FASAB

Federal Accounting Standards Advisory Board

October 8, 2019

MEMBER ACTIONS REQUESTED:
• Please responses to the questions on page 4 by October 18, 2019

Memorandum

To: Members of the Board
From: Grace Wu, Assistant Director
Through: Monica R. Valentine, Executive Director
Subject: Materiality [1] – Tab B

MEEETING OBJECTIVE

- To review the "probable" definition and assess its relevance to "could reasonably be expected" in the proposed Materiality concepts statement.
- To review and approve the updated draft *Materiality* concepts statement.

BRIEFING MATERIAL

You may electronically access all of the briefing material at https://fasab.gov/board-activities/briefing-materials/.

The briefing materials include this memorandum and the following attachments:

Attachment 1: Research on Probable Definition
Attachment 2: Updated Draft Concepts Statement *Materiality* Based on Pre-ballot 9/24/2019 Version- **Marked**
Attachment 3: Updated Draft Concepts Statement *Materiality* Based on Pre-ballot 9/24/2019 Version – **Clean**
Attachment 4: Proposed Draft Language for Basis for Conclusion Paragraphs A11-A15

BACKGROUND

At the August 28, 2019 Board meeting, members reviewed a *Materiality* pre-ballot draft and agreed on the following steps:

- Before the October Board meeting, staff will distribute an updated draft Statement based on the August Board meeting discussion.

[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 FASAB or its staff. Official positions of FASAB are determined only after extensive due process and deliberations.

- Staff will incorporate Mr. McNamee's updated dissent into the updated draft Statement and then distribute a pre-ballot based on the feedback received.
- Staff will prepare a ballot draft for consideration at the October meeting.

On September 13, 2019, an updated draft Statement based on the August Board meeting discussion was provided for members' review and comments. Mr. McNamee also provided an updated dissent. Based on feedback from members a pre-ballot draft was subsequently distributed for members' review on September 24, 2019.

An updated draft statement based on members' feedback on the September 24, 2019 version is included in Attachment 2: *Updated Draft Concepts Statement Materiality Based on Pre-ballot 9/24/2019 Version.*

In Mr. McNamee's updated dissent, he added the following new dissent discussion:

> *"Mr. McNamee dissents to the issuance of this Statement. This statement defines materiality as, "A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information." [Emphasis added.] The Board has used the same words, "reasonably be expected," in SFFAS 5, paragraph 33, to define the term "probable":*
>
> *"Probable" refers to that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims.*
>
> *Mr. McNamee believes this provision of SFFAS 5 establishes that, for federal financial reporting, "reasonably be expected" has the same meaning as "more likely than not" " and is thus not a suitable gauge of materiality in federal financial reporting."*

Based on the volume of member questions, comments, and edits on several paragraphs in the basis for conclusions staff is not proposing a pre-ballot draft of the Materiality concept Statement at this time.

To assist members understand the background on paragraph 33 of SFFAS 5 during the development of SFFAS 5 and assess the relationship between "reasonably be expected" "probable," and "more likely than not." Staff researched the history of the SFFAS 5 "probable" definition and the statistical application of "reasonably be expected" and "more likely than not." The research is included in Attachment 1: *Research on Probable Definition.* In that attachment, staff also provided an analysis developed by a Board member that summarizes the Board's use of "probable," "more likely than not," and "could reasonably be expected" in SFFAS 5 and 49.

Based on staff's research and comments from members staff is proposing a revised basis for conclusion in the draft Materiality concepts Statement. The proposed language is included in Attachment 4: *Proposed Draft Language for Basis for Conclusion Paragraphs A11-A15*

Probable Definition Research

The "probable" definition in SFFAS 5 varies in different sections. Under Definition and General Principle for Recognition of a Liability Section and Contingencies sections, it refers to more likely than not. In SFFAS 5 footnote 15a probable used in the context of assessing the outcome of matters of pending or threatened litigation and unasserted claims, and recognizing an associated liability, it refers to that which is likely, not to that which is more likely than not. SFFAS 5 doesn't discuss the relationship between "probable" and "can reasonably be expected", nor the relationship between "can reasonably be expected" and "more likely than not".

In the history of drafting the SFFAS 5 ED, the definition of "probable" was changed using "more likely than not," "probable future outflow," and adding "can reasonably be expected or believed to be" before "more likely than not" in the May 1994 draft ED. In the August 1994 draft ED, the "probable future outflow" was changed to "probable". In the November 1994 ED, the "probable future outflow" was changed to "probable."

