STAFF QUESTIONS AND ANSWERS

June 2017

THE APPLICATION OF THE CONCEPT OF MATERIALITY TO THE PREPARATION OF FINANCIAL STATEMENTS

This Questions & Answers (Q&A) publication is issued by the staff of the International Public Sector Accounting Standards Board® (IPSASB®) to highlight the provisions contained in International Public Sector Accounting Standards® (IPSAS®) regarding the application of the concept of materiality to the preparation of financial statements.

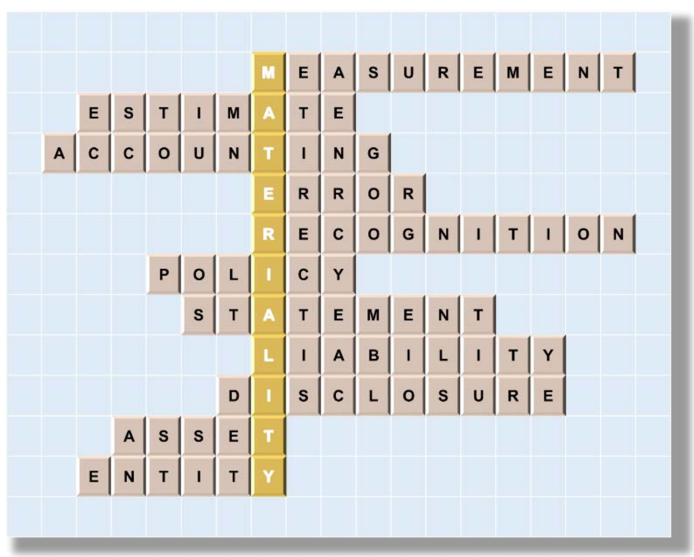
This document summarizes the accounting requirements regarding materiality in the IPSASB's existing literature.

This publication does not constitute an authoritative pronouncement of the IPSASB or an interpretation of one or more authoritative pronouncements of the IPSASB. It does not amend, or override the requirements of existing IPSASs or provide further implementation guidance. This publication is not meant to be exhaustive and this Q&A is not a substitute for reading the relevant Standards.

Background

Individual IPSAS include requirements for the recognition, measurement, presentation and disclosure of various items. However, IPSAS also include overarching provisions regarding materiality, which are applied when preparing financial statements.

Put simply, the concept of materiality means that specific accounting requirements can be disregarded for insignificant matters. However, these specific accounting requirements must be followed in full for important matters. Determining whether a matter is insignificant or not depends on a number of factors–the nature of the matter or item; its size; and the particular circumstances of each entity. Materiality applies to items individually and collectively.



The IPSASB does not have an interpretations capability. However, IPSASB staff have recently received a number of queries related to the application of the concept of materiality to the preparation of financial statements. The IPSASB staff therefore considered it appropriate to provide their views on such issues in the form of a short Questions and Answers (Q & A) document.

This document has been prepared by IPSASB staff. It is a non-authoritative document issued for information purposes only.

IPSASB

Questions and Answers

Q1. How is materiality defined in IPSAS?

IPSAS 1, *Presentation of Financial Statements*, defines "material" 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 and size of the omission or misstatement judged in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor."[1]

IPSAS 1 also notes that assessing materiality requires an understanding of the users of an entity's financial statements, and the knowledge they are expected to possess:

"Assessing whether an omission or misstatement could influence decisions of users, and so be material, requires consideration of the characteristics of those users. Users are assumed to have a reasonable knowledge of the public sector and economic activities and accounting, and a willingness to study the information with reasonable diligence. Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making and evaluating decisions."[2]

The IPSASB further considered materiality when it developed its Conceptual Framework[3]:

"3.32 Information is material if its omission or misstatement could influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's GPFRs[4] prepared for that reporting period. Materiality depends on both the nature and amount of the item judged in the particular circumstances of each entity. GPFRs may encompass qualitative and quantitative information about service delivery achievements during the reporting period, and expectations about service delivery and financial outcomes in the future. Consequently, it is not possible to specify a uniform quantitative threshold at which a particular type of information becomes material.

