ACCOUNTING GUIDE
FOR DEPARTMENTS

MCS GUIDELINE ON MATERIALITY

Financial Statements

Comment due by 31 August 2022

national treasury
Department:
National Treasury
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Chapter Content

1 Introduction

1.1 Determining materiality, particularly the application of judgement, is not a simple concept. It has been highlighted by preparers to be one of the most significant challenges when preparing financial statements. Preparers of financial statements make decisions about what information to include in the financial statements. In applying the requirements of the Modified Cash Standard (MCS), material information should be included in the financial statements. Insignificant information in the financial statements obscures the users from focussing on key issues; and could mislead the users of the financial statements in making appropriate judgements and decisions.

1.2 Information provided in the financial statements needs to be relevant to the users for accountability and decision-making purposes. The concept of materiality means that only information that is relevant to the users should be in the financial statements. Preparers of financial statements need to identify information necessary to meet the objective of financial reporting by making appropriate judgements and decisions about materiality.

1.3 Determining whether a matter is insignificant or not depends on a number of factors such as the nature of the matter or item; its size; and the particular circumstances of each department. Materiality applies to items individually and collectively.

2 Objective

2.1 The objective of this Guideline is to provide guidance that will assist departments to apply the concept of materiality when preparing financial statements in accordance with the MCS. It outlines a process that may be considered by departments when applying materiality to the preparation of financial statements.

2.2 This Guideline was developed based primarily on the *Guideline on the Application of Materiality to Financial Statements* issued by the Accounting Standards Board (ASB). Since the materiality principles in the Standards of GRAP clarified by the aforementioned guideline are accrual-based, in developing this MCS Guideline on Materiality the relevant modified cash concepts and principles were applied.

2.3 This Guideline includes examples and diagrams to illustrate how an department may apply the principles in this Guideline, based on specific facts presented.

3 Scope

3.1 This MCS Guideline on Materiality addresses the application of materiality when preparing financial statements. While the individual chapters of the MCS set out the recognition, recording, measurement, presentation and disclosure requirements, this guideline clarifies the MCS's overarching provisions pertaining to materiality.

3.2 The Guideline assists departments to make the decisions about the material information to be included in the financial statements. The MCS sets out accounting policies that the National Treasury has concluded result in financial statements containing relevant and reliable information about the transactions, other events, and conditions to which they apply. The National Treasury includes the accounting policies in the Annual Financial Statements Specimen (AFS Specimen) for departments thereby reducing inconsistent application where preparers of financial statements develop their own accounting policies. However, where a department has peculiar circumstances or transactions that warrant department-specific accounting policies in addition to those in the AFS Specimen, this guideline may be applied in developing such accounting policies that are aligned to the MCS requirements and is not to achieve a particular result.

3.3 Consistent with the Standard of GRAP on *Presentation of Financial Statements* (GRAP 1) at the time of publication of this Guideline, the **MCS Chapter 2 on *Concepts and Principles*** and the **MCS Chapter 3 on *Financial Statements Presentation*** focus on materiality on the preparation of financial statements. In comparison, the *Conceptual Framework for General Purpose Financial Reporting* (GRAP Conceptual Framework) issued by the Accounting Standards Board (ASB) in July 2017, addresses materiality broader on the basis of the entity's General-Purpose Financial Reports (GPFR) prepared for the reporting period. GPFRs encompass qualitative and quantitative information about service delivery achievements during the reporting period, and expectations about service delivery and financial outcomes in the future. Assessments of materiality of the entity's GPFR is made in the context of the legislative, institutional and operating environment within which the entity operates and, in respect of prospective financial and non-financial information, the preparer's knowledge and expectations about the future.

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

3.5 The content of this MCS Guideline on Materiality is not authoritative and is intended to be used for accounting materiality guidance purposes only for financial statements prepared in accordance with the MCS. It is important for the user to assess the department's circumstances when applying the guidance contained herein. This Guideline is not a substitute for existing legislative requirements or frameworks on materiality. It also does not amend or override the requirements of the MCS.

3.6 In all the examples included herein, unless otherwise indicated, it can be assumed that the amounts are material.

4 Definition

4.1 The definition of materiality is drawn from the discussion on the **relevance qualitative characteristic** in paragraph .24 of the **MCS Chapter 2 on *Concepts and Principles*** which reads as follows:

> *Information is material if its **omission**, **misstatement**, or **non-disclosure** could **influence the decisions of users** made on the basis of the financial statements. Materiality depends on the **nature or size** of the item or error judged in the particular circumstances of its omission, misstatement, or non-disclosure in the financial statements. Thus, materiality provides a **threshold or cut-off point** rather than being a primary qualitative characteristic which information must have to be useful.*

4.2 **MCS Chapter 2 on *Concepts and Principles*** paragraph .27 on the reliability qualitative characteristic refers to information being reliable when it **does not contain material errors** and free from bias. Paragraph .28 states one of the criteria for reliable information as being **complete, within the bounds of materiality** and cost.

4.3 The term "material" is further defined in the **MCS Chapter 3 on *Presentation of Financial Statements*** 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 size or nature of the information item, or a combination of both, could be the determining factor.*

4.4 The following key words defining materiality are discussed individually in the paragraphs below:

- Omissions
- Misstatements
  - Fraud
  - Error

- Non-disclosure
- Individual or collective
- Influence decisions or assessments
- Size or / and nature
- Threshold or cut-off point

5 Characteristics of materiality

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

5.2 Therefore, assessing materiality involves judgement about:

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

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

5.3 The assessment of materiality is concerned about **applying judgement in considering whether to include or exclude information in the financial statements**. A department is required to apply judgement to assess whether information provided could reasonably be expected to influence the discharge of accountability by a department 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.

Users of the financial statements

5.4 Understanding whether an omission, misstatement or non-disclosure could influence decisions of users, and be material, requires consideration of the **characteristics of those users of financial statements**. 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 consider 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, a department applies judgement to determine whether certain needs should be met in the financial statements as discussed in Section 8 below.

Nature, size or both

5.5 Materiality depends on the **nature or size or both**, of an item that is judged in the particular circumstances of a department at the time of reporting. The concept of materiality has been interpreted by some as only involving the absolute or relative size of information.

5.6 A department's assessment of materiality should also consider the interactions between the nature and size of the item in light of the department's circumstances. As such, materiality assessments are not only concerned about the quantitative assessment. Size or / and nature are discussed in Section 14 below.

Qualitative and quantitative factors

5.7 The assessment of materiality should consider both qualitative and quantitative factors as well as the relevant circumstances. Section 16 discusses the interactions between qualitative and quantitative factors.

6 Role of materiality in the financial statements

6.1 Applying materiality is pervasive to the preparation of financial statements. It requires departments to make key assessments and decisions. A department makes materiality judgements when making decisions about presentation, disclosure, recognition and measurement.