In the history of FASAB's SFFAS 5 "probable" definition discussion, the Board minutes reflect discussions on "probable" vs. "more likely than not." "Can reasonably be expected" was not reflected in the minutes discussion during the development of SFFAS 5 as a part of the "probable" definition consideration, nor any discussion on the relationships between "probable" and "can reasonably be expected", and between "can reasonably be expected " and "more likely than not".

Staff's review of the related Board exposure draft documents and meeting minutes when SFFAS 5 was being developed, showed Board discussions on "probable" vs. "more likely than not" as it relates to the liability definition, however the documents do not reflect any discussions on whether or not "probable, can reasonably be expected, and more likely than not" are synonyms. In addition, the general definition and statistics application research result indicated that from general definition and statistics calculation point of views, the terms "reasonably expected" and "more likely than not" are different.

Proposed Draft Language for Basis for Conclusion Paragraphs A11-A15

Based on staff's research and comments from members, staff is proposing a revised basis for conclusion in the draft Materiality concepts statement. The major changes to the basis for conclusion paragraphs A11-A15 are as follows:

- Original paragraph A11 was replaced with a summary discussions of why the Board chose not use “probable” and “more likely than not” in the materiality definition.

- Original paragraphs A13 and A14 were combined into one concise paragraph on the reasons the Board chose “could reasonably be expected” over “substantial likelihood”. More discussions about the reason why “could reasonably be expected” was selected were added at the end of this paragraph. This combined paragraph was moved to A12 to connect the discussion to A11 definition discussion.

- A14 was modified based on the Board members’ suggested edits and the conclusion was moved to A12.

QUESTIONS FOR THE BOARD

1. Based on the research provided in Attachment 1, what are the Board’s views on the relationship between “reasonably be expected” “probable,” and “more likely than not” as it relates to the proposed Materiality concepts Statement?

2. Is the Board comfortable with its conclusions on the use of “could reasonably be expected” in the Materiality concepts Statement?

3. Does the Board agree with the proposed basis for conclusion paragraphs A11-A14?

NEXT STEPS

Staff’s goal is to provide a ballot draft by the December 2019 meeting. Members who plan to submit a dissent should provide it to staff as soon as possible so that other Board members may consider these views during their review.

MEMBER FEEDBACK

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 ValentineM@fasab.gov.

Objective:

To provide a history of the "probable" definition in an effort to understand the Board's intent of paragraph 33 of *Accounting for Liabilities of the Federal Government (SFFAS5)* and paragraphs A30 – A32 SFFAS 49, *Public-Private Partnerships: Disclosure Requirements*. This research paper has three major parts: background, SFFAS 5 "probable" definition history research, and general definition and statistics application research.

Background:

SFFAS 5 paragraph 33 states:

> *33. "Probable" refers to that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims (footnote 15a).*

SFFAS 49 *Public-Private Partnerships: Disclosure Requirements* Basis for Conclusion states:

Materiality Includes Probability Assessments

> *A30. Statement of Federal Financial Accounting Standards 5 (SFFAS 5), Accounting for Liabilities of the Federal Government, states that "probable" refers to that which*
> *a. can reasonably be expected, or*
> *b. is believed to be more likely than not on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims.*
>
> *A31. The Board notes that the concept of probability is imprecise and may be difficult to apply with respect to certain P3 activities such as economic stabilization payments, in addition to other matters that could arise during the life of the P3 arrangement or transaction. However, the "more likely than not" phrase in SFFAS 5 accommodates the assessment of the probability of those uncertainties often associated with P3s due to their long-term nature and project variability.*
>
> *A32. Historically, some studies including work done by GAO suggest that, in practice, preparers and auditors in the private sector often interpret "probable" to mean a subjective assessment of probability considerably in excess of 50%. However, FASAB has defined "probable" as "more likely than not," that is, a subjective assessment of probability greater % (51% or more).*

Research Results:

I. SFFAS 5 "Probable" Definition History Research

1. Statement of Federal Financial Accounting Standards 5 Accounting for Liabilities of The Federal Government (as amended)

- Definition And General Principle For Recognition Of A Liability Section

19. A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize8 probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date.[9]

Footnote 9: This document uses the term "nonexchange transaction" in a way similar to FASB's "nonreciprocal transfer." That is, it implies a one-way flow of resources, services, or promises between two parties. "Transaction" in the phrase "nonexchange transaction" does not include reclassification, closing, and similar "internal" entries to the accounting records, though some accountants use the term in that broader sense. "Probable" means more likely than not. "Measurable" means reasonably estimable.

- Probable Future Outflow or Other Sacrifice of Resources Section

33. "Probable" refers to that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic with the exception of pending or
threatened litigation and unasserted claims (footnote 15a).

