable knowledge to review and analyse the information provided. Typically, this includes a reasonable knowledge of the entity's activities and operating environment, accounting and a willingness to read the

[7] See paragraph 2.6 of the Conceptual Framework.

information with reasonable diligence[8]. Therefore, an entity is entitled to assume that the users of its financial statements have a reasonable knowledge of the entity's activities and operations.

Example 2 – Identifying the relevant users

Background

An entity is responsible for constructing low cost housing for beneficiaries. The entity is wholly owned by government and funded by grants and a transfer payment from the national Department of Human Settlements. It operates a single transactional bank account, a CPD account to invest its surplus funds, a fleet of construction vehicles, equipment, machinery and buildings.

Application

The entity identifies its users of financial statements as:

<u>Resource providers and their representatives</u>

- The government (through the national Department of Human Settlements, the relevant treasury, Parliament and the oversight committees).
- Taxpayers who provided the funding to the government.
- Suppliers, creditors and employees.

<u>Service recipients and their representatives</u>

- Beneficiaries (and their representatives through the relevant treasury, Parliament and the oversight committees) who rely on the entity to continue to construct houses.

Even though the entity has a transactional bank account, the financial institution is unlikely to require specific information from the financial statements to continue to provide its goods and/or services. However, for the CPD account there may be specific information needed about the funds invested.

4.10 Having identified the relevant users, an entity should consider the users' likely interests and the types of decisions and assessments they could make on the basis of the information in the financial statements. This will enable an entity to identify information that the users could reasonably expect to receive, and that could reasonably be expected to influence their decisions or affect the discharge of accountability.

Identifying the information needs of the entity's users

4.11 The *Conceptual Framework for General Purpose Financial Reporting*[1] notes that GPFRs are prepared to respond to the information needs of service recipients and

[8] See paragraph 3.23 of the Conceptual Framework.

resource providers for accountability and decision-making purposes.[9]

4.12 Information in the financial statements is therefore relevant when it meets the information needs of users. Users need information that enables them to:

(a) hold entities accountable for the resources entrusted to them; and

(b) make decisions about the operating results for the year, the entity's ability to meet its obligations as they become due, and an entity's ability to continue to provide goods and/or services in the future.

4.13 The types of information that users may need to satisfy their information needs includes information that enables the users to make assessments of, and decisions about:

(a) The entity's accountability over:

- Whether current year revenues were sufficient to meet the cost of providing current year goods and/or services rendered.
- Whether resources were obtained and used in accordance with the entity's legally adopted budget, and demonstrating compliance with other finance-related legal or contractual requirements.
- The service efforts, costs, and accomplishments of the entity.

(b) The performance of an entity during the reporting period, for example, whether:

- An entity has met its operating and financial objectives, and is using resources effectively and as intended.
- The current levels of taxes or other resources raised are sufficient to maintain the volume and quality of services currently provided.

(c) The financial position of an entity, for example, whether:

- An entity's financial position has improved or deteriorated as a result of the current period's operations.
- An entity will be able to meet its obligations as they fall due.
- An entity has the capacity to continue to fund its activities and meet its operational objectives in the future, the extent to which an entity is dependent on, and vulnerable to, funding or demand pressures outside its control.
- The resources currently available are able to support the provision of services in future periods.

(d) The changes in the cash flows of an entity during the reporting period, for

[9] See paragraph 2.12 of the Conceptual Framework.

example:

- How an entity raised the cash it required to fund its activities and the manner in which that cash was used. For example, whether the entity met its cash flow requirements, including its borrowing and repayment of borrowing and its acquisition and sale of assets.

4.14 Entities should determine what the specific information needs of the entity's users are likely to be, to enable them to make the assessments outlined in paragraph 4.13.

4.15 When determining the users' information needs, it is important to consider whether the needs of the identified users are common to a broad range of users or specific only to that user. Across an entity's range of possible users, there may be a broad range of information needs and some may have dissimilar information needs and expectations. Therefore, an entity may first separately identify the information needs that are shared within its resource providers, and then repeats the assessment for its service recipients. The total of information needs identified is considered the set of common information that the entity aims to meet. This assessment does not require an entity to identify information needs shared across the two primary users. Some of the identified information needs will be common to both service recipients and resource providers, while others only to some service recipients and vice versa. Therefore, an entity cannot be reasonably expected to meet all of the information needs of all of the entity's users.

4.16 As noted in paragraph 4.7, an entity may have some users, for example regulatory and oversight bodies, who have the authority to require information tailored to meet their own specific information needs. In such cases, the users' information needs are specific to those other users, and do not meet the common information needs of a broad range of users.

4.17 In the public sector environment, care should be taken in making materiality judgements about the effects of public accountability. The purpose of the financial statements is to provide information about an entity's financial position, financial performance and cash flows for accountability and decision making purposes. While some information needs of users may be motivated by public accountability, this information does not necessarily reside in the financial statements, but may be included in other reports outside the financial statements. As such, that information does not necessarily form part of the information needs of an entity's users of financial statements.

Example 3 – Identifying the users' information needs

Background
Assume the same fact pattern in Example 2.

Application

The entity determines that its users of financial statements identified in the previous example are likely to require the following information:

- The amount of the government or grant funding that has been utilised and recognised as revenue during the reporting period.
- The amount of government or grant funding that is unutilised at year end, whether it must be repaid, conditions to be satisfied (if conditional grant) and what cash is held to either refund or utilise in the next reporting period.
- The amount of contract revenue recognised during the reporting period.
- The methods used and significant judgements made to determine contract revenue and the stage of completion of contracts in progress.
- The nature and type of expenses incurred to fulfil the entity's objectives of constructing low cost housing during the reporting period.
- The amount invested in property, plant and equipment.
- The amount of depreciation recognised in surplus or deficit or as part of the costs of other assets during the reporting period.
- The amount incurred to repair and maintain property, plant and equipment during the reporting period.
- The amount of contractual commitments to acquire property, plant and equipment.

When making materiality judgements in the preparation of its financial statements, the entity does not reduce its disclosures to only those of interest to the government. The entity also considers the information needs of its other users such as taxpayers, beneficiaries, suppliers, creditors and employees when making those judgements.

5. ASSESSING WHETHER INFORMATION IS MATERIAL

Introduction

5.1 The assessment of materiality depends on the nature or size or both, of the information, judged in the particular circumstances of an entity[10].