Diagram 1: Key assessments and decisions in considering materiality

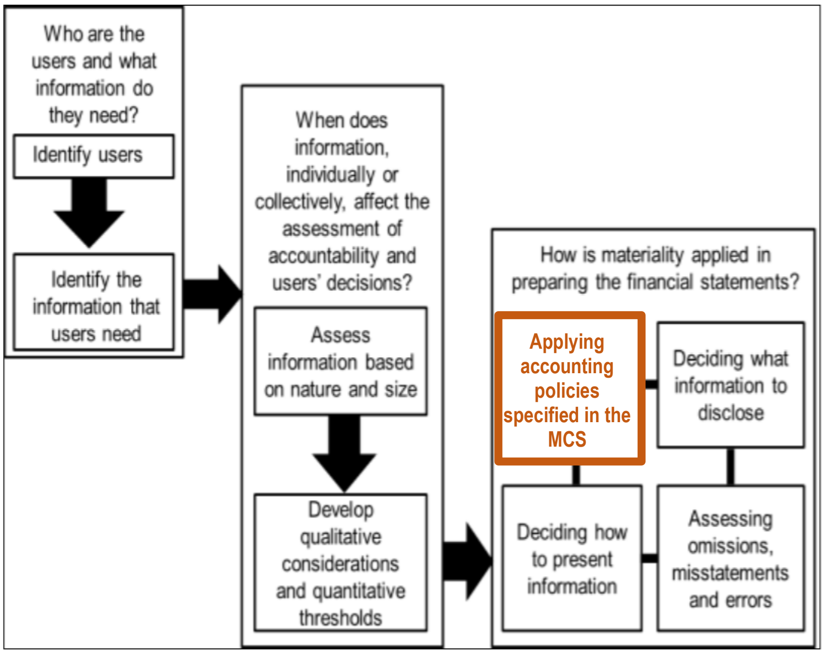


Diagram 1: Key assessments and decisions in considering materiality in an MCS environment (Source: Guideline on The Application of Materiality to Financial Statements, ASB)

6.2 In a GRAP environment, entities individually develop accounting policies aligned to the Standards of GRAP, whereas in an MCS environment the accounting policies are predetermined in the MCS. The orange block in Diagram 1 above illustrates this difference. MCS accounting policies are articulated in the AFS Specimen and AFS Template; these are tools used by departments to standardise the format of financial statements to achieve ease of preparation, comparability and consolidation. Notwithstanding the abovementioned difference relating to accounting policies determination using Standards of GRAP and the MCS, the diagram illustrates that similar approaches can be employed in determining materiality in a cash and an accrual accounting environment.

6.3 Even though financial statements are prepared after the end of the reporting period and final materiality decisions are made at that point, a department should consider these assessments and decisions throughout the reporting period, and not only when financial statements are prepared. This will ensure that relevant information is available on a timely basis and will also inform the level of aggregation and disaggregation.

6.4 Materiality assessments and decisions are made at a specific point in time, considering 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 a department to modify its assessments and decisions.

6.5 According to the requirements in **MCS Chapter 4 on *Accounting Policies, Estimates and Errors***, a department shall change an accounting policy only if the change is required by the Standard. The accounting policies are further articulated in the AFS Specimen for ease of application in the financial statements and to achieve consistency and comparability. This does not restrict the department from determining and documenting materiality in accordance with the relevant facts and circumstances.

6.6 When making these assessments and decisions, departments 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.

6.7 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 department, for example, management together with its relevant governance structures.

6.8 At this stage the MCS does not require departments to disclose the judgements made by management on their assessment of materiality. However, it is appropriate for management to document, for its own purposes, the principles, processes and policies regarding determining materiality and main decisions taken.

7 Materiality in relation to qualitative characteristics

7.1 *Relevance* is a **qualitative characteristic** in accounting frameworks including the MCS, Standards of GRAP, International Public Sector Accounting Standards (IPSAS) and International Financial Reporting Standard (IFRS). Relevant information is capable of influencing financial statements users' assessments and decisions.

7.2 The relevance of information included in the financial statements is established by reference to its **nature** and **materiality**. Information is material if its omission or misstatement could influence the discharge of accountability by management, or the users' decisions.

7.3 *Reliable* information **does not contain material errors** and is **complete, within the bounds of materiality**.

7.4 As stated in the definition, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have to be useful.

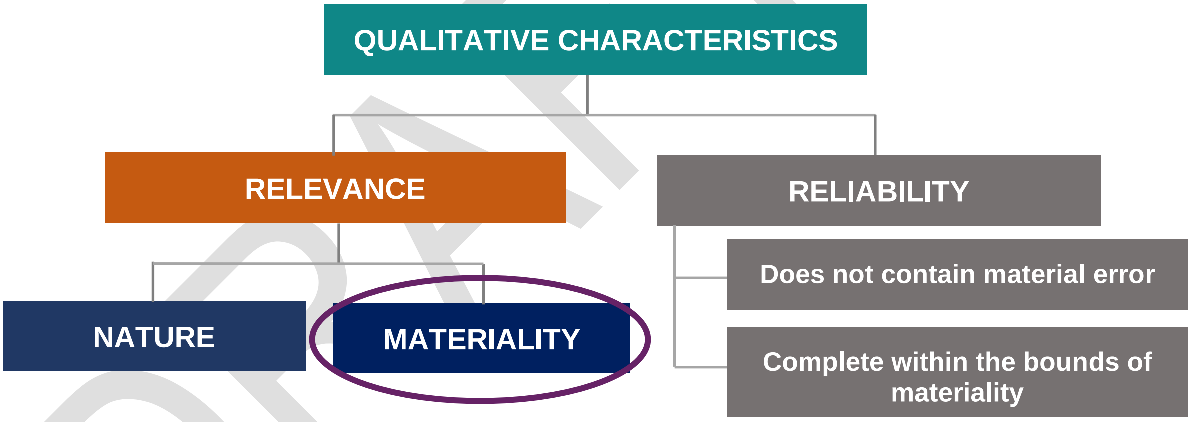


Diagram 2: Materiality as a criterion of the relevance qualitative characteristic

8 Users of financial statements

8.1 Materiality should be applied in deciding what information is considered most relevant to users of the financial statements.

8.2 Determining what information is material requires consideration of:

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

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

8.3 **MCS Chapter 2 on *Concepts and Principles*** states that financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all the information that users may need to make decisions since they largely portray the financial effects of past events and do not necessarily provide prospective information or non-financial information.

8.4 Furthermore, **MCS Chapter 2 on *Concepts and Principles*** identifies the users of the departmental financial statements to include:

- Parliament / Provincial Legislatures;
- Elected officials;
- National / Provincial Treasuries;
- The public (including taxpayers and employees of the department);
- Donors;
- Statisticians and economists;
- Suppliers and creditors;
- Present and potential institutional and individual lenders, including purchasers of government bonds;
- Other Governments; and
- The media.

8.5 In addition to the broad users mentioned in the preceding paragraph, 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.

8.6 In entities with a profit-motive, the key users of the financial statements considered in determining materiality are existing and potential investors. Their information needs are paramount to the preparers of these entities' financial statements and determining materiality.

8.7 In identifying the relevant users, a department considers 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 a department 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. A department is entitled to assume that the users of its financial statements have a reasonable knowledge of its activities and operations.

8.8 The identification of a department's relevant users will be made based on the knowledge and understanding of the department's:

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

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

Example: Identifying the relevant users

Background

A provincial Department of Human Settlements is responsible for constructing low cost housing for beneficiaries. The Department is wholly funded by government. It operates a single transactional bank account, a fleet of construction vehicles, equipment, machinery and buildings.

Application

The department 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 department to continue to construct houses. Even though the department has a transactional bank account, the financial institution may use the financial statements but is unlikely to require specific information from the financial statements to continue to provide its goods and/or services.

8.9 Users need information that enables them to:

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

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

8.10 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 department'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 department's legally adopted budget, and demonstrating compliance with other finance-related legal or contractual requirements.
- The **service** efforts, costs, and accomplishments of the department.