Footnote 15a: The concept of probability is imprecise and difficult to apply with respect to most legal matters. The "more likely than not" phrase suggests greater precision than is attainable when assessing the outcome of matters in litigation. Accordingly, in the context of assessing the outcome of matters of pending or threatened litigation and unasserted claims, and recognizing an associated liability, "probable" refers to that which is likely, not to that which is more likely than not. Note that the remaining two criteria for recognizing a liability--that is, a past event or exchange transaction has occurred and the future outflow or sacrifice of resources is measurable--also must be met before recognizing a contingent liability in matters involving litigation.

- Contingencies Section

35. A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm a gain (i.e., acquisition of an asset or

reduction of a liability) or a loss (i.e., loss or impairment of an asset or the incurrence of a liability).

36. This Statement does not deal with gain contingencies or measurement of contingencies that involve impairment of nonfinancial assets. When a loss contingency (i.e., contingent liability) exists, the likelihood that the future event or events will confirm the loss or the incurrence of a liability can range from probable to remote. The probability classifications are as follows:

- Probable: The future confirming event or events are more likely than not to occur, with the exception of pending or threatened litigation and unasserted claims. For pending or threatened litigation and unasserted claims, the future confirming event or events are likely to occur.
- Reasonably possible: The chance of the future confirming event or events occurring is more than remote but less than probable.
- Remote: The chance of the future event or events occurring is slight.

Discussion: *The "probable" definition in SFFAS 5 varies in different sections. Under Definition and General Principle for Recognition of a Liability Section and Contingencies sections, it refers to "more likely than not." In footnote 15a "probable" is used in the context of assessing the outcome of matters of pending or threatened litigation and unasserted claims, and recognizing an associated liability. It also refers to "that which is likely," not to "that which is more likely than not." SFFAS 5 doesn't discuss the relationship between "probable" and "can reasonably be expected," nor the relationship between "can reasonably be expected" and "more likely than not."*

2. *FASAB SFFAS 5 (Draft Statements) History of the Definition of "Probable"*

September 1, 1993 Staff's Initial Draft of Part I of the Liability and Future Claims ED at page 23 Glossary:

"Probable is the likelihood that a transaction or event will be or become true or real ('more likely than not') ".

May 3, 1994 Draft Liabilities ED:

Definition and General Principle for Recognition of Liabilities

Paragraph 23: "A federal liability is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports will recognize probable and measureable future outflows or other sacrifices of resources arising from past exchange transactions, government-related injuries or damage, or expected/scheduled nonexchange outlays that, according to current law and applicable policy, are due and payable."

Probable Future Outflow or Other Sacrifice

Paragraph 38: "Probable future outflow refers to that which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic, but is neither certain nor proven."

Contingencies

Paragraph 40: "Probable – The future confirming event or events are more likely than not to occur."

June 27, 1994 Draft Liabilities ED:

Definition and General Principle for Recognition of Liabilities

Paragraph 24: "A federal liability is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports will recognize probable and measureable future outflows or other sacrifices of resources arising from past exchange transactions, government-related injuries or damage, or expected/scheduled nonexchange outlays that, according to current law and applicable policy, are due and payable."

Probable future outflow or other sacrifice

Paragraph 39 "Probable future outflow refers to that which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but is neither certain nor proven."

Contingencies

Paragraph 41: "Probable – The future confirming event or events are more likely than not to occur."

August 2, 1994 Draft Liabilities ED paragraph 39:

Definition and General Principle for Recognition of Liabilities

Paragraph 24: "A federal liability is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports will recognize probable and measureable future outflows or other sacrifices of resources arising from past exchange transactions, government-related injuries or damage, or expected/scheduled nonexchange outlays that, according to current law and applicable policy, are due and payable."

Probable Future Outflow or Other Sacrifice of Resources

Paragraph 39 "Probable ~~future outflow~~ refers to that which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but is neither certain nor proven."

Contingencies

Paragraph 41: “Probable – The future confirming event or events are more likely than not to occur.”

November 7, 1994 ED paragraph 40:

Definition and General Principle for Recognition of Liabilities

Paragraph 25: “A federal liability is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports will recognize probable and measureable future outflows or other sacrifices of resources arising from past exchange transactions, government-related injuries or damage, or expected/scheduled nonexchange outlays that, according to current law and applicable policy, are due and payable.”

Probable Future Outflow or Other Sacrifice of Resources

Paragraph 40: “‘Probable’ refers to that which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic, but is neither certain nor proven.”

Contingencies

Paragraph 44: “Probable – The future confirming event or events are more likely than not to occur.”