Determinants of materiality

Nature

5.2 The nature of an item refers to its inherent characteristics or the circumstances in which the item was undertaken. Examples of characteristics that may make an item material include:

Legality, sensitivity, frequency and potential consequences of the item

- The item relates to legal or regulatory requirements, e.g. specific disclosures required by legislation, restrictions on certain transactions or activities imposed by legislation, or breaches of legislation.
- The regularity or frequency with which an item occurs, e.g. a once off transfer of funds to another entity in terms of legislation or a ministerial directive.
- The degree of estimation or judgement that is needed to determine the value of an item, e.g. a high degree of estimation may be involved in the measurement of a complex transaction such as a financial instrument.
- An error that results in key information in the financial statements being misstated, e.g. a mathematical error in an estimate of the fair value of plan assets in employee benefits.

Transactions or events giving rise to the item

- The identity of the party with whom the entity transacts, e.g. a related party.
- The item results in the reversal of a trend, e.g. changes a surplus to a deficit or vice versa.
- The commencement of a new activity, or the reduction or cessation of an existing activity, e.g. the transfer or introduction of a new programme or function.
- Events that occur after the reporting date, e.g. the discovery of fraud.
- The item is likely to have an impact on an entity's financial performance and financial position in the future, e.g. a change in accounting policy.

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[10] See paragraph 3.12 of the Conceptual Framework.

Account balances and disclosure notes affected

- An item that affects a key ratio or metric used to evaluate an entity's financial performance, financial position or cash flows, or any part of these three aspects, for the period.

Size

5.3 Size refers to the monetary value of the item recognised in the financial statements. It is usually determined on a relative basis (i.e. assessing materiality in relation to something else) to determine whether an item is large enough to affect either the users' assessment of accountability or making decisions. The size of an item could relate to:

- A class of transactions.
- A specific line item in the financial statements.
- An aggregation of specific line items in the financial statements.
- A specific statement in the financial statements, e.g. financial position, financial performance or cash flow statement.
- The overall assessment of the financial statements, e.g. an entity's financial state.

5.4 While the quantification of materiality is essential and unavoidable, materiality can never be judged exclusively on the basis of absolute size.

Materiality considerations and thresholds

5.5 In assessing whether an item is material, entities usually develop specific qualitative considerations and quantitative thresholds for specific items. These qualitative considerations and quantitative thresholds are used to make decisions about what information to report, how to present it as well as assess the effects of misstatements, omissions or errors.

5.6 Qualitative considerations are determined by identifying certain criteria or characteristics that will be used to decide when an item is material based on its nature. Quantitative thresholds are determined by applying a specific margin (e.g. a percentage) to a specific basis (e.g. a benchmark). Such thresholds will be used to decide when an item is material based on its size.

5.7 As noted in paragraph 5.5, qualitative considerations and quantitative thresholds can be used to inform many decisions and they should be developed at various levels based on the relevant information in the financial statements. When setting qualitative considerations and quantitative thresholds at various levels (referred to in paragraph 5.3), an entity should set them at an appropriate level with reference to the materiality set for the financial statements as a whole. In this way, the qualitative considerations and quantitative thresholds set for the individual classes of transactions, account balances or disclosures should be sufficiently lower than the materiality set for the financial statements.

Qualitative considerations

5.8 Paragraph 5.2 discussed the examples of inherent characteristics or circumstances that may make an item material based on its nature. When determining qualitative considerations, an entity considers both entity-specific and external qualitative factors. Entity-specific factors are characteristics of the item. For example, involvement of a related party, uncommon features of an item, unexpected variances and changes in trends. External factors represent characteristics of the context in which an item occurs, that if present, make information more likely to influence users' decisions. For example, geographical location, industry sector or the state of the economy in which the entity operates.

5.9 The mere presence of these criteria or characteristics will not necessarily make the information material, but it is likely to increase a user's interest in that information.

5.10 Entities operating in the same context might share a number of qualitative factors.

Quantitative thresholds

5.11 Currently, there is no standard international guidance on identifying measures against which an entity makes quantitative assessments. As such, identifying and selecting the appropriate thresholds is a matter of judgement.

5.12 The most common quantitative thresholds are determined by applying a percentage to an appropriate benchmark. In such cases, the quantitative threshold is defined as a percentage of the chosen benchmark.

5.13 When determining the appropriate benchmarks, entities should consider their specific circumstances as well as the following factors:

- Whether to base the benchmark on the elements of the financial statements (for example, assets, liabilities, net assets, revenue, or expenses)?
- Whether items exist on which the attention of the users of the entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance, users may tend to focus on surplus or deficit for the period, revenue, or net assets)?
- What is the nature of the entity's operations (for example, what drives cost, where the entity is in its life cycle and the cluster and economic environment in which the entity operates)?
- What is the entity's funding structure (for example, how it is financed through fees charged for goods and services, transfers from government or donor funding)?

- Whether the benchmark is relatively volatile (for example, when surplus or deficit for the period is volatile, other benchmarks such as total revenue may be more appropriate)?

5.14 The choice of appropriate benchmarks will therefore be influenced by the entity's circumstances. An entity may consider selecting an appropriate benchmark based on whether the item to be assessed for materiality relates to the statement of financial position, financial performance or changes in net assets or cash flows and in the financial statements in their entirety. In such cases, an entity considers paragraph 5.3 when selecting the appropriate benchmarks for determining quantitative thresholds.

5.15 Entities will need to apply judgement in considering which benchmark is appropriate. In the public sector, entities are primarily concerned about meeting their service delivery objectives rather than generating a profit. Accordingly, for some entities, it may not be appropriate to assess materiality with reference to surplus or deficit for the period. In such cases, an entity may consider total revenue, total expenses or total assets as appropriate benchmarks in relation to its service delivery objectives.

5.16 Given the nature of the public sector, it may be more appropriate to consider materiality in absolute and relative terms. In absolute terms, consideration is given to the financial statements as a whole. In particular, consideration is given to factors that may indicate deviations from normal activities, such as the reversal of a trend. For example, where the entity's financial position has deteriorated, and the entity has revalued its assets upwards, information regarding the revaluation of those assets would be likely to be material.