(b) The **performance** of a department during the reporting period, for example, whether:

- A department 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 a department, for example, whether:

- A department's financial position has **improved or deteriorated** as a result of the current period's operations.
- A department will be able to meet its **obligations** as they fall due.
- A department has the capacity to continue to fund its activities and meet its operational objectives in the **future**, the extent to which a department 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 a department during the reporting period, for example:

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

8.11 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 a department's range of possible users, there may be a broad range of information needs and some may have dissimilar information needs and expectations. Therefore, a department 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 department aims to meet. This assessment does not require a department 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, a department cannot be reasonably expected to meet all of the information needs of all of the department's users.

8.12 A department 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.

8.13 In the public sector environment, care should be taken in making materiality judgments about the effects of **public accountability**. The purpose of the financial statements is to provide information about a department'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 a department's users of financial statements.

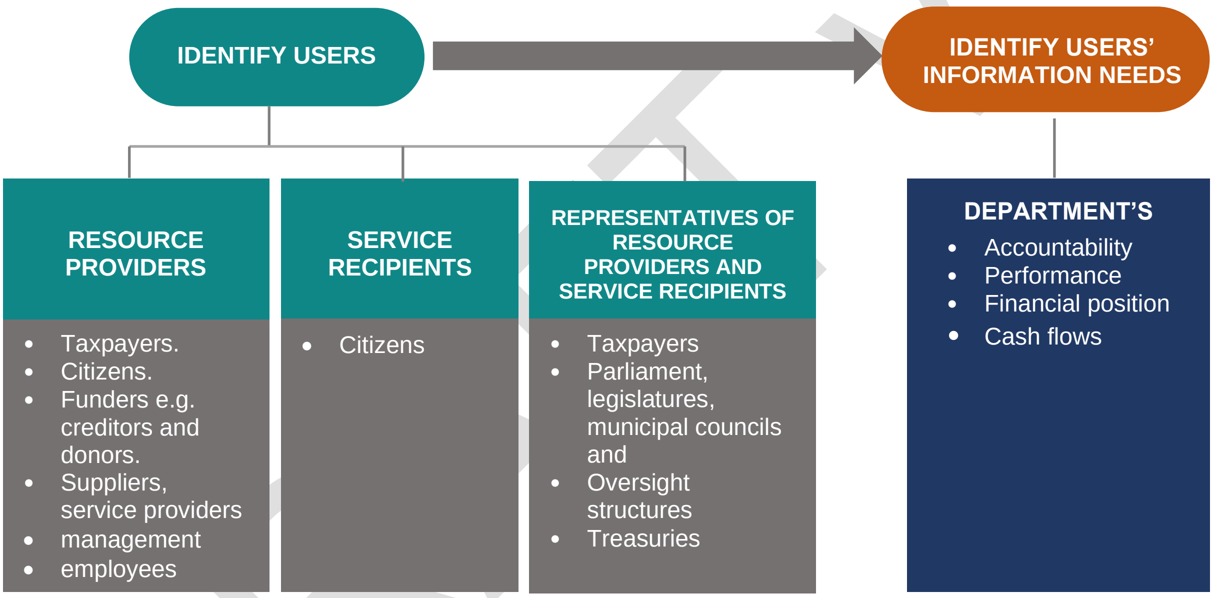


Diagram 3: Identifying users of the financial statements and their information needs

Example: Identifying the users' information needs

Background

Assume the same fact pattern in the preceding Example on Identifying the relevant users.

Application

The department 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 and conditions to be satisfied (if conditional grant).

	• The **nature and type of expenses** incurred to fulfil the department's objectives of constructing low cost housing during the reporting period. • The amount spent to acquire **capital assets**. • The amount incurred to **repair and maintain** capital assets during the reporting period. • The amount of contractual commitments to acquire capital assets (capital commitments) When making materiality judgements in the preparation of its financial statements, the department does not reduce its disclosures to only those of interest to the government. The department also considers the information needs of its other users such as taxpayers, beneficiaries, suppliers, creditors and employees when making those judgements.

9 Omissions

9.1 Omission involves **leaving out information** whereas misstatements pertain to incorrect treatment in the financial statements.

9.2 An omission of material information can cause the disclosure in the financial statements to be false or misleading.

9.3 In determining whether **MCS Chapter 3 on *Presentation Financial Statements*** permits a department to omit a specific disclosure required by the MCS, the department will need to exercise professional judgment. In making this assessment, a department should consider whether including a large number of disclosures about immaterial matters distracts attention from important disclosures and undermines understandability. A department should also consider whether the overall effect of omitting these disclosures would be to obscure information.

	**Example: Omission** A department has a pending lawsuit whose liability is possible but not probable. The department's legal unit estimates R850m loss if the department loses the case. This meets the definition of a contingent liability and should be disclosed as such in the notes to the financial statements. However, management omitted to disclose the contingent liability. In the event of a lawsuit loss, the resultant significant outflow of resources will affect the cash position of the department. Therefore, the omission of this contingent liability leaves out material information and this may mislead users of the financial statements.

10 Misstatements

Amount, classification, presentation or disclosure

10.1 Misstatement is the difference between the **amount, classification, presentation or disclosure** of a reported financial statement item and the amount, classification, presentation or disclosure that is required for the item to be in accordance MCS.

Example: Misstatement – amount, classification, presentation or disclosure

Amount: Department A entered into contracts with service providers for construction of various properties at a significant cost to the department. According to the MCS Department A is required to determine the amount that must be disclosed as Accruals at reporting date. Based on evidence available, Department A should have disclosed R799 million Accruals relating to these contracts. However, Department A disclosed Accruals for these contracts amounting to R623 million. The misstatement (understatement) of the Accruals amount is R166 million.

Classification: Department C has classified significant items amounting to R451 million as transfers and subsidies instead of the correct classification of goods and services under current expenditure. The misclassification is a misstatement. It also has budgetary and procurement implications.

Presentation: The MCS requires departments to present current and non-current liabilities as separate classifications on the face of its statement financial position. Department P combined current and non-current liabilities and incorrectly presented significant non-current payables amounting to R353 million as part of payables in current liabilities. Department P misstated non-current liabilities by R353 million by presenting it as part of current liabilities, thus misinforming users of the statement of financial position about the department's long-term operations.

Disclosure: For all financial assets (primary and secondary information), where there is an indication of impairment, appropriate disclosures should be included in the notes to the financial statements to show the estimated reduction in the recorded carrying value. There is evidence of significant impairment of Department D's receivables. However, Department D did not disclose the impairment although this is a requirement of the MCS. This is a disclosure misstatement.

Fraud or error

10.2 Misstatements in the financial statements can arise from **fraud** or **error**.' In other words, a misstatement arises where there is a difference between the reported figures, and what is expected to be reported in order for the financial statements to be fairly presented.

10.3 The difference between fraud and error is whether the underlying action that results in the misstatement of financial statements is intentional or unintentional.

10.4 Fraud refers to an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Error refers to an unintentional misstatement in the financial statements, including the unintentional omission of an amount or disclosure.

Example: Misstatement – fraud or error

Fraud: Department F officials are aware that a service provider has not provided services to Department F that are stipulated in an invoice amounting to R1,2 million. The officials collude to pay a service provider R1,2 million stipulated in the fraudulent invoice. Fraud committed by the officials is a misstatement as it misleads the users of the financial statements that Department F received services valued at R1,2 million. There would be other non-accounting implications following the fraud such as an investigation.

Error: Department E's finance official inadvertently added a zero to the amount paid due to a supplier and recorded as a payable not recognised as defined by the

	MCS as R10,000,000 instead of R1,000,000. This error was undetected and the payables not recognised note to the financial statements is overstated by R9,000,000.

