Departmental Financial Reporting Framework Guide

THE FINANCIAL REPORTING FRAMEWORK AND THE PREPARATION PROCESS

Chapter 1

For the year ended 31 March 2012
Chapter 1 - The Reporting Framework and the Preparation Process

Contents

1. Financial Reporting Framework ........................................................................................................ 3
   1.1 Introduction .................................................................................................................................. 3
   1.2 Legislation and the reporting framework ...................................................................................... 3
   1.3 Users of financial statements ......................................................................................................... 5
   1.4 Qualitative characteristics and fair presentation ........................................................................... 6
      1.4.1 Understandability ...................................................................................................................... 6
      1.4.2 Relevance .................................................................................................................................. 6
      1.4.3 Reliability .................................................................................................................................. 6
      1.4.4 Comparability ............................................................................................................................ 6
   1.5 The annual financial statements and the economic reporting format .............................................. 7

2. Financial statement preparation ........................................................................................................... 8
   2.1 Roles and responsibilities ............................................................................................................... 8
      2.1.1 Accounting Officer and Chief Financial Officer ..................................................................... 8
   2.2 Management assertions ................................................................................................................... 10
   2.3 Order of reports included in the financial statements section of the annual report .................... 12
   2.4 Key submission dates and responsibilities ..................................................................................... 13
   2.5 Planning for the preparation of the financial statements ............................................................... 14
   2.6 Materiality ....................................................................................................................................... 15

ANNEXURE A: Information to be submitted to relevant role players in the accountability cycle .............................................................................................................................................. 18

ANNEXURE B: Critical success factors for the preparation of financial statements ......................... 23

ANNEXURE C: Amendments made to chapter ......................................................................................... 25
1. Financial Reporting Framework

1.1 Introduction

The purpose of the financial statements is to present a true and fair view of an entity’s financial performance, financial position, changes in net assets and cash flows that is useful to a wide range of users. Financial statements also show the results of the stewardship of management, and the accountability of management for the resources entrusted to it. As such, they are an important means of demonstrating how the public sector meets its financial management responsibilities.

1.2 Legislation and the reporting framework

The Public Finance Management Act (PFMA), No. 1 of 1999, requires departments to “prepare financial statements for each financial year in accordance with generally recognised accounting practice”.

The PFMA was promulgated prior to the establishment of the Accounting Standards Board (ASB), therefore Treasury Regulation 18.2 stipulates that: “In the absence of any implementation dates set for the standards of generally recognised accounting practice issued by the Accounting Standards Board, the following reporting standard comprise generally recognised accounting practice and must be adhered to for the preparation of annual financial statements, unless otherwise approved by the National Treasury:

Departments Annual financial statements must consist of –
(a) a balance sheet (statement of financial position);
(b) a statement of changes in equity;
(c) an income statement (statement of financial performance);
(d) a cash flow statement;
(e) an appropriation statement;
(f) notes to the appropriation statement and annual financial statement; and
(g) such other statements as may be determined by the National Treasury. The statements must be prepared on a modified cash basis in accordance with the formats prescribed by the National Treasury and must be accompanied by the audit opinion of the Auditor-General. The annual financial statements must, by means of figures and a descriptive report, explain any other matters and information material to the affairs of the department.”

The PFMA defines generally recognised accounting practice as: “...an accounting practice complying in material respects with standards issued by the Accounting Standards Board”.

Released April 2011 (Updated October 2011)
Thus, the Treasury Regulations clarified that *generally recognised accounting practice* for departments is prescribed by the National Treasury until the Standards issued by the ASB become effective.

The ASB, in executing its authority, has developed financial reporting standards\(^2\) using the International Public Sector Standards (or IPSAS) as a first point of reference. These IPSASs prescribe the recognition, measurement, presentation and disclosure requirements for entities applying accrual accounting.

The decision to develop the Standards of GRAP using the accrual IPSASs was largely based on the financial management requirements prescribed in the PFMA and the view that accrual information will satisfy more user needs than any other bases of accounting.

As mentioned in the Treasury Regulations, the financial statements of all national and provincial departments are prepared using a modified cash basis of accounting. In the South African public sector the modified cash basis of accounting has been defined as “the cash basis of accounting modified for the recognition of certain near-cash balances\(^3\) and supplemented with disclosures on transactions and balances not recognised in the primary statements”.

The supplementary disclosures are based on the equivalent GRAP after considering the availability and the decision usefulness of the information.

Given that departments are not yet ready to fully implement the Standards of GRAP (and an accrual basis of accounting), the National Treasury, Office of the Accountant-General, prescribes the annual reporting requirements comprising of:

- accounting policies for the recognition and measurement of information in the primary statements (for a modified cash basis of accounting) and the disclosure notes (based on accruals);
- the format for the presentation of the information in the primary statements, the notes and the disclosure notes;
- guidance on the preparation and presentation of the information in the financial statements; and
- guidance on reports such as the report of the Accounting Officer and the Audit Committee.

The first three bullets above form the “Departmental Financial Reporting Framework” while the last item is simply an aid to assist departments in preparing their annual reports.