5.17 In relative terms, items are compared to any directly related items. For example, the amount of interest revenue would be compared with the amount of the relevant loans. Such a comparison may indicate that information about the interest is material because the amount is lower (or higher) than expected, having regard to the loan balance and the applicable interest rates. This could indicate changes in the proportion of loans being made to different categories of borrowers in comparison with prior periods.

5.18 In relation to the chosen benchmark, an entity may use its prior period's financial statements (for example, the latest available audited financial statements), the period-to-date financial results, and budgets or forecasts for the current period, adjusted for significant changes in the circumstances of an entity.

5.19 Determining a percentage to be applied to a chosen benchmark also involves judgement. Generally, there is a relationship between the percentage and chosen benchmark. For example, the percentage applied to surplus or deficit for the period will normally be higher than that applied to total revenue. The percentage selected by an entity, and the choice between higher and lower percentages will be entity-specific.

Interaction of qualitative and quantitative factors

5.20 An entity could assess an item as material based on one or more factors. Generally, the more factors that apply to a particular item, or the more significant those factors are, the more likely it is that the item could reasonably be expected to influence the discharge of accountability by the entity and the decisions of users.

5.21 The definition of materiality explains that materiality depends on the nature or size or both, of an item judged in the surrounding circumstances. When assessing the materiality of an item there is no hierarchy among the determining factors, an entity must consider both qualitative and quantitative factors in assessing an item's materiality. The application of a qualitative and quantitative assessment depends on what an entity considers to be the appropriate context for assessing materiality of an entity.

5.22 Where the nature and circumstances are of sufficient importance to the users, it is these qualitative factors rather than considerations of the size of an item alone that determines whether an item is assessed as material. Criteria that might apply when deciding whether separate disclosure of an item is needed include the assessment of an item's nature in relation to the matters set out in paragraph 5.2.

5.23 An entity may use quantitative thresholds as an efficient and practical approach to assessing materiality. If an entity identifies an item as material solely on the basis of the size of the impact of the item, the entity may need to assess that item further against other materiality considerations. However, a quantitative assessment alone is not always sufficient to conclude that an item is not material. The entity should further assess the presence of qualitative factors. In the absence of qualitative factors, an entity will judge that item as material based on its size. However, where there are qualitative factors present, an entity considers the interaction of the qualitative and quantitative factors to determine whether the item is material.

5.24 The consideration of the interaction between qualitative and quantitative factors ensures that entities do not assess materiality only on the basis of the size, regardless of the presence of qualitative factors, and vice versa. In some cases, an entity may decide that despite the presence of qualitative factors, an item is not material because its effect on the financial statements is so low that it could not reasonably be expected to influence the users' decisions.

5.25 In some other circumstances, an item could reasonably be expected to influence users' decisions regardless of its size. This may happen when information about an item is highly scrutinised by users of an entity's financial statements. For example, some financial items although low in value might by their nature be important to the users of financial statements. Similarly, some of the services delivered by an entity, although a small part of an entity's operations, might by their nature be important to the users.

Example 4 – Information about a related party transaction assessed as material

Background

A public entity receives a transfer payment from government to fund its ongoing operations. The entity has identified total expenses as the measure of interest to the primary users of its financial statements due to government's increased focus on cost containment. In the current reporting period, the entity signed a five-year contract with company A. Company A will provide the entity with repairs and maintenance services for the entity's fleet of vehicles for an annual fee. Company A is controlled by a member of the entity's Board. Hence, company A is a related party of the entity.

Application

The Standard of GRAP on *Related Party Disclosures* (GRAP 20) requires an entity to disclose, for each related party transaction that occurred during the period, the nature of the related party relationship as well as information about the transaction and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements.

When preparing its financial statements, the entity assessed whether information about the transaction with company A was material.

The entity started its assessment from a quantitative perspective and evaluated the impact of the related party transaction against its quantitative thresholds. Having initially concluded that the impact of the related party transaction was not material from a purely quantitative perspective, the entity further assessed the presence of any qualitative factors.

As the Board noted in developing GRAP 20, related parties may enter into transactions that unrelated parties would not enter into, and the transactions may be priced at amounts that differ from the price for transactions between unrelated parties.

The entity identified the fact that the agreement was concluded with a related party as a characteristic that makes information about that transaction more likely to influence the decisions of its primary users.

The entity further assessed the transaction from a qualitative perspective to determine whether the impact of the transaction could reasonably be expected to influence primary users' decisions when considered with the fact that the transaction was with a related party. Having considered that the transaction was with a related party, the entity concluded that the impact was large enough to reasonably be expected to influence primary users' decisions. Hence, the entity assessed information about the transaction with company A as material and disclosed that information in its financial statements.

Individual and collective assessment

5.26 Assessing whether information is material or immaterial should be undertaken both on an individual and collective basis[11].

5.27 In deciding whether an item should be assessed individually or collectively, entities consider the nature of the item, size of the item, or both.

5.28 Information can be considered to be immaterial individually however it might be material when considered together with other information. If an entity concludes that aggregation is appropriate, it should consider the nature of the items in deciding what to aggregate together. Aggregations can also be assessed at different levels, e.g. for a class of transactions, for line items in the financial statements, or for a sub-total/total presented.

Example 5 – Individual and collective assessment of items

Background

An entity is a development agency that invests in various businesses. The entity acquired controlling interests in a number of smaller entities in the current period. The entity considers whether it should consolidate all the controlled entities.

Application

The entity assesses that the acquisition of the individual interests is immaterial but needs to reassess those controlled entities collectively, to determine if the acquisitions are immaterial in aggregate. It is insufficient for each controlling entity to be individually assessed to be immaterial.

[11] See paragraph .05 of GRAP 1.

6. APPLYING MATERIALITY IN PREPARING FINANCIAL STATEMENTS

Introduction

6.1 The concept of materiality is pervasive to the preparation of the financial statements. It influences whether information is required to be recognised, measured, presented and disclosed in accordance with the requirements in the Standards of GRAP. Consequently, entities consider materiality when:

(a) Developing accounting policies.

(b) Deciding what information to disclose in the financial statements and how to present it.

(c) Assessing the effect of omissions, misstatements and errors in the financial statements.

6.2 Standards of GRAP do not specify requirements for the implementation and maintenance of an entity's internal record keeping procedures, as specifying how information is recorded goes beyond the scope of the Standards of GRAP. Consequently, the concept of materiality in the Standards does not apply to how information is recorded internally.