Factual or judgmental misstatements

10.5 Misstatements can be **factual**, in the case of a clear breach of a requirement of a financial reporting standard, or could be **judgmental**, arising from unsuitable estimation techniques or the selection of inappropriate accounting policies.

	Example: Factual or judgmental misstatements **Factual:** Paragraph .20 of the MCS Chapter 9 on *General Departmental Assets and Liabilities* requires that payables not recognised are recorded when goods are received or, in the case of services, when they are delivered to the department or, in the case of transfers and subsidies, when they are due and payable. For payables not recognised, an invoice has been received by the department. Undisputed evidence indicates that Department F received goods and services amounting to R760 million and invoices have been received. However, Department F did not record the payables not recognised amounting to R760 million in its financial statements. This is a breach of an MCS requirement meaning that Department F's financial statements are incorrect. **Judgmental:** MCS Chapter 11 on *Capital Assets* states instances when capital assets can be measured at fair value. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Department J purports to have used fair value in measuring a class of assets. On inspection of the method used in determining the fair value it is evident that the fair value is understated by at least R350 million. This is a judgment misstatement of financial statements as management's accounting estimates are unreasonable.

11 Non-disclosure

11.1 Non-disclosure is lack of inclusion of information that is key to the users of the financial statements. Thus, non-disclosure could influence the decisions of users made on the basis of the financial statements.

	Example: Non-disclosure Department G commenced a major litigation arising solely out of events that occurred after the reporting date. In terms of MCS Chapter 17 on *Events after the reporting date* this is a material non-adjusting event non-disclosure of which could influence the economic decisions of users taken on the basis of the financial statements. Accordingly, a department shall disclose the nature of the litigation and, an estimate of its financial effect.

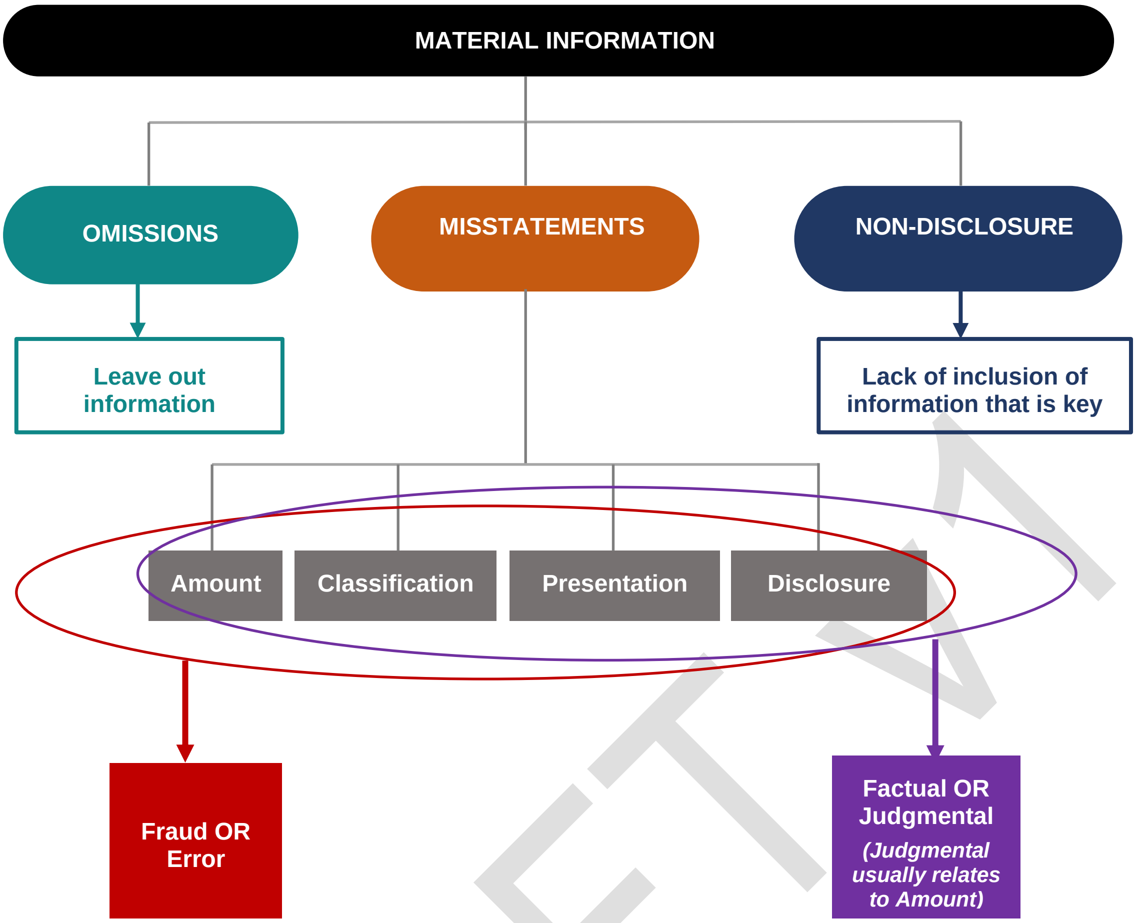


Diagram 4: Material information

12 Individual or collective

12.1 Materiality applies to items individually and collectively. In deciding whether an item should be assessed individually or collectively, departments consider the nature of the item, size of the item, or both.

12.2 An immaterial item may become material when taken collectively with other individually immaterial items.

12.3 If a department 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 subtotal/ total presented.

12.4 It is important to keep track of any uncorrected misstatements identified during a period in order to be able to assess their collective materiality. On the other hand, material misstatement cannot be offset by other material misstatements. For example, it is inappropriate to offset overstated material revenue and expenses.

12.5 The cumulative impact of immaterial misstatements from previous years may become material in a future financial year.

Example: Individual or collective

Department H has not recognised immaterial liability of R18,000 per year for the last 12 years resulting in a cumulative understatement of liabilities by R204,000 in year 12. While R18,000 may be immaterial in any of the 12 years, cumulative understatement of liabilities by R204,000 at the reporting date may be a material omission. If this is the case, the department cannot recognise R204,000 of liability in the current period as this would materially misstate current financial information. In such a case, a department needs to make a prior period error correction even though the error was not material in any of the previous years.

Source: Ifrscommunity.com

13 Influence decisions or assessments

13.1 According to the MCS, relevant information is capable of influencing users' assessments and decisions. For this reason, relevant information should be neutral or free of bias, and the selection and presentation of information should not made with the intention of attaining a particular predetermined result.

13.2 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 consider how users with such attributes could reasonably be expected to be influenced in making and evaluating decisions.

13.3 Assessments of materiality on financial information is made in the context of the legislative, institutional and operating environment within which the department operates.

14 Size or / and nature

14.1 The size or nature of the information item, or a combination of both, are factors considered in determining the department's materiality in its particular circumstances. Items, transactions and events are material if their nature or size (or both) affects users' decisions.

14.2 Broadly, size addresses the quantitative factor whereas nature addresses the qualitative factors.

Nature

14.3 The nature of an item refers to its **inherent characteristics or the circumstances** in which the item was undertaken. These are the **qualitative** factors of an item in the financial statements.

14.4 Examples of characteristics that may make an item material include:

a) Legality, sensitivity, frequency and potential consequences of the item

b) Transactions or events giving rise to the item, and / or

c) Account balances and notes affected

14.5 ***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 department 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.