---

\(^2\) Referred to as the Standards of Generally Recognised Accounting Practice (GRAP)

\(^3\) Near cash balances are receivables and payables and certain financial assets and liabilities.
1.3 Users of financial statements

The Departmental Financial Reporting Framework is based on best practice\(^4\) and ensures compliance with relevant prescripts to support decision making by a wide range of users such as:

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

Financial statements in general are aimed at meeting the information requirements of a wide range of users. The accounting standards are therefore set with this principle in mind. The financial statements of a department are no different. The Departmental Financial Reporting Framework provides information for the above users as far as possible\(^5\) to facilitate oversight and decision making, for example information is provided on:

- the utilisation of appropriated funds;
- the collection of departmental (own) revenue;
- the management of resources as well the resources available to deliver goods and services (such as the capital assets held by a department);
- extent of compliance with the PFMA and other regulations;
- future commitments and or savings (incl. roll-overs);
- how the funds have been used and to what extent funds have been made available to deliver goods and services;
- the effectiveness of the department's cash management and internal control environment; and
- the utilisation of donor funding;

\(^4\) This includes as far as possible the principles and disclosures within the GRAP standards.

\(^5\) Certain information may not be available or complete due to the modified cash basis of accounting applied by departments.
1.4 Qualitative characteristics and fair presentation

To achieve its stated objective, information in the financial statements must have certain qualitative characteristics. These qualitative characteristics are discussed below.

1.4.1 Understandability

The information contained in the financial statements must be understandable to the average user who has a reasonable knowledge of government, the department’s activities and environment, accounting and a willingness to study the information with reasonable diligence.

This does not imply that information should be excluded from the financial statements simply because it may be too complex for certain readers to understand.

1.4.2 Relevance

Relevant information is information that is decision useful and can therefore influence stewardship by helping users to evaluate past, present or future events, or confirming or correcting their past evaluations.

The relevance of information is established by reference to the nature and the materiality of the information concerned.

1.4.3 Reliability

Information is reliable when it does not contain material errors and is free from bias. The users of the financial statements should be able to rely on the information as a faithful representation of the transactions, balances and events that it purports to represent. The term “reliability” does not mean “absolute accuracy” but rather refers to information that the users can trust.

Reliable information will:

- reflect the substance rather than the legal form of the transactions or events;
- be neutral in that it should not present information in a manner to achieve a predetermined result; and
- be complete, within the bounds of materiality and cost.

1.4.4 Comparability

Information should be comparable to enable users to identify trends and to assess performance over time and between similar entities. One of the main reasons for the disclosure of accounting policies in the financial statements is to assist users in comparing the financial statements of different entities.

The application of the above mentioned qualitative characteristics along with the accounting policies contained in the Departmental Financial Reporting Framework should result in financial statements that convey what is generally understood as fair presentation.
Chapter 1- The Reporting Framework and the Preparation Process

It is important to note that the Departmental Financial Reporting Framework sets out the minimum requirements necessary to achieve fair presentation. In some instances management may identify and include information in addition to the minimum requirements. This should be done only after due consideration of the qualitative characteristics and the objective of the financial statements.

A departure (or exemption) from the Departmental Financial Reporting Framework is only permitted if a department is required to do so in terms of law\(^6\). In such instances, the following disclosure should be made in the notes (accounting policies) to the financial statements:

(a) that the department complied with the Financial Reporting Framework in all respects except that it has departed from a particular requirement to achieve fair presentation; and

(b) the accounting policy from which the department has departed, the nature of the departure and the reason for departure

1.5 The annual financial statements and the economic reporting format

On 1 April 2004 the National Treasury introduced the Economic Reporting Format (ERF), which in short is the format for the presentation of departmental budgets. The ERF is based on the principles in the Government Finance Statistics (GFS)\(^7\) with amendments to cater for South African specific circumstances. However, the principle that items should be grouped so that it is possible to calculate economic variables such as government’s contribution to GDP remains.

The receipt and payment categories in the ERF are also used to derive the budget surplus or deficit (an indicator of the government’s ability to sustain its operations). If positive (surplus) the balance shows the extent to which government makes financial resources available to other domestic sectors and the rest of the world. If negative (deficit), it is a measure of the financial resources the government requires from others to finance its activities. Thus the ERF provides meaningful information to parliamentarians, financial practitioners, economic analysts and other users of government financial data.

To avoid unnecessary reclassification, a decision was taken in 2004 to align the formats and the terminology as far as possible between the ERF and the financial statements of departments. As illustrated below, the harmonization of the two classification systems (the ERF and financial statements) has been made possible through the design and implementation of the standard chart of accounts.

\(^6\) Legislation delegates authority to approve departures/exceptions to the Accountant-General.

\(^7\) The GFS is designed to provide economic statistics that enables decision makers and analysts to evaluate and analyse fiscal policy, especially the performance of the general government sector and the broader public sector and country.
The standard chart of accounts\(^8\) comprises the coding of items used for classification, budgeting, recording and reporting of receipts and payments within the financial system. The coding and design of the chart of accounts was done in a manner to facilitate compliance with the budget, in-year and annual financial reporting requirements.

