Directive on Accounting Standards: GC 1010 Financial Statement Concepts (Materiality)

Note to reader

This document is part of the Appendix A of the Directive on Accounting Standards.

A. Primary PSAS references

PS 1000 Financial statement concepts

PS 1201 Financial statement presentation

B. Effective date

April 1, 2017

C. Government of Canada Consolidated Financial Statements

1. Materiality is a matter of professional judgment in the particular circumstances. Materiality may be judged in relation to the

reasonable prospect of its significance in the making of assessments and judgments by the users of financial statements. A material item would be expected to affect assessments of and judgments on government financial operations and management (PS 1201.15)

2. There are two basic types of users of financial information: those internal to the organization and users external to the organization. PS 1000.14-.20 discusses external user needs.
3. Internal users include parliamentarians and members of the public service. The list of potential internal uses of financial information is virtually endless. Examples include:
    a. Determining what services can be provided at what cost;
    b. Planning for future funding requirements for asset maintenance and replacement;
    c. Managing cash position and financing requirements; and
    d. Finding ways to deliver services more efficiently.
4. 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. (International Public Sector Accounting Standard (IPSAS) 1.13 – Presentation of Financial Statements)
5. Given this range of users and decisions, it may be difficult to say whether a particular piece of information would influence a decision. This would suggest that all financial information be recorded and reported in excessive detail. However, excessive detail would make

most financial reports too confusing and cumbersome for users. Properly applying the concept of materiality ensures that sufficient and appropriate information is presented in such a manner as to assist the user in the decision-making process.

D. Materiality requirements

6. There are two aspects that should be considered when applying materiality:
    a. **Quantitative materiality**: Determining materiality involves the exercise of professional judgement. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark in the Government of Canada include: the elements of the financial statements (assets, liabilities, revenue, expenses) and whether there are items on which the attention of the users of the particular entity's financial statements tend to focus (Canadian Auditing Standard (CAS) 320, paragraph A4). In general, quantitative materiality is defined as 0.5% to 2% of total expenses, unless there is a clear metric which is more relevant. This threshold is applied to the aggregate of all errors and misstatements, not on an individual item basis.
    b. **Qualitative materiality**: The qualitative aspect recognizes that materiality cannot be determined solely by means of the application of a numeric threshold. There are many instances, beyond consideration of influence in decision-making, where an item may be material even though it is

below a quantitative threshold. Qualitative considerations include but are not limited to:

i. Deviations from accounting policies - materiality is not a reason to disregard the rules;
ii. Potential effect of a misstatement on trends and their analysis by users;
iii. Whether the misstatement affects determination of an entity's compliance with legislation, regulations, etc.;
iv. Nature of the misstatement - does it arise from an item that can be accurately and objectively measured, or arise from the subjectivity of estimated amounts;
v. Potential of offsetting effects of individually material misstatements;
vi. An amount that is immaterial now, but may become material in future with accumulation over several periods;
vii. Motivation – for instance, using materiality to manage financial reporting results, continuing unwillingness to correct known weaknesses in the financial reporting process, etc.; and
viii. Misstatement on segment information.

E. Application of materiality

7. Materiality is an important element in designing the accounting policies and practices of a department or agency. Materiality should be an opportunity for departments to apply accounting policies

taking into consideration administrative ease in the handling of certain types of transactions. However, this must be done within the overall materiality limits and without deviating from the recommendations of PSAS, the Directive on Accounting Standards (DAS) or the Government of Canada Accounting Handbook (GCAH).

8. Departmental accounting policies should be established in a way that ensures there is no material deviation from generally accepted accounting principles, as non-adherence could negatively impact the accuracy of the financial statements.
9. It is important to note that although a transaction in itself may not be material, the summation of a number of transactions may have a material impact on the financial statements.
10. Professional judgment is required when determining an appropriate threshold for materiality. However, it is recommended that the quantitative departmental materiality threshold be towards the lower end of the range mentioned above; near 0.5%.
11. With very few exceptions, the concept of materiality does not apply in recording and reporting on appropriations usage; all amounts are important.

F. Departmental Financial Statements

12. Applies without additional policy choices or interpretation for Departmental Financial Statements.

G. Other related references

PS 2100 Disclosure of accounting policies [1]

CAS 320 Materiality in planning and performing an audit [1]

IPSAS 1 Presentation of Financial Statements

Footnotes

1 Please note that a CPA Canada membership or annual subscription is necessary to access this content.

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