14.6 ***Transactions or events giving rise to the item***

- The identity of the **party** with whom the department 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 a department's financial performance and financial position in the future**, e.g. a change in accounting policy.

14.7 ***Account balances and notes affected***

- An item that **affects the methods used to evaluate** a department's financial performance, financial position or cash flows, or any part of these three aspects, for the period.

Size

14.8 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. These are the **quantitative** factors of an item in the financial statements.

14.9 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. a department's financial state.

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

Example: Nature and size

Department N is affiliated to 15 international organisations. Payments to these international organisations are allocated to an item **Transfers to international organisations**. This item is used for clear illustrative purposes. It does not mean that in determining materiality management is compelled to assess up to these lowest levels for each item in the financial statements. Management may group the items analysed if the features are similar.

Nature

Determinant	Analysis
Legality, sensitivity, frequency and potential consequences of the item	
Legality	PFMA and Treasury Regulations (TR) refer to Transfers and Subsidies particularly when addressing Virement, Roll-overs and the ERF. Transfers and Subsidies are also covered in the Appropriation Act. International organisations are governed by laws in countries where they operate which

	adds complexity compared to transfers to local organisations. In transferring funds to the international bodies, the laws of the foreign country should not be transgressed. This has not been a challenge in the past.
Sensitivity	There is a degree of sensitivity on transfers international organisations that are affiliated to certain groups.
Frequency	Most transfers are done quarterly (80%); the rest of the transfers are done annually (20%).
Potential consequences	Non-payment of Transfers to international organisations can result in the following: Losses • Cessation of membership to the international organisation • Access to have a say and / or vote on the plans of the organisation for the greater benefit of the South African citizens • Sharing information, networking training opportunities • Future services that may be provided by the international organisation • Sour the relations with the affected foreign countries • Reputation Gains • Funds can be redirected to other competing priorities
Transactions or events giving rise to the item	
Other party	15 International organisations whose objectives are closely linked to the service delivery mandate of the department.
Reversal of a trend	Transfers to international bodies have remained relatively the same over the years. They will not result in a reversal of a trend.
New / cessation of activity	20% of Transfers to international bodies are new. 12% of the International bodies ceased to exist or were replaced by new ones.
After the reporting date	No unusual transactions are identified as the international bodies have a good reputation, provide the required supporting documents which are verifiable.
Likely impact on performance and position	Transfers to international bodies are unlikely to have an impact on performance and position.
Account balances and notes affected	
Affects the methods used to evaluate performance and position	Transfers to international bodies are unlikely to affect the methods used to evaluate performance and position

Size

Determinant	Analysis
Class of transactions	Transfer to international organisations is 90% of **Transfers to Foreign governments and International organisations**, which make up 20% and all **Transfers and subsidies** Transfers and subsidies are 25% of **Total Expenditure**
Specific line item	*Transfers to International Organisations*

Aggregation of specific line items	<u>*Aggregated as follows:*</u> Expenditure (PER) Transfers and subsidies (PER and Appropriation Statement) Foreign governments and International organisations (Note and Appropriation Statement) Name of International organisation (Annexure E)
A specific statement in the financial statements	Appropriation Statements Statement of financial performance (PER) Notes
The overall assessment of the financial statements	There are no operations or going concern matters that will disable the department to honour future payments to the international organisations

15 Threshold or cut-off point

15.1 The materiality threshold refers to the benchmark used to assist management from not detecting material misstatements that can significantly impact the usability of financial statements.

15.2 In assessing whether an item is material, entities usually develop specific qualitative considerations and quantitative thresholds for specific items.

15.3 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.

15.4 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.

15.5 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.

15.6 When setting qualitative considerations and quantitative thresholds at various levels (referred to in paragraph 14.9 on size), a department 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

15.7 When determining qualitative considerations, a department considers both **department-specific and external qualitative factors**.

15.8 **Department-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.

15.9 **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 department operates.

15.10 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.

15.11 Departments operating in the same context, for example, the security cluster in the national sphere of government, might share a number of qualitative factors.

Quantitative thresholds

15.12 Currently, **there is no standard international guidance on identifying measures against which a department makes quantitative assessments**. Materiality is **department-specific** and standardsetters do not provide quantitative thresholds. As such, identifying and selecting the appropriate thresholds is a matter of judgement.

15.13 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.

15.14 When determining the appropriate benchmarks, departments 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 department'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 department's operations** (for example, what drives cost, where the department is in its life cycle and the cluster and economic environment in which the department operates)?
- What is the department's **funding structure** (for example, how it is funded through appropriated funds 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)?

15.15 The choice of appropriate benchmarks will therefore be influenced by the **department's circumstances**. A department 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, a department considers paragraph 14.9 on size when selecting the appropriate benchmarks for determining quantitative thresholds.

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

15.17 Given the nature of the public sector, it may be more appropriate to **consider materiality in absolute and relative terms**.

15.18 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 department's cash position is unfavourable and the department records accruals and payables not recognised instead of paying for goods and services received as this will put the department in a more unfavourable cash position and possible overspending.

15.19 In **relative terms**, items are compared to any directly related items.

15.20 In relation to the chosen benchmark, a department 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 a department.

Example: Relative terms using prior period financial statements

Department R charges levies to a predominantly homogenous group of private entities. There were no changes to the levies charged by the department and the mostly same entities are charged levies meaning the levies revenue of the current financial year should be similar to the levies collected in the previous financial year.

The department collected significantly lower (higher) than expected levies in the current financial year in comparison to the previous financial year. This may indicate that information about the revenue attributable to levies is material. It could indicate recoverability concerns on major levies receivables in comparison with prior periods.

15.21 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 a department, and the choice between higher and lower percentages will be **department-specific**.

15.22 A parameter usually applied in the private sector entities is between 5 and 10 percent of earnings. Materiality Tracker (2021) states that "when profit before tax from continuing operations is volatile, other benchmarks such as total revenues (sales) may be more appropriate to use (e.g. 0.2 – 2 percent of total revenue). Also, where the organization's operating results are so poor that liquidity or solvency is a real concern, basing overall materiality on financial position (e.g. equity) may be more appropriate to use (e.g. 1 – 2 percent of owner's equity)."

15.23 According to Materiality Tracker (2021), a more conservative approach and lower percentages would tend to be applied in enterprises with the following characteristics:

- In high-risk industries,
- face high risk of fraud,
- have history of deficient accounting and controls,
- high staff turnover, and
- operate in various locations; local and international.

15.24 Departments should also consider their characteristics to determine the appropriate component of the financial statement and percentage to apply.

15.25 The threshold guidance given to public entities which can be considered by departments is as follows:

3.7.1 The parameters are derived from the rand values of certain elements of the individual public entity's audited annual financial statements, as follows:

Element:	% range to be applied against R value
Total Assets	1% - 2%
Total Revenue	0,5% - 1%
Profit after tax	2% - 5%

The finalised rand amount to be applied for purposes of determining the significance threshold for each public entity will require sound judgment:

- The rand value of the above elements will differ from one public entity to the next;
- The most appropriate % chosen within the range is also entity-specific;
- The rand amounts calculated per element may require averaging in the interests of prudence;
- Qualitative factors, for example, where the transaction is likely to result in large-scale retrenchments should also be taken into account.

3.7.2 The latest available audited financial statements should be used to calculate the above.

3.7.3 The elements as well as % range selected should be consistent from one year to the next.

3.7.4 The finalised rand amount should be reviewed at least annually.

Diagram 5: Practice Note on Application of Section 54 of the PFMA by Public Entities

Example: Quantitative threshold

Department A has Revenue totaling R900 million entered into contracts with suppliers.