2. **Financial statement preparation**

2.1 **Roles and responsibilities**

2.1.1 **Accounting Officer and Chief Financial Officer**

Effective implementation of the Departmental Reporting Framework requires departments to have in place a range of delegations, policies and procedures that outline the responsibilities within the department for the various elements of the framework. This is primarily the job of the Chief Financial Officer (CFO) who, if delegated by the Accounting Officer, must:

- maintain a close liaison with the accounting officer and all managers;
- respond to changing needs for financial information and advice;
- make a major contribution to the financial aspects of the strategic planning process;
- ensure that internal financial targets and budgets are fully consistent with the strategic plan and any associated agreement with Government;
- manage working capital, assets and liabilities;
- manage the accounting and finance staff;
- pay accounts and collect receipts;
- meet reporting requirements (for example, monthly reports under the PFMA and DoRA, and

\(^8\) Refer to chapter 3 for further guidance on the segments and items within the standard chart of accounts

Released April 2011 (Updated October 2011)
annual financial statements);

- maintain systems of internal control, which comply with internal audit requirements;
- undertake product and service costing tasks

In broad terms, the Accounting Officer is responsible for overall effective, efficient, economical and transparent use of resources. More specifically, the Accounting Officer must ensure that the following are in place:

- an effective, efficient and transparent system of financial and risk management and internal control;
- a system of internal audit, controlled and directed by an audit committee;
- effective and appropriate disciplinary procedures;
- a system for the proper evaluation of all major capital proposals;

In addition to the above, the PFMA prescribes certain reporting responsibilities for the Accounting Officer. These are summarised in the table below:

<table>
<thead>
<tr>
<th>Responsibility</th>
<th>Action required</th>
<th>When</th>
<th>PFMA Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unauthorised and other expenditure</td>
<td>Report, in writing, to the relevant treasury (and tender board in the case of irregular expenditure) particulars of unauthorised, irregular or fruitless and wasteful expenditure</td>
<td>On discovery</td>
<td>S 38(1)(g)</td>
</tr>
</tbody>
</table>
| Undercollection or overexpenditure  | Report to the executive authority and the relevant treasury any impending:  
                                        | - undercollection of revenue  
                                        | - shortfall in budgeted revenue  
                                        | - overspending of the vote or main division | No specific time stipulated | S 39(2)(b)     |
| Financial statements                | Submit financial statements to the Auditor-General and the relevant treasury | Within two months of the end of the year | S 40(1)(c)     |
| Annual reports                      | Submit to the relevant treasury and executive authority:  
                                        | - annual report  
                                        | - audited financial statements  
                                        | - report of the Auditor-General | Within five months of the end of a financial year | S 40(1)(d)     |
| Breakdown per month                 | Provide the relevant treasury with a monthly breakdown of the anticipated revenue and expenditure for the year | Before the beginning of the financial year | S 40(4)(a)     |
| Actual and anticipated figures      | Submit to the relevant treasury revenue and expenditure information for the previous month and the budget for that month | Within 15 days of each month-end | S 40(4)(b)     |
| Projected figures                   | Submit to the relevant treasury and executive authority:  
                                        | - a projection of expenditure and revenue to the year-end | Within 15 days of the end of each month | S 40(4)(c)     |
## 2.2 Management assertions

It is the Accounting Officer that declares whether the financial statements are prepared on the basis of properly maintained financial records and that the statements give a true and fair view of the matters required by the PFMA. In doing so, management implicitly or explicitly makes assertions regarding the recognition, measurement, presentation and disclosure of the various elements in the financial statements and related disclosures. These assertions are outlined below.

### In relation to classes of transactions and events for the period under audit:

<table>
<thead>
<tr>
<th>Assertion</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Occurrence</td>
<td>Transactions and events that have been recorded have occurred and pertain to the department.</td>
</tr>
<tr>
<td>Completeness</td>
<td>All transactions and events that should have been recorded have been recorded.</td>
</tr>
<tr>
<td>Accuracy</td>
<td>Amounts and other data relating to recorded transactions and events have been recorded appropriately.</td>
</tr>
<tr>
<td>Cut-off</td>
<td>Transactions and events have been recorded in the correct accounting period.</td>
</tr>
<tr>
<td>Classification</td>
<td>Transactions and events have been recorded in the proper accounts.</td>
</tr>
</tbody>
</table>
In relation to account balances at period end:

<table>
<thead>
<tr>
<th>Assertion</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Existence</td>
<td>Assets, liabilities, and net assets (where applicable) exist.</td>
</tr>
<tr>
<td>Rights and obligations</td>
<td>The department holds or controls the rights to assets, and liabilities are the obligations of the department.</td>
</tr>
<tr>
<td>Completeness</td>
<td>All assets, liabilities and net assets that should have been recorded have been recorded.</td>
</tr>
<tr>
<td>Valuation and allocation</td>
<td>Assets, liabilities, and net assets are included in the financial report at appropriate amounts and any resulting valuation or allocation adjustments are appropriately disclosed (where required).</td>
</tr>
</tbody>
</table>

In relation to presentation and disclosure:

<table>
<thead>
<tr>
<th>Assertion</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Occurrence and rights and obligations</td>
<td>Disclosed events, transactions, and other matters have occurred and pertain to the department.</td>
</tr>
<tr>
<td>Completeness</td>
<td>All disclosures that should have been included in the financial report have been included.</td>
</tr>
<tr>
<td>Classification and understandability</td>
<td>Financial information is appropriately presented and described, and disclosures are clearly expressed.</td>
</tr>
<tr>
<td>Accuracy and valuation</td>
<td>Financial and other information are disclosed fairly and at appropriate amounts.</td>
</tr>
</tbody>
</table>

The financial statements are viewed as an assembly of assertions by management. Therefore, in order to make these assertions it is important to ensure that the department has a robust system of internal controls.

