New Zealand Society of Accountants

STATEMENT OF STANDARD
ACCOUNTING PRACTICE NO. 6
Revised 1985

MATERIALITY IN FINANCIAL STATEMENTS

Issued by the Council, New Zealand Society of Accountants

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This Statement should be read in the context of
the Explanatory Foreword to Statements of Standard Accounting Practice

1 INTRODUCTION

1.1 The purpose of this Statement is to establish criteria for applying the materiality test to information for inclusion in the external financial statements of any reporting entity.

2 APPLICATION

2.1 The standards in this Statement apply to all external financial statements.

2.2 This Statement of Standard Accounting Practice becomes operative for financial statements covering periods beginning on or after 1 April 1985.

3 DEFINITION

3.1 *Material.* A statement, fact, or item is material if, given full consideration of the surrounding circumstances at the time of completion of the financial statements, it is of such a nature that its disclosure, or the method of treating it, would be likely to influence the making of decisions by the users of the financial statements.

4 DISCUSSION

4.1 Accounting, as a process of measurement and communication, frequently involves judgements. In making these judgements, considerations of materiality play an essential part.

4.2 The following are examples of issues which have to be settled by reference to materiality —

(a) the separate disclosure of an item;

(b) the disclosure of the particular accounting method adopted;

(c) the disclosure of the fact, and the financial effect, of a change in accounting method;

(d) the disclosure of the fact, and the financial effect, of a departure from an accounting standard;

(e) whether an error in the accounting records, detected prior to completion of the financial statements, should be corrected and such statements consequently be amended, or whether the correction be left until after completion of the statements.

4.3 The test of materiality calls for consideration as to the likely users of the particular financial statements, and as to the information needs of those users. The information presented in financial statements may be used by various and often quite different classes of persons, each class having its own particular interest in the reporting entity.

4.4 In deciding whether an item is material, its nature and its amount usually need to be evaluated together. It may be necessary to treat as material an item which on the basis of the amount involved would otherwise have to be judged immaterial, for instance, where the effect of a change in accounting method in the current period is negligible, but is expected to affect materially the results of future periods.

4.5 Requirements as to the form or content of financial statements in statutes or in any regulations, rules or agreements binding upon the reporting entity, must be considered to override considerations of materiality except to the extent that such requirements themselves refer to the criterion of materiality.

5 STANDARD ACCOUNTING PRACTICE

Materiality in Financial Statements

The Standard set out in the following paragraphs should be read in the context of the foregoing paragraphs of this Statement and the Explanatory Foreword issued by the Council of the New Zealand Society of Accountants.

5.1 Subject to compliance with statutory or other requirements binding upon the reporting entity, financial statements should be prepared having regard to the materiality of the information to be given.

5.2 In deciding whether an item is material, its nature and its amount should both be taken into account. Ordinarily, the nature and the amount of an item should be evaluated together, although in particular circumstances either alone may have to be recognised as the decisive factor.

5.3 For the purpose of determining whether an amount is material —

(a) items of the same or a similar category should be considered in aggregate;

(b) profit and loss statement items for which separate disclosure is not made may be aggregated even though they are dissimilar.

5.4 When considering the materiality of an item, its amount should be compared with an appropriate base amount.

5.5 In applying the materiality test, the following should also be considered —

(a) the purpose of the financial statements in question;

(b) the identity, and the information needs, of the users of those statements; and

(c) the obligations of the reporting entity.

APPENDIX

Note: This Appendix is included for illustrative purposes only and does not form part of the Standard in this Statement.

Criteria to Assist in Determining Materiality

Determining materiality of an item is essentially a matter of judgement. In making that judgement the following comparisons might be made where applicable:

(a) Profit and loss statement items (including extraordinary items) could be compared with the pre-tax profit before extraordinary items for the current year or the average pre-tax profit for the last, say, three years (including the current year), whichever is the more relevant measure of profit having regard to the trend of the business over that period. Where the tax charge is not fully equal to a charge at current tax rates on pre-tax profits, or an item being considered for adjustment is not tax deductible, it may be more appropriate to evaluate the materiality of the item based on the after tax profits.

(b) Balance sheet items could be compared with the lower of:

  (i) total share capital and reserves, and

  (ii) the appropriate balance sheet class total, for example, current assets, non-current assets, current liabilities, non-current liabilities.

(c) Where an item is subject to comparison with the base amounts in both (a) and (b) above, the more stringent test should prevail.

To assist in practical situations the following percentage limits are suggested as guidelines:

(a) A variation in amount which is equal to or greater than 10 percent of the appropriate base amount, could be presumed to be material unless there is evidence to the contrary.

(b) A variation in amount which is equal to or less than 5 percent of the appropriate base amount could be presumed to be immaterial, unless there is evidence to the contrary.

(c) Whether or not a variation which lies between 5 percent and 10 percent of the appropriate base amount could be material is a matter of judgement and depends upon the particular circumstances of the case.

In providing these percentage limits it must be stressed that percentages are not “magic numbers”, and all circumstances surrounding the items, the reporting entity, and the users should be taken into account.