R9 million misstatement represents 1% margin impact which is material.

Contracts

Contract 1: Supplier K, 36 months contract; R275,000 Total R9,900,000

Contract 2: Supplier L, Once-off payment R9,900,000

Contract 3: Supplier M, Blacklisted, R99,000 (qualitative)

	Analysis	Conclusion
Contract 1: Supplier K 36 months contract R275,000 Total R9,900,000	Cumulative contract value is R9,9m which exceeds the materiality threshold.	Contract is material
Contract 2: Supplier L Once-off R9,900,000	The contract value is R9,9m which exceeds the materiality threshold.	Contract is material
Contract 3: Supplier M Blacklisted Once-off R99,000	The contract value is R99k which is below the materiality threshold. However, the supplier is blacklisted which makes	Contract is material

		transacting with it significant.	

16 Interaction of qualitative and quantitative factors

16.1 A department 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 department and the decisions of users.

16.2 When assessing the materiality of an item there is no hierarchy among the determining factors, a department must consider both qualitative and quantitative factors in assessing an item's materiality. The application of a qualitative and quantitative assessment depends on what a department considers to be the appropriate context for assessing materiality of a department.

16.3 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.

16.4 A department may use quantitative thresholds as an efficient and practical approach to assessing materiality. If a department identifies an item as material solely on the basis of the size of the impact of the item, the department 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 department should further assess the presence of qualitative factors. In the absence of qualitative factors, a department will judge that item as material based on its size. However, where there are qualitative factors present, a department considers the interaction of the qualitative and quantitative factors to determine whether the item is material.

16.5 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, a department 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.

16.6 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 a department'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 a department, although a small part of a department's operations, might by their nature be important to the users.

Example: Information about a related party transaction assessed as material

Background

Department B 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 department intended to enter into a two-year contract with Company A for Company A to provide the department with security services for the department's buildings for a monthly fee. Company A is controlled by a member of the department's key management personnel (KMP).

	Application The department should assess whether information about the contract with Company A pending approval to determine if it is material to affect the financial statements. The department started its assessment from a quantitative perspective and evaluated the impact of the amount of the contract being considered against its quantitative thresholds. Having initially concluded that the impact of the contract with Company A was not material from a purely quantitative perspective, the department further assessed the presence of any qualitative factors. Supply chain management **prescripts prohibit departments from entering into contracts of this nature with KMP**. The department concluded that **the impact of concluding the contract would be large enough to reasonably be expected to influence primary users' decisions**. Hence, the department assessed information about the contract with Company A as quantitatively immaterial yet qualitatively material.

17 Preparation of financial statements

17.1 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 MCS.

17.2 Consequently, departments consider materiality when:

(a) Applying **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.

17.3 MCS does not specify requirements for the implementation and maintenance of a department's internal record keeping procedures, as specifying how information is recorded goes beyond the scope of the MCS.

17.4 Consequently, the concept of materiality in the MCS does not apply to how information is recorded internally in the department.

Applying accounting policies

17.5 Some Chapters of the MCS set out how an item should be recognised, measured and disclosed in the financial statements. In such cases, the MCS 4 on *Accounting Policies, Estimates and Errors* explains these accounting policies should not be applied when the effect of the applying them is immaterial. This means that a department does not need to recognise, measure, present or disclose information in accordance with the specific requirements outlined in the MCS 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.

17.6 It means that:

(a) A department cannot depart from the requirements of the MCS for material items, unless permitted by a MCS Chapter.

(b) A department cannot depart from the recognition and measurement requirements of the MCS for material items and rather disclose information about the item in the notes.

(c) A department cannot depart from the requirements of the MCS for material items and develop its own accounting policies.

(d) A department cannot depart from the requirements of the MCS for immaterial item, to achieve a particular presentation of a department's financial position, financial performance and cash flows.

(e) A department cannot make, or leave uncorrected, immaterial departures from MCS to achieve a particular presentation of a department's financial position, financial performance and cash flows.

(f) A department 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.

17.7 In rare circumstances, a department may formulate its own accounting policy, if the transaction, other event or condition is not specifically covered by the MCS but should be reported in the financial statements.

Reference

MCS Chapter 4 on Accounting Policies, Estimates and Errors

.06 Where a chapter does not specifically apply to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

a) relevant to the economic decision-making needs of users; and

b) reliable, in that the financial statements and or notes:

   (i) represent faithfully the financial position, financial performance and cash flows of the department;

   (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

   (iii) are neutral, i.e. free from bias;

   (iv) are prudent; and

c) are complete in all material respects.

17.8 A department 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 MCS.

17.9 When a department has developed a particular accounting policy, without following the specific requirements in the MCS as outlined in paragraph 14.6, 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.

17.10 Consequently, a department 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 department'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 15.2 to 15.6).

17.11 In assessing whether the effect of applying accounting policies is immaterial, a department considers both qualitative and quantitative factors in its assessment (see paragraphs 16.1 to 16.6).

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

17.12 When a department 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, departments will decide what information should be provided, and whether such information should be presented in the financial statements or disclosed in the notes.

17.13 In developing the MCS, the National Treasury has considered that the information that is expected to meet the needs of a broad range of users, for a variety of departments operating in the national and provincial spheres of government. The requirements in the MCS have been developed by National Treasury considering 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 MCS is not a factor for departments to consider when assessing whether information is material. However, it is insufficient to apply the presentation and disclosure requirements in a Chapter of the MCS, without considering the department's specific circumstances, whether the department's users have any special needs and whether the information provided meets or exceeds the needs of a department's users.

Selecting information for presentation and disclosure

17.14 When departments consider what information should be presented in the financial statements, the requirements in the MCS should provide the basis for that assessment. When a department has decided to apply a particular Chapter of the MCS, the presentation and disclosure requirements in that Standard should be assessed to determine whether they are material to the users' decisions.

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

17.16 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 MCS. This is because immaterial information may obscure relevant information and hinder the understanding of the financial statements for users.

17.17 The MCS does not prohibit departments from presenting and disclosing immaterial information. Nevertheless, entities should consider whether the presentation and disclosure of immaterial information results in material information being obscured15. 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: Materiality assessments on disclosures specified in the MCS

Background

A department that is service-orientated discloses capital assets as a separate note in the financial statements. It has a contract with a service provider.

Application

MCS Chapter 11 on *Capital Assets* sets out specific disclosure requirements for capital assets, including expenditure incurred to repair and maintain capital assets (paragraph .88). MCS Chapter 14 on *Provisions and Contingents* requires the disclosure of the amount of contractual capital commitments for the acquisition of capital assets (paragraphs .63).

When preparing its financial statements, the department assesses whether disclosures specified in MCS Chapter 11 on *Capital Assets* provide material information. In the absence of any qualitative considerations, if the amount of contractual commitments for the acquisition of capital assets, is not material, the department is not required to disclose this information.

Example: Providing additional information in the financial statements that is not required by the MCS

Background

Legal action has been instituted against a department 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 department's legal advisors, the possibility of an outflow of economic benefits in settlement is remote. The MCS Chapter 14 on *Provisions and Contingents* 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 the MCS Chapter 14 on *Provisions and Contingents* is that the department should not disclose the contingent liability if the possibility of any outflows is remote, the department assesses whether information related to the lawsuit is material to the financial statements and should be disclosed in the financial statements. The department concludes that information about the lawsuit is qualitatively material as the potential breach occurred in a protected area.