Internal controls are the systems (manual or electronic), procedures and processes that are implemented to minimise the risk (and any financial consequences) to which the department might otherwise be exposed as a result of fraud, negligence, error, incapacity or other cause.

Good internal controls ensure that the transactions on which financial reports are based are complete, accurate and valid, and include procedures to ensure that:

- transactions are initiated by someone with the authority to do so;
- financial and physical assets are safeguarded from loss, theft and misuse;
- goods and services are paid for only after they have been provided and accepted (unless there is a contractual requirement to prepay);
- entries in the subsidiary and general ledgers are checked for accuracy before and/or after being recorded.

---

9 It is important to note that even though certain balances are not recognised in the POS the management assertions are still appropriate to those year-end balances included in the disclosure notes.
subsidiary systems are regularly reconciled to the general ledger and reviewed by someone not involved in the reconciliation.

The figure below illustrates the interaction between the most common types of errors and management assertions to be considered in the design and implementation of internal controls:

<table>
<thead>
<tr>
<th>Error</th>
<th>Management assertions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recorded but not real</td>
<td>Existence/Occurrence</td>
</tr>
<tr>
<td>Real but not recorded</td>
<td>Completeness</td>
</tr>
<tr>
<td>Wrong amount</td>
<td>Valuation</td>
</tr>
<tr>
<td></td>
<td>Classification</td>
</tr>
<tr>
<td>Classification</td>
<td>Existence/Occurrence</td>
</tr>
<tr>
<td></td>
<td>Completeness</td>
</tr>
<tr>
<td></td>
<td>Valuation</td>
</tr>
<tr>
<td>Cut-off</td>
<td>Existence/Occurrence</td>
</tr>
<tr>
<td></td>
<td>Completeness</td>
</tr>
<tr>
<td></td>
<td>Valuation</td>
</tr>
<tr>
<td>Not authorized</td>
<td>Rights &amp; obligations</td>
</tr>
<tr>
<td></td>
<td>Occurrence</td>
</tr>
</tbody>
</table>

2.3 Order of reports included in the financial statements section of the annual report

The annual financial statements within the annual report of a department comprise of the following reports in ascending order:

1. Report of the Audit Committee
2. Report of the Accounting-Officer(s)
3. Report of the Auditor-General
4. Appropriation Statement
5. Notes to the Appropriation Statement
6. Statement of Financial Performance
7. Statement of Financial Position
8. Statement of Changes in Net Assets
9. Cash Flow Statement
10. Notes to the Financial statements (includes accounting policies and disclosure notes)
11. Unaudited supplementary schedules (Annexures)
2.4 Key submission dates and responsibilities

The PFMA allows departments a two month period after the close of the financial year to prepare the financial information for audit. The reporting timetable is outlined below:

<table>
<thead>
<tr>
<th>Action</th>
<th>PFMA</th>
<th>Date</th>
<th>Resp.</th>
</tr>
</thead>
<tbody>
<tr>
<td>s40(1)(b) (PFMA)</td>
<td>Reporting date</td>
<td>40(1)(b) (see below)</td>
<td>31/03</td>
</tr>
<tr>
<td>s40(1)(c)(i)&amp;(ii)I (PFMA)</td>
<td>Submit approved financial statements and report of the accounting officer to relevant treasury and Auditor-General (for auditing).</td>
<td>40(1)(c)(i)&amp;(ii)I (see below)</td>
<td>31/05 (Final date) (Within 2 months after year-end)</td>
</tr>
<tr>
<td>s40(2) (PFMA)</td>
<td>Auditors must submit Audit report to the Accounting Officer</td>
<td>40(2) (see below)</td>
<td>31/07 (Final date) (Within 2 months of receiving the financial statements)</td>
</tr>
<tr>
<td>s40(1)(d) (PFMA)</td>
<td>Submission of annual report, annual financial statements and audit report to relevant treasury and the executive authority</td>
<td>40(1)(d) (see below)</td>
<td>31/08 (Within 5 months after year-end)</td>
</tr>
<tr>
<td>s65(1)(a) (PFMA)</td>
<td>Executive authority to table in National Assembly or provincial legislature</td>
<td>65(1)(a)</td>
<td>31/08 (Within 1 month after the accounting officer received the audit report) 30/09 (Final date) (Within 6 months of the year end)</td>
</tr>
<tr>
<td></td>
<td>Final date for executive authority to table to relevant legislature without tabling a written explanation on non-tabling Note: N1</td>
<td>65 (2) (see below)</td>
<td></td>
</tr>
<tr>
<td>Announcement, Tabling and Committee report date</td>
<td>No specific deadline</td>
<td>Speaker</td>
<td></td>
</tr>
<tr>
<td>Consideration date (Designated committee)</td>
<td>Internally decided</td>
<td>Parliament</td>
<td></td>
</tr>
</tbody>
</table>

From the aforementioned, it is clear that there is a contradiction between sections 40(2) and 65(1)(a) of the PFMA with regard to the receipt of the audit report by the Accounting Officer, submission to the executive authority and the tabling dates by the executive authority of the annual reports and financial statements. National Treasury has therefore been advising departments, trading entities, constitutional institutions and public entities to submit their annual reports, financial statements and audit reports to the relevant treasuries and to the executive authority by 31 August and for the executive authority to table such in the legislature before 30 September.