Developing accounting policies

6.3 Some Standards of GRAP set out how an item should be recognised, measured and disclosed in the financial statements. In such cases, the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors* (GRAP 3) explains these accounting policies should not be applied when the effect of the applying them is immaterial[12]. This means that an entity does not need to recognise, measure, present or disclose information in accordance with the specific requirements outlined in the Standards of GRAP if the effect of applying those requirements is immaterial. However, this does not mean that the item is not recorded or recognised at all in the financial statements.

6.4 It does mean that an entity may formulate its own accounting policy, without following the specific requirements in the Standards of GRAP[13]. It also means that:

(a) An entity cannot depart from the requirements of the Standards of GRAP for material items, unless permitted by a Standard of GRAP.

[12] See paragraph .07 of GRAP 3.

[13] See paragraph .07 of GRAP 3.

(b) An entity cannot depart from the recognition and measurement requirements of the Standards of GRAP for material items and rather disclose information about the item in the notes.

(c) An entity cannot depart from the requirements of the Standards of GRAP for material items and develop its own accounting policies.

(d) An entity cannot depart from the requirements of the Standards of GRAP for immaterial item, to achieve a particular presentation of an entity's financial position, financial performance and cash flows.

(e) An entity cannot make, or leave uncorrected, immaterial departures from Standards of GRAP to achieve a particular presentation of an entity's financial position, financial performance and cash flows.

(f) An entity cannot select an inappropriate accounting policy for a material item and disclose the inappropriate accounting policy and/or provide disclosures about the accounting for the item in the notes to the financial statements.

6.5 An entity should review its accounting policies on an on-going basis to assess whether they are still appropriate for its current operations, and to ensure that material items are accounted for in accordance with the Standards of GRAP.

6.6 When an entity has developed a particular accounting policy, without following the specific requirements in the Standards of GRAP as outlined in paragraph 6.4, it needs to be aware of the materiality of the individual or aggregate transactions and the cumulative effect that the policy may have on the statement of financial position, statement of changes in net assets and notes to the financial statements. Consequently, an entity does not only assess the impact of the individual or aggregate transactions but considers the potential accumulation of those transactions in the line items affected in the financial statements for the current or future periods. The assessment is made with reference to the entity's materiality considerations and thresholds set for the individual classes of transactions, account balances, disclosures and/or the financial statements as a whole (see paragraphs 5.5 to 5.7). In assessing whether the effect of applying accounting policies is immaterial, an entity takes into account both qualitative and quantitative factors in its assessment (see paragraphs 5.20 to 5.25).

Assessing what information should be presented and how it should be disclosed

6.7 When an entity has established that a particular item is material, it needs to exercise judgement in assessing that information for possible presentation and disclosure in the financial statements. Consequently, entities will decide what information should be provided, and whether such information should be presented in the financial statements or disclosed in the notes.

6.8 In developing Standards of GRAP, the Board has considered that the information that is expected to meet the needs of a broad range of users, for a variety of entities operating in different spheres of government. The requirements in the Standards of GRAP have been developed by the Board taking into account the balance between the benefits of providing information to users of financial statements and the costs of complying with those requirements. Consequently, the cost of applying the requirements in the Standards of GRAP is not a factor for entities to consider when assessing whether information is material. However, it is insufficient to apply the presentation and disclosure requirements in a Standard of GRAP, without considering the entity's specific circumstances, whether the entity's users have any special needs and whether the information provided meets or exceeds the needs of an entity's users.

Selecting information for presentation and disclosure in the financial statements and notes

6.9 When entities consider what information should be presented in the financial statements, the requirements in the Standards of GRAP should provide the basis for that assessment. When an entity has decided to apply a particular Standard of GRAP, the presentation and disclosure requirements in that Standard should be assessed to determine whether they are material to the users' decisions.

6.10 Standards of GRAP usually contain a list of specific presentation and disclosure requirements (or describes them as "minimum requirements") to be provided in the financial statements. An entity is not required to provide those specific presentation and disclosures if the information resulting from them is immaterial. Conversely, the entity should consider whether to provide additional information not specified by the Standards of GRAP if that information is necessary for the users to understand the impact of the particular item on the financial statements[14].

6.11 Traditionally, the focus of materiality is to ensure that entities do not omit material information from the financial statements. However, assessing materiality also requires consideration of whether immaterial information is not presented and disclosed in accordance with the Standards of GRAP. This is because immaterial information may obscure relevant information and hinder the understanding of the financial statements for users.

6.12 The Standards of GRAP do not prohibit entities from presenting and disclosing immaterial information. Nevertheless, entities should consider whether the presentation and disclosure of immaterial information results in material information

[14] See paragraph .19(c) and .38 of GRAP 1.

being obscured[15]. However, as discussed in paragraph 6.3, this does not mean that the information is not recorded or recognised at all in the financial statements.

Example 6 – Materiality assessments on disclosures specified in the Standards of GRAP

Background

An entity that is service-orientated presents property, plant and equipment (PP&E) as a separate line item in its statement of financial position.

Application

GRAP 17 sets out specific disclosure requirements for PP&E, including the disclosure of the amount of contractual commitments for the acquisition of PP&E (paragraphs .86(b)) and expenditure incurred to repair and maintain PP&E (paragraph .88).

When preparing its financial statements, the entity assesses whether disclosures specified in GRAP 17 provide material information. Even if PP&E is presented as a separate line item in the statement of financial position, not all disclosures specified in GRAP 17 will automatically be required. In the absence of any qualitative considerations, if the amount of contractual commitments for the acquisition of PP&E, and expenditure incurred on repairs and maintenance is not material, the entity is not required to disclose this information.

Example 7 – Providing additional information in the financial statements that is not required by the Standards of GRAP

Background

Legal action has been instituted against a municipality for a breach of an environmental law in a protected area but it is unclear whether any damage was caused to the environment. According to the entity's legal advisors, the possibility of an outflow of economic benefits in settlement is remote. The Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets* (GRAP 19) states that contingent liabilities are not required to be disclosed in the financial statements if the possibility of an outflow of economic benefits is remote.

Application

Even though the requirement in GRAP 19 is that the municipality should not disclose the contingent liability if the possibility of any outflows is remote, the municipality assesses whether information related to the lawsuit is material to the financial statements and should be disclosed in the financial statements. The municipality concludes that information about the lawsuit is qualitatively material as the potential breach occurred in a protected area.

