Federal Accounting Standards Advisory Board

August 7, 2018

MEMBER ACTIONS REQUESTED:

- Please provide responses to the questions starting page 2 before August 17

Memorandum

To: Members of the Board

From: Grace Wu, Assistant Director

*Wendy M. Payne /s/*
Through: Wendy M. Payne, Executive Director

Subject: Updated Draft Materiality ED[1]

**MEMO OBJECTIVE**

The objective of this memorandum is to seek the Board's input on the updated draft of materiality exposure draft (ED).

**BRIEFING MATERIAL**

- Staff Memo
- Attachment 1: Draft Materiality ED

**BACKGROUND**

During the June Board meeting, a materiality ED draft was introduced. The Board reviewed the draft and concurred on the majority of the proposed changes prior to the meeting. While in the meeting, the Board discussed the following two areas:

- ED 191b: Whether "substantial likelihood" correctly captured the degree of certainty that members had intended regarding material misstatements. Various members expressed concern that materiality required a higher threshold of certainty than "substantial likelihood" communicated and stressed the importance of making this

[1] The Staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

clear to readers. Ultimately, members decided to replace “substantial likelihood” with “reasonably be expected” in the discussion of material misstatements.

- ED 191 g: Whether or not to address irrelevant information in the materiality ED. This led the Board to discuss levels of materiality in the context of reporting across the entity. The materiality considerations may change as financial information is rolled up into the reporting entity. Given these considerations, OMB will draft language regarding levels of materiality and relevance of financial information. After reviewing the language, the Board will make changes and determine whether the new text belongs in the proposed concepts or basis for conclusions.

Based on the above discussion, staff and OMB proposed new updates to the draft materiality ED in Attachment 1. While some other minor updates were edited in the draft ED, below are different proposed languages in certain key areas for the Board to review and consider.

**191c**

Option 1: 191c. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement. Consequently, the materiality considerations may change as financial information is consolidated from sub-component to component to government-wide reporting entities.

Option 2: 191c. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement. Consequently, materiality for a sub-component reporting entity should be lower than or different from materiality for a component reporting entity, which in turn should be lower than or different from materiality for the government-wide reporting entity.

Option 3: 191c. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement.

**A13** The Board does not provide specific quantitative or qualitative considerations in the proposed section. Both quantitative and qualitative considerations are typically entity specific. Existing audit and regulatory literature already provides detailed guidance on the quantitative considerations. Qualitative considerations will likely vary depending on whether the reporting entity is a sub-component, component, or the government-wide reporting entity. The entity-specific nature of the quantitative and qualitative considerations will likely require sub-components to consider different factors than components.

**Question 1:** The change intends to address the level of materiality. Beside the proposed changes in 191C, A13 was updated for further understanding of this topic. Which option do you prefer? Do you have any other suggestions?

**191g**

Option 1: 191g. Material misstatements may occur with any information included in the financial report. A reporting entity should disclose relevant information and also be mindful that inclusion of significant amounts of irrelevant information could, in some circumstances, affect the judgment of a reasonable user.

Option 2: 191g. Material misstatements may occur with any information included in the financial report. A reporting entity should disclose only relevant information and also be mindful that financial reports must be concise and clearly written to allow a reasonable user to reach a conclusion about the reporting entity's financial position and condition.

**A12** The proposed concepts focus on the effect of misstatements on a reasonable user's judgment, but the Board recognizes that other aspects of a financial report may also affect a reasonable user's judgment. Specifically, a poorly written or unnecessarily verbose financial report may affect a reasonable user's judgment. Nevertheless, in response to a need expressed by the financial reporting community, this Statement focuses on guidance for the community in applying the concept of materiality.

**Question 2:** The change intends to address the relevance of financial information disclosure. Beside the proposed changes in 191g, A12 was added for further understanding of this topic. Which option do you prefer? Do you have any other suggestions?

**Question 3:** Does the Board have any other input on the draft materiality ED?

**NEXT STEPS**

Once edits are finalized during the meeting, staff will provide a pre-ballot version for review after the meeting. Staff hopes to seek final approval of the ED after receiving the pre-ballot feedback.

**MEMBER FEEDBACK**

If you require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the Board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at (202) 512-7377 or by e-mail at wug@fasab.gov with a cc to paynew@fasab.gov.