N1 As a matter of practice, recognising the role of the Executive in using annual reports as a tool to assess both financial and non-financial performance, it is recommended that all Ministers / MECs also submit their annual reports to Cabinet or provincial Exco, together with a Cabinet memorandum.
Chapter 1 - The Reporting Framework and the Preparation Process

outlining the key performance issues, and corrective steps to be taken for any adverse audit report or poor performance.

This anomalous situation will be addressed in the PFMA Amendment Bill where it is proposed that section 65(1)(a) will be amended to read that the annual reports, financial statements and audit report must be tabled within one month after the executive authority has received the annual report. The information to be submitted to the relevant role players is included in Annexure A.

2.5 Planning for the preparation of the financial statements

Given the strict submission dates described in section 2.4 above it may be beneficial for the department to prepare a plan for the preparation and finalisation of the financial statements (and annual report). The plan should cover:

**What** is to be done?

How is it to be done?

Who is going to do it?

When is it to be done?

Using the information provided in section 2.4 as a base, the plan should include other activities such as the:

- annual asset (and inventory) count including activities for updating and reconciling the asset register;
- commencement and completion of external audit including audit steering committee meetings;
- audit committee meetings and the distribution of information to the audit committee;
- identification and collection of information on commitments and accruals;
- preparation of comparative information (including opening balances);
- year-end reconciliations on control and suspense accounts;
- compilation of working papers and audit file;
- compilation of draft & final financial statements;
- process for correcting errors identified during management review and audit;
- review by management (including internal audit) of the draft financial statements;
- process for identifying related parties and related party transactions requiring disclosure;
- process for identifying events after reporting dates requiring disclosure or adjustments to the financial statements; and
- analysis and response to management letter issued by the AGSA.

Refer to **Annexure B** for indicators for the successful completion of the financial statements
2.6 Materiality

Certain disclosures in the departmental reporting framework are only required if the amount and or event is material. “Materiality” is explained in the Framework for the Preparation and Presentation of Financial Statements (issued by the ASB) in the following terms:

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 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 if it is to be useful.

Given the range of users (see section 1.3 above), it may be difficult to say with any degree of certainty that a particular piece of information would not influence a decision. This would suggest that all financial information be recorded and reported in copious detail. However, too much detail would make the financial statements too confusing for users. Therefore, 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.

An assessment of “what is material” is not only based on the size of the figures in the budget or financial statements of a department but also on other factors such as those described below.

2.6.1 Nature of the activities undertaken by the department

In the public sector, departments are held publically accountable for their performance throughout the year. Materiality levels should be guided by this concept of public accountability as well as the sensitivity of the accounts, activities and functions regarding matters of public interest bearing in mind that the reported information influences the decisions and actions taken by the users.

2.6.2 Statutory requirements

Materiality levels could be influenced by considerations such as the legal and regularity requirements. All the appropriate laws and regulations should therefore be considered.

2.6.3 Risks associated with the activities of the department

The risk of failing to achieve the objective of the financial reporting framework must also be considered in assessing materiality. These risks include, but are not limited to:

<table>
<thead>
<tr>
<th>Risk</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operational risk</td>
<td>The risk arising from the day to day operational activities which may result in a direct or indirect loss</td>
</tr>
<tr>
<td>Liquidity risk</td>
<td>The inability of the entity to meet obligations when they are due</td>
</tr>
<tr>
<td>Credit risk</td>
<td>The risk that a borrower or debtor fails to meet when the obligation is due</td>
</tr>
<tr>
<td>Human resources risk</td>
<td>The risk that adequate quantities of appropriate qualified and skilled staff and resources are not available within the entity</td>
</tr>
</tbody>
</table>
Chapter 1 - The Reporting Framework and the Preparation Process

<table>
<thead>
<tr>
<th>Risk</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal and documentation risk</td>
<td>The risk that a transaction or contract could not be consummated because of some legal barrier</td>
</tr>
<tr>
<td>Regulatory and compliance risk</td>
<td>The risk of incurring penalties or restrictions as a result of non-compliance with legal requirements</td>
</tr>
<tr>
<td>Information risk</td>
<td>The risk that confidentiality will be breached or the unavailability of information when required</td>
</tr>
<tr>
<td>Insurance risk</td>
<td>The risk that the entity are not adequately insured against losses or claims</td>
</tr>
<tr>
<td>Technology risk</td>
<td>The risk that systems are not adequately monitored, accounted for or serviced to deliver a service</td>
</tr>
<tr>
<td>Reputational risk</td>
<td>The risk of damaging the entity’s image</td>
</tr>
</tbody>
</table>

### 2.6.4 Qualitative and quantitative factors

Quantitative factors relates to the size of the department or the value of an item to the value of the financial statements. The two aspects that should be considered when determining the materiality figure is the amount of the item to the financial information and second the special characteristics of the item.