3.33 Assessments of materiality will be 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. Disclosure of information about compliance or non-compliance with legislation, regulation or other authority may be material because of its nature—irrespective of the magnitude of any amounts involved. In determining whether an item is material in these circumstances, consideration will be given to such matters as the nature, legality, sensitivity and consequences of past or anticipated transactions and events, the parties involved in any such transactions and the circumstances giving rise to them."

1 IPSAS 1, paragraph 7

2 IPSAS 1, paragraph 13

3 The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

4 General Purpose Financial Reports

It follows that preparers will need to exercise professional judgment in weighing all the relevant factors to determine whether information is material or not.

Q2. Do I have to follow the recognition and measurement requirements of IPSAS in all cases?

No. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, states that:

"IPSASs set out accounting policies that the IPSASB has concluded result in financial statements containing relevant and reliable information about the transactions, other events, and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial. However, it is inappropriate to make, or leave uncorrected, immaterial departures from IPSASs to achieve a particular presentation of an entity's financial position, financial performance, or cash flows."[5]

These requirements in IPSAS 3 establish an overarching principle that the requirements of any IPSAS are subject to considerations of materiality.

Consequently, entities need not apply the accounting policies set out in an individual IPSAS regarding recognition and measurement, but may instead apply an alternative accounting policy, provided that:

- The difference between applying the two policies is immaterial; and
- The reason for applying the alternative policy is not to achieve a particular result.

In determining whether IPSAS 3 permits the application of an alternative accounting policy, an entity will need to exercise professional judgment, as discussed in the answer to question 1 above.

Q3. Do I have to include all the disclosures required by IPSAS?

No. IPSAS 1 states that:

"Applying the concept of materiality means that a specific disclosure requirement in an IPSAS need not be satisfied if the information is not material."[6]

In determining whether IPSAS 1 permits an entity to omit a specific disclosure required by an IPSAS, the entity will need to exercise professional judgment. In making this assessment, an entity should consider whether including a large number of disclosures about immaterial matters distracts attention from important disclosures and undermines understandability. An entity should also consider whether the overall effect of omitting these disclosures would be to obscure information.

Materiality also extends to the presentation of the financial statements. IPSAS 1 states that:

"… If a line item is not individually material, it is aggregated with other items either on the face of those statements or in the notes. An item that is not sufficiently material to warrant separate presentation on the face of those statements may nevertheless be sufficiently material for it to be presented separately in the notes."[7]

---

[5] IPSAS 3, paragraph 10

[6] IPSAS 1, paragraph 47

[7] IPSAS 1, paragraph 46

Once more, the exercise of professional judgment is required to determine whether:

- An item is sufficiently material to warrant separate presentation on the face of the statements; and if not
- Whether it is sufficiently material for it to be presented separately in the notes.

Q4. Where can I find more information about materiality?

The International Accounting Standards Board (IASB) has an active project to develop a materiality practice statement. The aim of the project is to "help preparers, auditors and regulators to use judgement when applying the concept of materiality." Materiality is one component of the IASB's Disclosure Initiative. You can follow the progress of this project on the IASB's web site. Information about the other Disclosure Initiative projects can be accessed from the Work Plan page of the IASB's web site.

The International Standards on Auditing (ISA), issued by the International Auditing and Assurance Standards Board (IAASB), also provide guidance on materiality. In particular, ISA 450, *Evaluation of Misstatements Identified during the Audit*, explains how materiality is applied in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements. ISA are available from the IAASB's web site.

The International Organisation of Supreme Audit Institutions (INTOSAI) issues the International Standards of Supreme Audit Institutions (ISSAI). ISSAI include practice notes that provide guidance on applying ISA in public sector audits. ISSAI are available from the ISSAI web site.

Key Contacts

Paul Mason, IPSASB Principal (paulmason@ipsasb.org)
Ross Smith, IPSASB Deputy Director (rosssmith@ipsasb.org)
John Stanford, IPSASB Technical Director (johnstanford@ipsasb.org)

Published by: International Federation of Accountants®

IPSASB
International Public
Sector Accounting
Standards Board®

529 Fifth Avenue, 6th Floor, New York, NY 10017
T + 1 (212) 286-9344 **F** +1 (212) 286-9570
www.ipsasb.org