While there is no contingent liability to disclose in accordance with MCS Chapter 14 on *Provisions and Contingents*, the information about the existence of the lawsuit is assessed as material and disclosed in the entity's financial statements in accordance with MCS Chapter 2 on *Concepts and Principles*. MCS Chapter 2 on *Concepts and Principles* permits the disclosure of additional information when it is relevant to the understanding of the financial statements.

Deciding where to present and disclose information

17.18 In some MCS Chapters, it is clear where information should be located in the financial statements. However, in some cases the MCS Chapters do not specify the location of information. In these cases, departments should consider whether the financial statements or notes are the most appropriate **location** for that information.

17.19 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 a department's financial position, financial performance and cash flows. Too much information in the financial statements can create "clutter" that may obscure this picture. When the concept of materiality is not applied appropriately, it may result in disclosure of too much information (sometimes called clutter) or too little information.

(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.

17.20 In deciding where to present and disclose information, a department 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.

17.21 When departments 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

17.22 It is also important for departments to consider how information is organised in the financial statements and notes as this can affect its interpretation by users. A department should apply its judgement in ensuring that meaningful information is provided to the users of the financial statements. For example, a department 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.

(d) Describe the department'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.

17.23 Departments should also assess whether there are any material items that should be presented individually in the financial statements and/or notes. A department 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.

17.24 In the IFRS environment the Practice Statement 2 on *Making Materiality Judgements* outlines a four-step process for assessing whether items, including disclosures, are material to the financial statements.

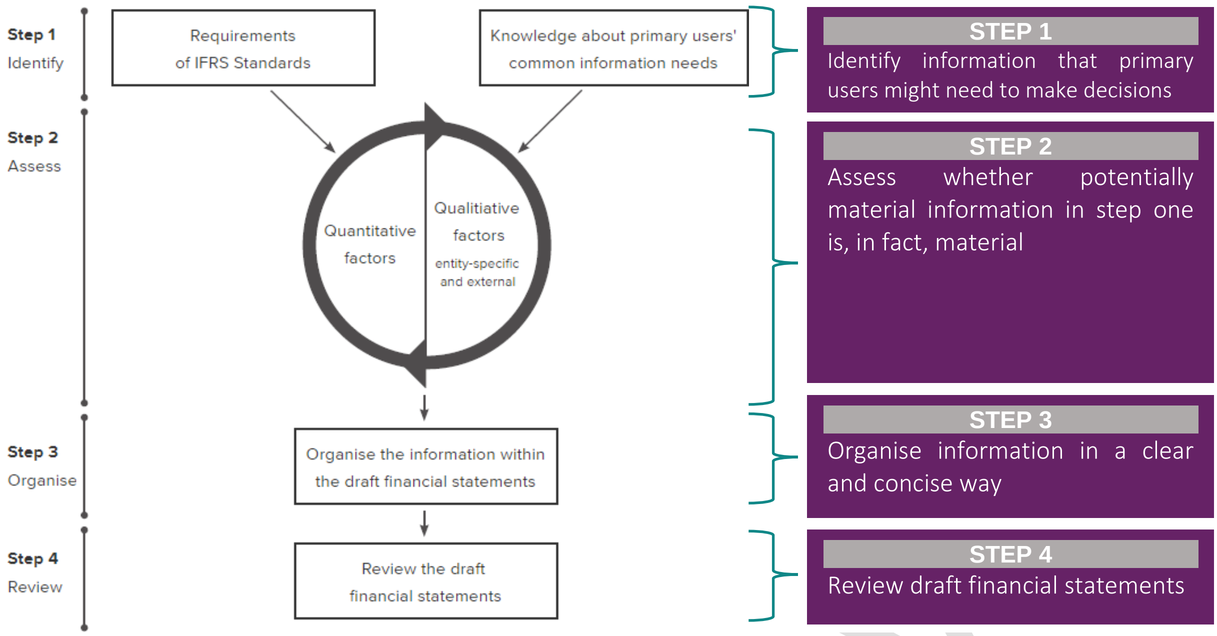


***Diagram 6: Extract from IFRS Practice Statement 2* Making Materiality Judgements**

18 Interaction of materiality with laws and regulations

18.1 To state compliance with the MCS, a department must comply with the requirements in the Standards, including requirements related to materiality. Therefore, a department cannot provide less information than the information required in the MCS, even if laws and regulations permit otherwise.

18.2 Where legislation requires certain information to be disclosed, a department may not be in a position to apply its materiality considerations to that information. Departments will need to analyse the specific requirements of legislation to establish whether applying the concept of materiality is appropriate. Generally, if required by laws and regulations, departments include disclosures that are additional to the MCS requirements, regardless of their materiality.

Example: Providing additional information in the financial statements that is not required by the MCS

Background

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

Application

The PFMA requires departments to include particulars of any unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, that occurred during the financial year in the financial statements. To comply with the legislative requirement, a department is required to disclose these amounts in the financial statements, even though the information is not required by and / or not material in terms of the MCS. The PFMA requirement makes the information material.

19 Impact of publicly available information

19.1 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 a department operates in, its peers and the state of the economy, the department's press releases as well as other documents the department has published.

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

19.3 Moreover, public availability of information does not relieve a department of the obligation to provide material information in its financial statements.

Example: Providing additional information in the financial statements that is not required by the MCS

Background

A proclamation stating transfer of Function X from Department A to Department B was issued and Function X was transferred to Department B in the current reporting period. On the acquisition date, Department 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, Department B first considered the disclosure requirements in the MCS Chapter 19 on *Transfer of Functions*. MCS Chapter 19 on *Transfer of Functions* requires a department to disclose a reference to the proclamation or declaration giving effect to the transfer or receipt of functions.

Department B concludes that information about the transfer of functions is material because the acquisition is expected to have a significant impact on the department'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 department needs to provide the information in its financial statements as it could reasonably be expected to influence decisions made by the primary users of Department B's financial statements.

20 Prior period information

20.1 A department assesses and applies materiality on the complete set of financial statements, including prior period information provided in the financial statements.

20.2 Except when the MCS 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. A department 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 [paragraph .30 of the MCS Chapter 3 on *Financial Statement Presentation*]. This translates into a department presenting 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.

20.3 Assessing whether prior period information is material to the current period financial statements might lead a department to provide more prior period information than was provided in the prior period financial statements.

20.4 A department 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 department to provide prior period information in addition to the minimum comparative information required by the MCS. Where additional information is included, such additional information should be prepared in accordance with the MCS and should not obscure material information. To ensure compliance with the Standards, a department cannot provide less information than required by the Standards, if material, even if laws and regulations permit otherwise.

Prior period information not previously provided

20.5 A department must provide prior period information needed to understand the current period financial statements, 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: Prior period information not previously provided

Background

In the prior period, a department assessed impairment on a category of receivables. Information about impairment on these receivables was appropriately assessed as immaterial in the prior period, and so the department did not disclose the impairment.

In the current period, the receivables in this category increased significantly. On assessing impairment, the department concluded that impairment in the current year was material and disclosed it, in the current period financial statements.

Application

Although, impairment on this category of receivables was not presented in the prior year's financial statements, the department concluded that including a prior period impairment on these receivables in the financial statements would be necessary for primary users to understand the change in trend from low to high receivables of this category in the current period financial statements. In these circumstances, a narrative description of the impairment of the prior period receivables of this category might be sufficient.