Qualitative materiality focuses on the inherent nature of the item under consideration. These items do not necessarily influence the reasonableness of the financial statements, but due to their nature they are of importance to the users of the financial statements. The following factors could be taken into consideration when determining qualitative materiality:

- **statutory requirements:** compliance with legislative requirements, regulations, policy control measures, procedures, instructions and authorisations (including budgets) which reasonably have direct financial impact;
- **unusual items:** items that are of a non-recurring or exceptional nature or arise from unusual circumstances;
- **degree of estimation:** the risk of material misstatement
- **Related amounts:** the relationship of the item to other amounts that appear in the financial statements
- **critical points:** an item that would otherwise be regarded as insignificant, may, if corrected or disclosed, have a critical impact on the overall view; and

Establishing a materiality framework for financial reporting purposes is the responsibility of management (and not the external auditors) and should be based on all of the above. External auditors’ determination of audit materiality is independent of materiality determined by management and may accordingly differ. It is important to note that the range/level of materiality will be influenced by the strength of internal control environment within the department. For example, if a department does not have a proper asset register the risk of errors in the amount disclosed is high and therefore the materiality level should be lowered.

---

10 This risk may not be relevant to departments due to the limitations in the Treasury Regulations (TR 12.1)
Given that materiality is inherently a matter of professional judgement which can only be properly made by those who have the facts the following quantitative (arbitrary) thresholds may be used as a guide in determining the materiality of an amount:

(a) an amount which is equal to or greater than 5% of the appropriate base amount may be presumed to be material unless there is evidence or convincing argument to the contrary; and

(b) an amount which is equal to or less than 2% of the appropriate base amount may be presumed not to be material unless there is evidence, or convincing argument, to the contrary.

The base amount is either:

- the appropriate asset or liability category total; or
- the appropriate revenue or expense category for the current reporting period; or
- the net cash provided by or used in the operating, investing, financing activities as appropriate, for the current reporting period;

The user is however reminded that the factors discussed in 2.6.1 – 2.6.3 above may influence the value of figure calculated using the above percentage thresholds.

**Application of materiality**

Materiality can be impacted both through policy and through the application of policy at a transaction level. Generally, a policy has a more significant impact on materiality than the application of a policy at a transaction level. If for example a department were to adopt a policy on related parties that is contrary to the policy set by the National Treasury (NT), all transactions applied in accordance with the departmental policy could potentially represent a material deviation from the NT policy. This may result in a negative finding in the audit report of the department. Individual transactions that are accounted for incorrectly are (in theory) less likely to be material on the overall financial statements.

Remember: The concept of materiality should not only be considered during the audit process but also when individual transactions are recorded or disclosed in the system and financial statements. The detail and accuracy used to collect and record the information determines the possible accuracy of the information in any financial reports.

Materiality at a transaction level determines:

(a) when a transaction is recorded or the frequency of recording (e.g. when the transaction arises or on a monthly/yearly basis);

(b) the classification of the elements of the transaction (e.g. minor or a major asset);

(c) level of detail to be included in the narrative disclosures.
ANNEXURE A: Information to be submitted to relevant role players in the accountability cycle

1 Submission of information to the National Treasury

The Annual Financial Statements shall be submitted in the following formats:

- hard copy; and
- electronically, on a compact disk (CD).

1.1 National Departments

1.1.1 Documents to be submitted

The following documents should be submitted:

- Completed Specimen AFS – Microsoft WORD document
- Completed AFS Template – Microsoft EXCEL document (as issued by OAG)
- Compact Disk (CD) – containing both the above documents

1.1.2 Documents must be submitted to the following officials

<table>
<thead>
<tr>
<th>Submit to</th>
<th>Physical Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. OAG representative indicated on the “Cover” sheet of the template</td>
<td>240 Vermeulen Street Pretoria 0002</td>
</tr>
<tr>
<td>2. Rensie Hurn Budget Office</td>
<td>40 Church Square Pretoria 0002</td>
</tr>
<tr>
<td>Tel: (012) 315 5567</td>
<td>e-mail: <a href="mailto:rensie.hurn@treasury.gov.za">rensie.hurn@treasury.gov.za</a></td>
</tr>
</tbody>
</table>

1.1.3 Submission due dates

<table>
<thead>
<tr>
<th></th>
<th>Due date of submissions to OAG</th>
<th>Number of copies to OAG</th>
<th>Due date of submissions to Budget office (BO)</th>
<th>Number of copies to BO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unaudited financials</td>
<td>31/05/2012</td>
<td>1</td>
<td>31/05/2012</td>
<td>1</td>
</tr>
<tr>
<td>Audited financials</td>
<td>31/07/2012</td>
<td>1</td>
<td>31/08/2012</td>
<td>1</td>
</tr>
<tr>
<td>Annual reports</td>
<td>31/08/2012</td>
<td>5</td>
<td>31/08/2012</td>
<td>9</td>
</tr>
</tbody>
</table>
1.2 Provincial Departments

1.2.1 Documents to be submitted

The following documents should be submitted:

- Completed Specimen AFS – Microsoft WORD document
- Completed AFS Template – Microsoft EXCEL document (as issued by OAG)
- Compact Disk (CD) – containing both the above documents