[15] See paragraph .37A in the Amendments to the Standard of GRAP on *Presentation of Financial Statements*.

While there is no contingent liability to disclose in accordance with GRAP 19, the information about the existence of the lawsuit is assessed as material and disclosed in the entity's financial statements in accordance with GRAP 1. GRAP 1 permits the disclosure of additional information when it is relevant to the understanding of the financial statements.

Deciding where to present and disclose information in the financial statements and notes

6.13 In some Standards of GRAP, it is clear where information should be located in the financial statements. However, in some cases the Standards do not specify the location of information. In these cases, entities should consider whether the financial statements or notes are the most appropriate location for that information. Some factors to consider are:

(a) Information that is selected for display in the financial statements is aimed at communicating a comprehensive financial picture about an entity's financial position, financial performance and cash flows. Too much information in the financial statements can create "clutter" that may obscure this picture.

(b) Information that is selected for disclosure in the notes is aimed at providing additional or disaggregated information to support the information provided in the financial statements. Such information is usually of a supplementary nature, and is there to enhance the users' understanding of key aspects to clarify the financial picture.

6.14 In deciding where to present and disclose information, an entity should consider that:

(a) The concept of materiality applies equally to information presented in the financial statements and disclosed in the notes.

(b) Information overload reduces understandability. Too much information may make it difficult for users to understand the key messages, and, consequently undermines achievement of the objectives of financial reporting.

(c) The level of aggregation, and order in which information is disclosed in the notes helps to ensure that key messages are understandable; clearly identifies important relationships; gives appropriate prominence to information that conveys key messages; and facilitates comparisons (the qualitative characteristics of relevance, understandability and comparability apply).

(d) Duplication of information in different parts of the financial statements and/or notes is unnecessary, and makes financial statements less understandable.

6.15 When entities have established the need for disclosures in the notes, the quality and quantity of the information should be considered carefully. The level of detail provided by information in the notes, relating to a material item reported in the financial statements, contributes to achievement of the objectives of financial reporting, without being excessive.

Organising information in the financial statements and notes

6.16 It is also important for entities to consider how information is organised in the financial statements and notes as this can affect its interpretation by users. An entity should apply its judgement in ensuring that meaningful information is provided to the users of the financial statements. For example, an entity is more likely to clearly and concisely communicate the material information identified by organising it to:

(a) Emphasise material matters i.e. the order of disclosures. Entities should ensure that in emphasising material matters it does so without adding information that achieves a particular presentation of its financial position, performance and cash flows.

(b) Ensure material information is not obscured by immaterial information.

(c) Tailor information to the entity's own circumstances. While the use of boilerplate templates and disclosure checklists may assist entities to assess compliance with the Standards of GRAP, entities should ensure that the financial statements are refined to reflect relevant information to users about the entity's own circumstances.

(d) Describe the entity's information as simply and directly as possible without omitting material information and without unnecessarily increasing the length of the financial statements.

(e) Highlight relationships between different pieces of information.

(f) Provide information in a format that is appropriate for its type, e.g. tabular or narrative.

(g) Provide information in a way that maximises, to the extent possible, comparability among entities and across reporting periods.

(h) Avoid or minimise duplication of information in different parts of the financial statements.

Example 8 – Use of boilerplates, templates and tailoring information to an entity's own circumstances

<u>Notes to the financial statements of Municipality X for the period ended 30 June 20XX</u>

<u>Accounting policies</u>

Revenue from non-exchange transactions

Scenario 1: This accounting policy was developed without tailoring the information to an entity's own circumstances:

Municipality X collects non-exchange revenue from taxes and fines. Tax revenue is recognised when the taxable event occurs. Fines are recognised when they are measurable. Taxes and fines are measured at fair value.

Scenario 2: This accounting policy was developed tailoring the information to an entity's own circumstances:

Municipality X collects non-exchange revenue from taxes and fines. Taxes consist of property rates levied on individual and commercial properties. Fines consist of traffic fines.

Property taxes are recognised at the start of each financial year, for each rateable property for the year, in accordance with the Municipal Property Rates Act. Property taxes are collected over the year in 11 equal instalments. Property taxes are measured at fair value. Fair value is determined based on the valuation roll effective on (date) and by applying the tax rate approved by the Council. Interest is levied on outstanding amounts at X%.

Traffic fines are recognised when the offence occurs and the fine is issued. Traffic fines are measured at fair value, which is based on the value of the fines issued, excluding the value of any early settlement discounts that are likely to be taken up by motorists. For the period under review, this was 15% of the value of the fines. Interest is not levied on overdue amounts.

6.17 Entities should also assess whether there are any material items that should be presented individually in the financial statements and/or notes. An entity considers whether information is material both individually and in combination with other information, in the context of its financial statements as a whole. Even if information is judged not to be material on its own, it might be material when considered in combination with other information in the complete set of financial statements.

Interaction of materiality with laws and regulations

6.18 To state compliance with the Standards of GRAP, an entity must comply with the requirements in the Standards, including requirements related to materiality. Therefore, an entity cannot provide less information than the information required in the Standards, even if laws and regulations permit otherwise.

6.19 Where legislation requires certain information to be disclosed, an entity may not be in a position to apply its materiality considerations to that information. Entities will need to analyse the specific requirements of legislation to establish whether applying the concept of materiality is appropriate.

Example 9 - Information that is material according to Standards of GRAP but is not required by laws and regulations

Background

An entity is required by legislation to report to its relevant treasury, the acquisition or disposal of significant assets. Based on legislation, the acquisition or disposal is significant when the cost of the asset acquired or disposed of exceeds a specified percentage of the total cost of assets of an entity.

In the current year, the entity sold land. The cost of the land is below the legislated threshold.

Application

In preparing the current period's financial statements, the entity concludes that the disposal could reasonably be expected to influence users' decisions and assessed the item to be quantitatively material in the financial statements. An entity will disclose the information in the financial statements as required by GRAP 1.102 even though the amount is below the legislated threshold, and does not need to report the acquisition to the relevant treasury.

Example 10 – Information that is material according to laws and regulations but is not required by Standards of GRAP

Background

A municipality discovered and confirmed incidents of unauthorised, irregular and fruitless and wasteful expenditure in the current period.