Summarising prior period information

20.6 Except to the extent required to comply with laws or regulations affecting the preparation of financial statements or their audit, a department 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: Summarising prior period information

Background

A department disclosed, in the prior period financial statements, details of a legal dispute which led to the recording, in that period, of a provision. In accordance with the MCS Chapter on *Provisions and Contingents* the department 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 recorded in the financial statements by the department. The department 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 MCS, the department 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.

Reference

IASB issued a non-binding IFRS Practice Statement 2 Making Materiality Judgements *(Requires registration according to IASB terms and conditions to access)*

21 Assessing errors

21.1 The MCS defines the prior period errors as follows:

> ***Prior period errors*** *are* ***omissions*** *from, and* ***misstatements*** *in, the department'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.*

21.2 Errors may affect the narrative descriptions disclosed in the notes as well as amounts presented in the financial statements and notes.

21.3 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. A department assesses whether an error is material. This assessment also involves both quantitative and qualitative considerations. The department also considers whether any identified errors are material on a collective basis.

Material errors

21.4 To ensure compliance with the MCS, a department must correct all material errors. A department should refer to MCS Chapter 4 on *Accounting Policies, Estimates and Errors* for guidance on how to correct an error.

Immaterial errors

21.5 A department 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.

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

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

21.8 The **netting** of errors is inappropriate. If an error is individually assessed as material, the existence of other errors that may affect the department'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.

Cumulative errors

21.9 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.

21.10 In **subsequent reporting periods**, a department 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 department 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 considered in the preparation of those financial statements.

21.11 A department must **correct cumulative errors** if they have become material to the current reporting period's financial statements in accordance with MCS Chapter 4 on *Accounting Policies, Estimates and Errors* guidance on how to correct an error.

21.12 6.41 When assessing whether a cumulative error has become material to the **current reporting period's financial statements**, a department considers whether, in the current period:

(a) the department'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: Assessing cumulative errors in the current period

Background

Three years ago, the department created a new category of receivables resulting from the department's new revenue stream. The department recognised the receivables but did not record any impairment on these receivables (cumulative error). In each prior period, the department assessed the error of not impairing these receivables 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 department started impairing the receivables of this category as the unfavourable economic-conditions led to a significant decrease in repayment of receivables.

Application

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

In this scenario, the department 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 department must apply the requirements in MCS Chapter 4 on *Accounting Policies, Estimates and Errors* to correct it.

22 GRAP Guideline on the Application of Materiality to Financial Statements versus the MCS Guideline on Materiality

Accounting policies

22.1 Although in both the GRAP and the MCS environments accounting policies are developed in alignment with the relevant framework, in a GRAP environment entities develop accounting policies whereas in an MCS environment, accounting policies are specified by the National Treasury and included in the AFS Specimen or AFS template; a prescribed format or boilerplate of the financial statements. A department shall change an accounting policy only if the change is required by the Standard. Therefore, in this guide it is specified that departments consider materiality when **applying** accounting policies contrasted with GRAP consideration of materiality when **developing** accounting policies.

Funding

22.2 GRAP entities may be mandated to raise fees charged for goods and services provided, recognise and utilise the fees collected. Department may also charge fees for goods and services. However, in terms of the PFMA, generally fees collected by a department must be paid into the relevant revenue fund and may not be utilised.

Reference

PFMA, 1999
13. Deposits into National Revenue Fund.—(1) All money received by the national government must be paid into the National Revenue Fund, except money received by—
…
(e) the national government from donor agencies which in terms of legislation or the agreement with the donor, must be paid to the Reconstruction and Development Programme Fund;
(f) a national department—
(i) operating a trading department, if the money is received in the ordinary course of operating the trading department;
(ii) in trust for a specific person or category of persons or for a specific purpose;
(iii) from another department to render an agency service for that department; or
(iv) if the money is of a kind described in Schedule 4

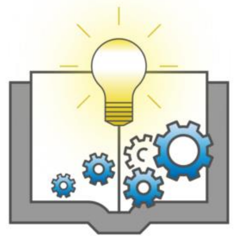
Paragraph 22 relating to provinces is similar to paragraph 13:

22. Deposits into Provincial Revenue Funds.—(1) All money received by a provincial government, including the province's equitable share, and grants made to it, in terms of the annual Division of Revenue Act, must be paid into the province's Provincial Revenue Fund, except money received by—

	…

Surplus at the end of the reporting period

22.3 Public entities may request to retain a surplus at the end of the reporting date whereas departments are required to surrender surplus for the financial year to the relevant revenue fund. Examples included in these departmental guidelines exclude retention of surplus as this is generally not permissible[1] for departments.

	**Reference** **PFMA, 1999** **15.8 Surrender of voted surplus funds** 15.8.1 At the end of each financial year, and after the books of account of a department have been closed, the accounting officer must surrender to the relevant treasury any unexpended voted money, for redepositing into the Exchequer bank account of the relevant revenue fund.

Related party transactions

22.4 MCS disclosure requirements on related party transaction shave been curtailed as Departments currently do not have adequate systems to identify all related party transactions as defined in a GRAP environment. According to the MCS Chapter 15 on Related Party Disclosures, a department shall disclose transactions, balances and nature of relationship with related parties falling under the Minister / MEC's portfolio. Therefore, reference to related parties in the GRAP Guidelines on Materiality was considered and, where relevant, amended to make it MCS appropriate.

Organising information

22.5 GRAP Guideline on materiality requires entities to 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.

22.6 National Treasury annually considers various factors such as departments' readiness, systems capacity before introducing additional accrual concepts in the MCS. Thus, this validates the need by the National Treasury to prepare boilerplate templates in a form of AFS Specimen and AFS Excel Template for efficiency and to increase standardisation in the structure in the MCS environment. These boilerplates are exposed for comments by users annually to ensure the circumstances of all departments are catered for. The boilerplates are used for consolidation purposes as well.

Interaction of materiality with laws and regulations

22.7 Reporting provisions of legislation are applicable to departments only, public entities only or to both departments and public entities. For example, there is a specific provision for public entities to inform the relevant treasury about acquisition or disposal of a significant asset. Public entities are obligated to consider these provisions and related legislation in determining materiality while departments are not.

[1] Except when it is permitted in law or in the case of aid assistance, when provided for in the technical assistance agreement.

Reference

PFMA, 1999
Paragraph 54(2) relating to information to be submitted by accounting authorities

54. Information to be submitted by accounting authorities
(2) Before a public entity concludes any of the following transactions, the accounting authority for the public entity must promptly and in writing inform the relevant treasury of the transaction and submit relevant particulars of the transaction to its executive authority for approval of the transaction:
(*a*) establishment or participation in the establishment of a company;
(*b*) participation in a significant partnership, trust, unincorporated joint venture or similar arrangement;
(*c*) acquisition or disposal of a significant shareholding in a company;
(*d*) acquisition or disposal of a significant asset;
(*e*) commencement or cessation of a significant business activity; and
(*f*) a significant change in the nature or extent of its interest in a significant partnership, trust, unincorporated joint venture or similar arrangement.

Comparative information

22.8 Although GRAP 1 on *Presentation of Financial Statements* has additional paragraphs relating to comparative information, the essence of presenting and disclosing comparative information in the MCS Chapter 3 on *Financial Statement Presentation* and GRAP environment are consistent. For example, additional paragraph .45 on comparative information in GRAP 1 states that "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." This paragraph is not included in MCS Chapter 3. However, exclusion of the paragraph does not eliminate the comparative information requirement.

Examples

22.9 A number of examples, such as an example on **Prior period information not previously provided**, have been amended to ensure they are MCS-relevant.

23 References

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