1.2.2 Documents must be submitted (via the Provincial Accountant-General) to the following National Treasury officials

<table>
<thead>
<tr>
<th>Submit to</th>
<th>Physical Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Rigard Lemmer (Intergovernmental relations) Tel: (012) 315 5821 Fax: (012) 315 5045 e-mail: <a href="mailto:rigard.lemmer@treasury.gov.za">rigard.lemmer@treasury.gov.za</a></td>
<td>40 Church Square Pretoria 0002</td>
</tr>
</tbody>
</table>

1.2.3 Submission due dates

<table>
<thead>
<tr>
<th></th>
<th>Due date of submissions to the PAG’s</th>
<th>Due date of submissions to Intergovernmental Relations (IGR)</th>
<th>Number of copies to IGR (NT)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unaudited financials</td>
<td>31/05/2012</td>
<td>31/05/2012</td>
<td>1</td>
</tr>
<tr>
<td>Audited financials</td>
<td>31/07/2012</td>
<td>31/08/2012</td>
<td>1</td>
</tr>
<tr>
<td>Annual reports</td>
<td>31/08/2012</td>
<td>31/08/2012</td>
<td>9</td>
</tr>
</tbody>
</table>

Note: Each provincial treasury may have their own deadlines for the submission of the documents listed above for the purposes of provincial consolidations required in terms of the PFMA.
Chapter 1 - The Reporting Framework and the Preparation Process

2 Submission of information to the Auditor-General

2.1 Submission of AFS for auditing purposes to the Auditor-General (AGSA):

Before submission of the AFS for auditing purposes, the Accounting Officer needs to complete the confirmation letter. In this letter the Accounting Officer accepts responsibility for the accuracy and fair presentation of the AFS submitted to the AGSA and relevant treasury, and confirms that the AFS conforms to certain set standards. A copy of this letter is attached to this guide.

2.2 Submission of the annual report to the Auditor-General (AGSA):

The annual report must be submitted to the Auditor-General by 31 May 2012. The Auditor–General will review the contents of the annual report to ensure that the content of the annual report is consistent with the annual financial statements. A confirmation letter must be completed by the Accounting Officer to accept responsibility for the accuracy and fair presentation of the Annual Report including the information on predetermined objectives submitted to the AGSA and relevant treasury, and confirms that the Annual Report conforms to certain set guidelines. A copy of this letter is attached to this guide.

2.3 Submission of information on predetermined objectives to the Auditor-General (AGSA):

The information on predetermined objectives, which is included in the annual report, needs to be submitted for audit purposes at the latest on 31 May 2012 to enable the auditors to perform the necessary audit procedures and complete the audit within their prescribed timeframe of 31 July 2012.

2.4 Submission due dates:

<table>
<thead>
<tr>
<th>Due date of submission to Auditor General (AG)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unaudited financials</td>
</tr>
<tr>
<td>Annual reports including report by the Accounting Officer</td>
</tr>
<tr>
<td>Information on predetermined objectives</td>
</tr>
</tbody>
</table>

The annual performance report has been prepared in accordance with the relevant laws and regulations, the NT Framework for Managing Programme Performance information and relevant guidelines specified/issued by the National Treasury.
CONFIRMATION OF THE ACCURACY AND FAIR PRESENTATION OF THE ANNUAL FINANCIAL STATEMENTS SUBMITTED

TO: .................................................................  

DATE: ..........................................................

CC: The Auditor-General

FINANCIAL STATEMENTS FOR THE 200X/200Y FINANCIAL YEAR END

I hereby acknowledge that the annual financial statements of ......................... , have been submitted to the Auditor-General for auditing in terms section .... of the ....................... .

I acknowledge my responsibility for the accuracy of the accounting records and the fair presentation of the financial statements and confirm, to the best of my knowledge and belief, the following:

- the financial statements have been prepared in accordance with ......................... as prescribed in the ......................... and relevant guidelines specified / issued by the National Treasury.
- the financial statements are complete and accurate
- all amounts appearing on the financial statements have been cast and cross-cast and been accurately cross referenced
- the financial statements are free from material misstatements, including omissions; and
- accounting estimates are reasonable in the circumstances.

Yours faithfully

___________________
Chief Financial Officer

___________________
Accounting Officer

11 The letter should be addressed to the relevant treasury, Auditor-General, and external auditoras required by the PFMA / Treasury regulations.
12 The date of submission of the financial statements for auditing should be reflected here, being a date before or on 31 May in respect of national and provincial departments, trading entities and constitutional institutions and public entities.
13 Insert the name of the entity.
14 Insert the relevant reference, for example for national and provincial departments, trading entities and constitutional institutions – section 40(1)(c) of the PFMA; for public entities – section 55(1)(c) of the PFMA.
15 Insert the applicable accounting framework. For example GRAP, GAAP, NT determined framework.
16 Insert the relevant reference, for example for national and provincial departments, trading entities and constitutional institutions and public entities - the Treasury Regulations and the PFMA,
CONFIRMATION OF THE ACCURACY AND FAIR PRESENTATION OF THE ANNUAL REPORT
(INCLUDING INFORMATION ON PREDETERMINED OBJECTIVES) SUBMITTED

TO: .......................................................... 17 DATE: .................................................. 18

CC: The Auditor-General

ANNUAL REPORT FOR THE 200X/200Y FINANCIAL YEAR END

I hereby acknowledge that the annual report of ......................... 19, have been submitted to the
Auditor-General for auditing in terms section ...... of the ......................... 20.