Application

Section 125 of the Municipal Financial Management Act, No 56 of 2003 requires municipalities to disclose any material unauthorised, irregular and fruitless and wasteful expenditure in the notes to the annual financial statements. To comply with the legislative requirement, an entity is required to disclose material amounts in the notes even though the information is not required by the Standards of GRAP.

Impact of publicly available information

6.20 The users of financial statements generally consider information from sources other than just the financial statements. For example, they might also consider other sections of the annual report, information about the industry an entity operates in, its peers and the state of the economy, the entity's press releases as well as other documents the entity has published.

6.21 The financial statements are required to be a comprehensive document that provides information about the financial position, financial performance and cash flows of an entity that is relevant to users in making decisions about providing resources to the entity. Consequently, the entity assesses whether information is material to the financial statements, regardless of whether such information is also publicly available from another source.

6.22 Moreover, public availability of information does not relieve an entity of the obligation to provide material information in its financial statements.

Example 11 – Publicly available information

Background
Following a directive by the Municipal Dermacation Board, municipality A does not meet all the legislative requirements to be a stand-alone municipality and its functions are transferred to municipality B in the current reporting period. On the acquisition date, municipality B issued a public statement providing an extensive explanation of the primary reasons for the transfer of functions and a description of how it obtained control over the acquiree, together with other information related to the transfer of functions.
Application
In preparing its financial statements, municipality B first considered the disclosure requirements in the Standard of GRAP on *Transfer of Functions Between Entities Not Under Common Control* (GRAP 106). Paragraph .91(d) of GRAP 106 requires an entity to disclose, for each transfer of functions that occurs during the reporting period, "the primary reasons for the transfer of functions and a description of how the acquirer obtained control of the acquiree".
Municipality B concludes that information about the transfer of functions is material because the acquisition is expected to have a significant impact on the entity's operations. In these circumstances, even though information relating to the primary reasons for the transfer of functions and the description of how it obtained control is already included in a public statement, the entity needs to provide the information in its financial statements as it could reasonably be expected to influence decisions made by the primary users of municipality B's financial statements.

Prior period information

6.23 An entity assesses and applies materiality on the complete set of financial statements, including prior period information provided in the financial statements.

6.24 Except when a Standard of GRAP permits or requires otherwise, entities are required to present information in respect of the preceding period for all amounts reported in the current period's financial statements. An entity is also required to present narrative and descriptive information in respect of comparative information if it is relevant to an understanding of the current period's financial statements[16]. As a minimum, entities should present two statements of financial position, two statements of financial performance, two cash flow statements and two statements of changes in net assets, and related notes[17].

6.25 Assessing whether prior period information is material to the current period financial statements might lead an entity to provide more prior period information than was

[16] See paragraph .44 of GRAP 1.

[17] See paragraph .45 of GRAP 1.

provided in the prior period financial statements (see paragraph 6.27).

6.26 As discussed in paragraphs 6.18 and 6.19, an entity also needs to consider any laws or regulations, in respect of the prior period information to be provided in financial statements, when making decisions on what prior period information to provide in the current period financial statements. For example, legislation may require the entity to provide prior period information in addition to the minimum comparative information required by the Standards of GRAP. The Standards permit the inclusion of such additional information, but require that it is prepared in accordance with the Standards[18] and does not obscure material information[19]. To ensure compliance with the Standards, an entity cannot provide less information than required by the Standards, if material, even if laws and regulations permit otherwise.

Prior period information not previously provided

6.27 An entity must provide prior period information needed to understand the current period financial statements[16], regardless of whether that information was provided in the prior period financial statements - this requirement is not conditional on whether the prior period information was provided in the prior period financial statements. Consequently, the inclusion of prior period information not previously included would be required if this is necessary for the users to understand the current period financial statements.

Example 12 – Prior period information not previously provided

Background

In the prior period, an entity had a low Rand-value of debt outstanding. Information about this debt was appropriately assessed as immaterial in the prior period, and so the entity did not disclose any maturity analysis showing the remaining contractual maturities or other information that would otherwise be required by paragraph .131(a) of the Standard of GRAP on *Financial Instruments*.

In the current period, the entity issued a high Rand-value of debt. The entity concluded that information about debt maturity was material information and disclosed it, in the form of a table, in the current period financial statements.

Application

Although, the debt maturity analysis was not presented in the prior year's financial statements, the entity might conclude that including a prior period debt maturity analysis in the financial statements would be necessary for primary users to understand the change in trend from low to high borrowing in the current period financial statements. In these

[18] See paragraph .47 of GRAP 1.
[19] See paragraph .37A of GRAP 1.

circumstances, a narrative description of the maturity of the prior period balances of the outstanding debt might be sufficient.

Summarising prior period information

6.28 Except to the extent required to comply with laws or regulations affecting the preparation of financial statements or their audit, an entity does not automatically reproduce in the current period financial statements all the information provided in the prior period financial statements. Instead, the entity may summarise prior period information, retaining the information necessary for primary users to understand the current period financial statements.

Example 13 – Summarising prior period information

Background

An entity disclosed, in the prior period financial statements, details of a legal dispute which led to the recognition, in that period, of a provision. In accordance with the Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets* the entity disclosed in the prior period financial statements a detailed description of uncertainties about the amount and timing of possible cash outflows, in respect of the dispute, together with the major assumptions made concerning future events.

Most of the uncertainties have been resolved in the current period, and, even though the liability has not been settled, a court pronouncement confirmed the amount already recognised in the financial statements by the entity.

The entity considered the relevant local laws, regulations and other reporting requirements and concluded that there were no locally prescribed obligations relating to the inclusion of prior period information in the current period financial statements.

Application

In these circumstances, on the basis of the requirements in the Standards of GRAP, the entity may not need to reproduce in the current period financial statements all of the information about the legal dispute provided in the prior period financial statements. Because most of the uncertainties have been resolved, users of the financial statements for the current period may no longer need detailed information about those uncertainties. Instead, information about those uncertainties might be summarised and updated to reflect the current period events and circumstances and the resolution of previously reported uncertainties.

Assessing omissions, misstatements and errors

6.29 When preparing financial statements it can be expected that omissions, misstatements and errors will occur. While it is clear that material omissions, misstatements and errors should be corrected, it is often unclear what the position is with immaterial omissions, misstatements and errors.

