## Tool 7 example: Materiality assessment paper

**Materiality assessment for [Entity name] 202X-2X financial statements disclosures**

**Purpose**

The purpose of this position paper is to document the materiality policy and thresholds to be used in the preparation of the [Entity name] 202X-2X annual financial statements. The materiality thresholds will be used to support management decisions in relation to information disclosure in the 202X-2X financial statements and identification of major variances for further investigation. Any audit differences will continue to be worked through with the OAG on a case-by-case basis.

This document should be reviewed annually and updated where necessary to account for any changes in funding, thresholds, legislation and guiding rules for the entity’s assessment of materiality in its financial statements.

**[Entity’s name] position**

[Entity’s name] considers the appropriate materiality threshold for the 202X-2X financial statements information disclosure to be X% of total expenses. This results in a materiality threshold of $X million. Refer to Attachment A for 202X-2X materiality assessment.

In addition to applying materiality thresholds, [entity’s name] will also apply professional judgement and consider relevance for users of its financial statements when assessing items for disclosure. This may result in information disclosed that may not be numerically material but by nature may assist users to understand the underlying business transactions. Application of professional judgement may result in disclosures for material items not being equal in terms of size and detail.

This materiality assessment applies to the 202X-2X financial statements. [Entity’s Name] will undertake an annual review of materiality and adjust where necessary.

[Entity’s Name] will not apply materiality assessment against disclosures which are material by nature such as appropriations and special purpose accounts, and mandatory requirements under the Australian Accounting Standards (AAS), the *Financial Management Act 2006* (FM Act), Treasurer’s instructions, *Local Government Act 1995* (LG Act) and Local Government Regulations (LG Regs) and other authoritative requirements.

**Background**

Sections 61 and 62 of the FM Act requires State entities to prepare financial statements in accordance with AAS and TIs. AAS and TIs require that entities’ financial statements are based on proper accounts and records to present fairly the financial transactions for the reporting period. Similarly, section 6.4 of LG Act require the financial statements to be based on proper accounts and records to present fairly the financial position and the results of operations for the reporting period and compliance with the LG Act to the extent they are not inconsistent with AAS. Furthermore, the AAS require that materiality must be assessed by entities in determining disclosure requirements noting that the TIs require the application of materiality.

For 202X-2X financial statements, [entity’s name] is aiming to improve the usefulness and readability to users by simplifying disclosures and reducing unnecessary clutter. In revising the disclosures, the entity has also considered the materiality of information in addition to compliance with AAS and the TIs.

**Defining materiality**

Materiality can be difficult to define as it is based on both quantitative and qualitative factors, with the latter requiring more judgement. Some useful guidance is contained in AASB 101 *Presentation of Financial Statements* and in AASB Practice Statement 2 *Making Materiality Judgements*.

As per AASB 101.7, materiality is defined as: *‘Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity’.*

The entity needs to assess how users of financial statements (with a reasonable knowledge of business and economic activities) could reasonably be expected to be influenced in making economic decisions (AASB 101.7).

Finally, AASB 108.8 highlights the need to balance AAS requirements with materiality assessments. Whilst it is appropriate to not apply some accounting policies where the effect is immaterial, *‘it is inappropriate to make, or leave uncorrected, immaterial departures from the AAS to achieve a particular presentation of an entity’s financial position, financial performance or cash flows’.*

**Setting the materiality threshold for 202X-2X**

The OAG sets an audit materiality threshold for each entity in accordance with the auditing standards made by the Australian Auditing and Assurance Board. These materiality levels are expected to be conservative and are not generally shared with audit clients. Whilst [entity’s name] does not have access to the OAG adopted materiality threshold, it is prudent to define materiality in [entity’s name] financial statements.

The entity-defined materiality threshold for information disclosure which is calculated as X% of 202X-2X total expenditure is consistent with the AAS (refer Attachment A). This judgement is guided by consideration of the impact the omission, misstatement or non-disclosure has individually or collectively on the discharge of accountability by the accountable authority and discussion with the auditors and the audit committee.

**Specific line item considerations**

In applying the above levels, [entity’s name] will remain mindful of any qualitative factors impacting on its materiality assessment - in particular whether the nature of the particular item causes it to be material even though it would be judged immaterial on the basis of the amount involved.

For other required disclosures, tolerance levels for misstatements at an individual line item needs to be assessed by [entity’s name] on a case-by-case basis with regard to the inherent risk, effectiveness of internal controls, volume and quantum of errors expected and degree of subjectivity underpinning the measurement of the account balance.

While the materiality threshold is set at X% due to the impracticality in setting a single materiality level for individual line items, individual line items may also be considered in the context of other appropriate measurement bases. An appropriate measurement base could be all items in the financial statements, relative items, or classes of items. For example:

1. balance sheet items could be assessed relative to the appropriate asset or liability base
2. cash flow items could be assessed against the net cash flow for operating, investing or financing activities
3. statement of comprehensive income items could be assessed against relative net revenue and net expense figures.

**Budgetary reporting**

AASB 1055 *Budgetary Reporting* does not define a major variance or provide any specific guidance on what would constitute a major variance. However, TI 945 *Explanatory Statement* provides guidance to State entities subject to the FM Act. AASB 1055.15 states that explanations of major variances are: ‘*…those relevant to an assessment of the discharge of accountability and to an analysis of performance…, not merely focusing on the numerical differences between original budget and actual amounts. They include high-level explanations of the causes of major variances rather than merely the nature of the variances’.*

[Entity’s name] has considered the requirements of AASB 1055 and TI 945 in addition to exercising judgement in adopting the materiality thresholds for budgetary reporting purposes.

**Attachment A – Materiality assessment for 202X-2X**

[Entity’s name] has performed calculations for materiality on the following balances derived from actual total expenditure.

Expenses – based on expenses included in net cost of services/total expenses.

Assets – includes all financial and non-financial assets balances.

Liabilities – includes all payables and provisions.

[The following tables are examples only. If these are used as a basis for preparing an   
entity- specific position paper they should reflect the relevant base amounts for the entity.]

|  |  |  |
| --- | --- | --- |
| **State entity/LG entity** |  |  |
| **Major category** | **202X-2X actual expenditure $’000** | **0.5 to 2% materiality threshold $’000** |
| Expenses | 550,000 | 2,750 to 11,000 |
| Assets | 1,000,000 | 5,000 to 20,000 |
| Liabilities | 700,000 | 3,500 to 14,000 |

**Recalculation using prior-year financial statements actuals**

These materiality levels are reasonably consistent when compared with a calculation based on the prior financial statements for 202X-2X using X% of actual total expenditure which yielded similar results.

|  |  |  |
| --- | --- | --- |
| **State entity/LG entity** |  |  |
| **Major category** | **202X-2X actuals $’000** | **0.5 to 2% materiality threshold $’000** |
| Expenses | 563,125 | 2,816 to 11,263 |
| Assets | 956,000 | 4,780 to 19,120 |
| Liabilities | 697,740 | 3,489 to 13,955 |