I acknowledge my responsibility for the accuracy of the accounting records and the fair presentation
of the financial statements and confirm, to the best of my knowledge and belief, the following:

- the financial statements have been prepared in accordance with ......................... 21 as
  prescribed in the ......................... 22 and relevant guidelines specified / issued by the
  National Treasury
- the annual report is complete and accurate
- all amounts appearing on the annual report and information in the annual report are
  consistent with the financial statements submitted to the Auditor-General for audit purposes
  and;
- the annual report is free from any omissions.

Yours faithfully

___________________
Chief Financial Officer

___________________
Accounting Officer

---

17 The letter should be addressed to the relevant treasury, Auditor-General, and external auditors required by
the PFMA / Treasury regulations.
18 The date of submission of the financial statements for auditing should be reflected here, being a date before or
on 31 May in respect of national and provincial departments, trading entities and constitutional institutions and
public entities.
19 Insert the name of the entity.
20 Insert the relevant reference, for example for national and provincial departments, trading entities and
constitutional institutions – section 40(1)(c) of the PFMA; for public entities – section 55(1)(c) of the PFMA.
21 Insert the applicable accounting framework. For example GRAP, GAAP, NT determined framework.
22 Insert the relevant reference, for example for national and provincial departments, trading entities and
constitutional institutions and public entities - the Treasury Regulations and the PFMA,
ANNEXURE B: Critical success factors for the preparation of financial statements

1. Management demonstrates commitment and ownership of the process
   ✓ a strong financial management culture is established across the entity;
   ✓ there is ongoing commitment and support by management for effective financial controls (and the review thereof);
   ✓ the benefits of producing reliable and timely financial statements are well understood by management and staff (it is not just a compliance exercise);
   ✓ robust arrangements are established and maintained for the approval, review and oversight of financial management activities;
   ✓ there are appropriate accountability arrangements such as management sign-offs and individual performance reviews;
   ✓ the CFO has the required skills, qualifications and experience, as well as the necessary authority, to carry out his/her responsibilities; and
   ✓ a strategy or plan has been developed that improves the preparation of the financial statements and to clear any matters reported by oversight structures (such as the AGSA, SCOPA and the audit committee).

2. Management implements and maintains risk management practices and internal controls
   ✓ risks to achieving reliable and timely financial statements are considered as part of an annual review of the financial management strategy or plan;
   ✓ sufficient time and financial statement resources are devoted to managing risks;
   ✓ roles and responsibilities regarding risk management for financial statement purposes are clearly understood and applied throughout the entity;
   ✓ clearly understood reporting mechanisms exist to alert senior management to new and changing risks regarding financial statements;
   ✓ reliable controls are embedded in day-to-day operations to manage risks and to enable compliance with relevant legislative financial management requirements;
   ✓ ineffective or unnecessary controls are identified and replaced/corrected to reduce costs and/or reallocate resources
   ✓ adequate monitoring of internal controls is in place to ensure that they are applied effectively and appropriate action is taken when control breakdowns are identified;
   ✓ accounting and business systems record complete and accurate financial information throughout the year;
   ✓ proper financial accounts and records of the entity’s operations are maintained;
   ✓ control activities are performed effectively to help prevent, detect or correct error or fraud, and
   ✓ rigorous quality control and assurance processes over financial statement preparation are in place.
3. **Good financial reporting practices are applied throughout the year**
   - interim financial reports are prepared to identify, and address, to the extent practicable, issues that have the potential to adversely affect the preparation of the financial statements at year-end;
   - key reconciliations are completed monthly, with due diligence checks of the reconciliations being conducted periodically by senior managers;
   - month-end processes are streamlined and used to minimise the work required at year-end, and
   - errors and problems are identified and addressed progressively throughout the year.

4. **An open and constructive relationship exists with key stakeholders**
   - the respective roles and responsibilities of stakeholders are well understood and contained in relevant charters and memoranda of understanding;
   - the matters that are important for stakeholders in discharging their financial statement responsibilities are well defined and understood;
   - issues are raised as soon as they are identified and resolution strategies are agreed and monitored;
   - relationships between stakeholders are open and constructive, and
   - reports to relevant stakeholders are informative and identify key issues and risks including actions taken to address them.

5. **Staff and other resources are managed effectively**
   - proper attention is given to recruiting, training and retaining skilled finance professionals;
   - practical strategies for succession planning and longer-term financial workforce needs are in place;
   - there is an organisational structure with clear lines of responsibility and accountability in relation to financial statement preparation;
   - the finance team and business areas are sufficiently resourced to meet their respective financial statement responsibilities;
   - the mix of resources utilised is effective in managing peak financial statement workloads;
   - appropriate training and support are provided to staff who exercise delegations and expend moneys;
   - the roles and responsibilities of relevant staff are understood and communicated clearly as a basis for setting accountability and performance expectations, and
   - opportunities are taken to maximise interaction between the finance team and line managers.
**ANNEXURE C:** Amendments made to chapter

<table>
<thead>
<tr>
<th>Version</th>
<th>Nature of amendment</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 2011</td>
<td>Dates updated</td>
<td>Various</td>
</tr>
</tbody>
</table>