Errors

6.30 GRAP 3 explains that prior period errors are omissions from, and/or misstatements in, an entity's financial statements arising from failure to use, misuse of, reliable information that is available, or could reasonably be expected to be obtained. Errors may affect the narrative descriptions disclosed in the notes as wells as amounts presented in the financial statements and notes.

6.31 Material errors are errors that individually or collectively could reasonably be expected to influence the users' decisions taken on the basis of those financial statements.

6.32 An entity assesses whether an error is material by applying the same considerations discussed in section 5. This assessment also involves both quantitative and qualitative considerations. The entity also considers whether any identified errors are material on a collective basis.

Material errors

6.33 To ensure compliance with the Standards of GRAP an entity must correct all material errors[20]. An entity should refer to GRAP 3 for guidance on how to correct an error.

Immaterial errors

6.34 An entity should correct errors made intentionally to achieve a particular presentation of its financial position, financial performance or cash flows in the preparation of the financial statements as it lowers the risk that immaterial errors will accumulate over reporting periods and make the financial statements materially misstated.

6.35 Immaterial errors, if not made intentionally to achieve a particular presentation, do not need to be corrected to ensure compliance with the Standards of GRAP. However, it is inappropriate to leave uncorrected immaterial errors in order to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

Aggregation of individually immaterial errors

6.36 When an entity assesses an error not to be material individually, it considers whether it may be material in aggregate with other immaterial errors.

6.37 The netting of errors is inappropriate. If an error is individually assessed as material, the existence of other errors that may affect the entity's financial position, financial performance or cash flows in the opposite way, does not make the error immaterial, nor does it eliminate the need to correct the error.

[20] See paragraph .43 of GRAP 3.

Cumulative errors

6.38 Cumulative errors are those uncorrected errors that have accumulated over more than one period. For example, errors that are immaterial both in individual prior periods and cumulatively over all prior periods may have occurred, over a number of reporting periods.

6.39 In subsequent reporting periods, an entity does not need to reassess materiality considerations about cumulative errors in the prior period financial statements that it made at the time those financial statements were authorised for issue unless the entity failed to use, or misused, information that:

(a) was available when the financial statements for those periods were authorised for issue; and

(b) could reasonably be expected to have been obtained and take into account in the preparation of those financial statements[21].

6.40 An entity must correct cumulative errors if they have become material to the current reporting period's financial statements in accordance with GRAP 3 guidance on how to correct an error.

6.41 When assessing whether a cumulative error has become material to the current reporting period's financial statements, an entity considers whether, in the current period:

(a) the entity's circumstances have changed, leading to a different materiality assessment for the current period; or

(b) further accumulation of a current period error to the cumulative error has occurred.

Example 14 – Assessing cumulative errors in the current period

Background

An entity, three years ago, purchased a plant. The plant has a useful life of 50 years and a residual value amounting to 20 per cent of the plant cost. The entity started to use the plant three years ago, but has not recognised any depreciation for it (cumulative error). In each prior period, the entity assessed the error of not depreciating its plant as being individually and cumulatively immaterial to the financial statements for that period. There is no indication that the materiality assessments of prior periods were wrong. In the current period, the entity started depreciating the plant.

In the same period, the entity experienced a significant reduction in its budgeted expenditure (the type of circumstance referred to in paragraph 6.39(a) above).

[21] See paragraph 5 of GRAP 3.

Application

When making its materiality judgements in the preparation of the current period financial statements, the entity concluded that the cumulative error was material to the current_period financial statements.

In this scenario, the entity does not need to revisit the materiality assessments it made in prior periods. However, because in the current period the cumulative error has become material to the current period financial statements, the entity must apply the requirements in GRAP 3 to correct it.

Appendix A – References to the *Conceptual Framework for General Purpose Financial Reporting*[1] and Standards of GRAP

Extracts from the *Conceptual Framework for General Purpose Financial Reporting*

Paragraph 2.4

Referred to in paragraph 4.5 of the Guideline

> Consequently, GPFRs of public sector entities are developed primarily to respond to the information needs of service recipients and resource providers who do not possess the authority to require a public sector entity to disclose the information they need for accountability and decision-making purposes. Parliament, the legislatures, municipal councils or other relevant authorities are also primary users of GPFRs, and make extensive and ongoing use of GPFRs when acting in their capacity as representatives of the interests of service recipients and resource providers. Therefore, for the purposes of the Conceptual Framework, the primary users of GPFRs are service recipients and their representatives and resource providers and their representatives (hereafter referred to as "service recipients and resource providers", unless identified otherwise).

Paragraph 2.6

Referred to in paragraph 4.7 of the Guideline

> GPFRs prepared to respond to the information needs of service recipients and resource providers for accountability and decision-making purposes may also provide information useful to other parties and for other purposes. For example, statisticians, analysts, the media, financial advisors, public interest and lobby groups and others may find the information provided by GPFRs useful for their own purposes. Organisations that have the authority to require the preparation of financial reports tailored to meet their own specific information needs may also use the information provided by GPFRs for their own purposes — for example, regulatory and oversight bodies, the Auditor-General of South Africa, subcommittees of Parliament, the legislatures, municipal councils or other relevant authorities, central agencies and budget controllers, entity management, rating agencies and, in some cases, lending institutions and providers of development and other assistance. While these other parties may find the information provided by GPFRs useful, they are not the primary users of GPFRs. Therefore, GPFRs are not developed to specifically respond to their particular information needs.

Paragraph 2.12

Referred to in paragraph 4.11 of the Guideline

For accountability and decision-making purposes, service recipients and resource providers will need information that supports the assessments of such matters as:

- the performance of the entity during the reporting period in, for example:
  - meeting its service delivery and other operating and financial objectives;
  - managing the resources it is responsible for;
  - complying with relevant budgetary, legislative, and other authority regulating the raising and use of resources;
- the liquidity (for example, ability to meet current obligations) and solvency (for example, ability to meet obligations over the long term) of the entity;
- the sustainability of the entity's service delivery and other operations over the long term, and changes therein as a result of the activities of the entity during the reporting period including, for example:
  - the capacity of the entity to continue to fund its activities and to meet its operational objectives in the future (its financial capacity), including the likely sources of funding and the extent to which the entity is dependent on, and therefore vulnerable to, funding or demand pressures outside its control;
  - the physical and other resources currently available to support the provision of services in future periods (its operational capacity); and
- the capacity of the entity to adapt to changing circumstances, whether changes in demographics or changes in domestic or global economic conditions which are likely to impact the nature or composition of the activities it undertakes and the services it provides.

Paragraph 3.12

Referred to in paragraphs 2.3 and 5.1 of the Guideline

Information is material if its omission or misstatement could influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's GPFRs prepared for that reporting period. Materiality depends on both the nature and amount of the item judged in the particular circumstances of each entity. GPFRs may encompass qualitative and quantitative information about service delivery achievements during the reporting period, and expectations about service delivery and financial outcomes in the future. Consequently, it is not possible to specify a uniform quantitative threshold at which a particular type of information becomes material.

Paragraph 3.23

Referred to in paragraph 4.9 of the Guideline

Users of GPFRs are assumed to have a reasonable knowledge of the entity's activities and the environment in which it operates, to be able and prepared to read GPFRs, and to review and analyse the information presented with reasonable diligence. Some economic and other phenomena are particularly complex and difficult to represent in GPFRs, and some users may need to seek the aid of an advisor to assist in their understanding of them. All efforts should be undertaken to represent economic and other phenomena included in GPFRs in a manner that is understandable to a wide range of users. However, information should not be excluded from GPFRs solely because it may be too complex or difficult for some users to understand without assistance.

Extracts from the Standard of GRAP on *Presentation of Financial Statements*

Paragraph .05

Referred to in paragraphs 2.1 and 5.26 of the Guideline

> Omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature or size of the omission or misstatement judged in the surrounding circumstances. The nature or size of the information item, or a combination of both, could be the determining factor.

Paragraph .06

Referred to in paragraph 2.7 of the Guideline

> Assessing whether an omission or misstatement could influence decisions of users, and so be material, requires consideration of the characteristics of those users. The *Framework for the Preparation and Presentation of Financial Statements* states that users are assumed to have a reasonable knowledge of government, its activities, accounting and a willingness to study the information with reasonable diligence. Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making and evaluating decisions.

Paragraph .19(c)

Referred to in paragraph 6.10 of the Guideline

> In virtually all circumstances, a fair presentation is achieved by compliance with applicable Standards of GRAP. A fair presentation also requires an entity:
>
> (a) to select and apply accounting policies in accordance with the requirements of the Standard of GRAP *on Accounting Policies, Changes in Accounting Estimates and Errors* (GRAP 3), which sets out a hierarchy of authoritative guidance that management considers in the absence of a Standard that specifically applies to an item;
>
> (b) to present information, including accounting policies, in a manner which provides relevant, reliable, comparable and understandable information; and
>
> (c) to provide additional disclosures when compliance with the specific requirements in Standards of GRAP is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Paragraph .37A[22]

Referred to in paragraphs 6.12 and 6.26 of the Guideline

> When applying this and other Standards of GRAP an entity shall decide, taking into consideration all relevant facts and circumstances, how it aggregates information in the financial statements, which includes the notes. An entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions.

Paragraph .38[23]

Referred to in paragraph 6.10 of the Guideline

> Some Standards of GRAP specify information that is required to be included in the financial statements, which include the notes. Applying the concept of materiality means that a specific disclosure requirement in a Standard of GRAP need not be satisfied if the information resulting from that disclosure is not material. This is the case even if a Standard of GRAP contains a list of specific requirements or describes them as minimum requirements. An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in a Standard of GRAP is insufficient to enable the users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Paragraph .44

Referred to in paragraph 6.24 and 6.27 of the Guideline

> Except when a Standard of GRAP permits or requires otherwise, comparative information shall be presented in respect of the preceding period for all amounts reported in the financial statements. Comparative information shall be included for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.

Paragraph .45

Referred to in paragraph 6.24 of the Guideline

> An entity shall present, as a minimum, two statements of financial position, two statements of financial performance, two cash flow statements and two statements of changes in net assets, and related notes.

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[22] The Board added this paragraph as part of the Amendments to the Standard of GRAP on *Presentation of Financial Statements.*

[23] The Board amend this paragraph as part of the Amendments to the Standard of GRAP on *Presentation of Financial Statements.*

Paragraph .47

Referred to in paragraph 6.26 of the Guideline

> An entity may present comparative information in addition to the minimum comparative financial statements required by the Standards of GRAP, as long as that information is prepared in accordance with the Standards. This comparative information may consist of one or more statements referred to in paragraph .11, but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.

Paragraph .132

Referred to in paragraph 3.6 of the Guideline

> An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph .135), management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.

Extracts from the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors*

Paragraph .05

Referred to in paragraph 6.39 of the Guideline

> Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that: (a) was available when financial statements for those periods were authorised for issue; and (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Paragraph .07

Referred to in paragraphs 6.3 and 6.4 of the Guideline

> Standards of GRAP set out accounting policies that the Accounting Standards Board has concluded result in financial statements containing relevant and reliable information about the transactions, other events and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial. However, it is inappropriate to make, or leave uncorrected, immaterial departures from Standards of GRAP to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

Paragraph .43

Referred to in paragraph 6.33 of the Guideline

> Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Standards of GRAP if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the statements are authorised for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs .44 to .49).

Appendix B - References

Conceptual Framework for General Purpose Financial Reporting, 2017 (Published by the ASB)

Discussion Paper 9 on Materiality – Reducing Complexity and Improving Reporting, 2014 (Published by the ASB)

Standard of GRAP on Presentation of Financial Statements (GRAP 1), 2009 (Published by the ASB)

Standard of GRAP on Accounting Polices, Changes in Accounting Estimates and Errors (GRAP 3), 2010 (Published by the ASB)

IASB Practice Statement 2 Making Materiality Judgements, 2017 (Published by the IASB)

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AASB 1031 – Materiality, 2013 (Published by the AASB)

AASB 1031 – Materiality, 2009 (Published by the AASB)

ISA 320 - Materiality in Planning and Performing an Audit, 2009 (Published by the IAASB of IFAC)

ISA 450 - Evaluation of Misstatements Identified During the Audit, 2009 (Published by the IAASB of IFAC)

Technical Release – Guidance on Materiality in Financial Reporting by UK Entities, June 2008 (Published by the Institute of Chartered Accountants of England and Wales)

Discussion Paper - Towards a Disclosure Framework for the Notes (Published by the European Financial Reporting Advisory Group (EFRAG))