Discussion: *In the history of drafting the SFFAS 5 ED, the definition of “probable” was changed using “more likely than not,” “probable future outflow,” and adding “can reasonably be expected or believed to be“ before “more likely than not” in the May 1994 draft ED. In the August 1994 draft ED, the “probable future outflow” was changed to “probable”. In the November 1994 ED, the “probable future outflow” was changed to “probable.”*

3. *FASAB Minutes History for the Definition of “Probable” in SFFAS 5 (1991 - 1995)*

1991 to 1995:

The minutes did not have a discussion of the comparison between “probable” and “can reasonably be expected”, nor between “can reasonably be expected” and “more likely than not” in the minutes.

1991 Prior to SFFAS 5 ED:

“One member noted that the GAO has recommended that FASB Statements No. 5 and 15 should be tightened. The term ‘probable’ should be interpreted to mean ‘more likely than not,’ rather than ‘almost certain.’ Several Board members expressed desire for the language in the Exposure Draft to be strengthened to address this interpretation problem.”

February 24, 1994, prior to SFFAS 5 ED:

“Board member Bill Kendig said that he had observed some confusion about the definition and recognition of liabilities. Debra Cary, a member of Mr. Kendig's staff, then reviewed a paper on six concepts, their implications, and specific applications to liabilities. Table 1 (last page) summarizes the paper. The Board suggested that the word ‘economic’ in the phrase ‘underlying economic event’ should be deleted. One member suggested that the idea of ‘unpaid expense’ should be added to the definition. Finally, still to be resolved is the issue of ‘more likely than not’ versus ‘probable.’ Also, it was suggested that the concepts in the table be reflected in the Liabilities ED. “

July 21, 1994, prior to SFFAS 5 ED:

“Probable concept -- One Board member would like to replace the term "probable" with the phrase "more likely than not." The member states that "more likely than not" is a more even-handed way of recognizing liabilities then "probable." The Board member who initiated the change was not present at the meeting, but Bob Bramlett (FASAB staff member) explained the Board member's reasoning for the suggested change. One other member noted that he did not like either of the terms and thought that the definition could survive without any reference to probable or more likely than not, as does the Canadian liability definition. The members debated the pros and cons of the possible changes and agreed to stay with "probable."

“Mr. Young informed the Board that most of their changes to the Liability ED had been completed and that Staff would return a draft of the ED with redlines and strikeout for the Board's final review. Staff would also return the members' comment letters noting how comments were addressed in the document.”

March 15/16, 1995 after ED issuance:

“Issue: When an estimated liability is a range of amounts and no amount within the range is a better estimate than any other amount, should either the midpoint or, alternatively, the "expected value" (as the term is used in statistics) be recognized as a liability instead of the minimum amount?

One member noted that one could not use "expected value" to pinpoint an estimate within a range. The expected value model would assign a probability percentage to each of the numbers within the range. Therefore, expected value could not be used to pinpoint a single amount within the range because either all numbers would be assigned the same probability percentage or one number within the range would have a higher probability. If all numbers have the same probability percentage, no single point estimate can be recognized. If one amount within the range has a higher probability than the other amounts, that one amount would be the best estimate in the range and would be recognized.”

Discussion: *In the history of FASAB’s SFFAS 5 “probable” definition discussion, the Board minutes reflect discussions on “probable” vs. “more likely than not.” “Can* *reasonably be expected” was not reflected in the minutes discussion during the development of SFFAS 5 as a part of the “probable” definition consideration, nor any discussion on the relationships between “probable” and “can reasonably be expected”, and between “can reasonably be expected “ and “more likely than not”.*

II. “Reasonably be expected” and “more likely than not” General Definition and Statistics Application Research

Reasonably expected:

- Law Insider Dictionary: “**Reasonably expected** means the reasonable expectation of a Person who has the pertinent knowledge, competency, skills and expertise to evaluate a given condition or situation after due investigation, diligence and/or analysis.”
- Oxford: “**Expected value** is a predicted value of a variable, calculated as the sum of all possible values each multiplied by the probability of its occurrence.”
- Investopedia: “The **expected value** (EV) is an anticipated **value** for an investment at some point in the future. In statistics and probability analysis, the **expected value** is **calculated** by multiplying each of the possible outcomes by the likelihood each outcome will occur and then summing all of those **values”.**

More likely than not:

- Merriam-Webster**: “**Definition of **more often than not**: happening more than half the time”.
- Merriam-Webster: “Definition of **more than likely:** 1 : very probable or likely 2 : more likely than not : probably**”**
- Usingenglish.com: “The expression is probably 'more likely than not'. It means that there is a 'more than 50% probability'.”

The following summarizes how probable/can reasonably be expected/more likely than not were used and/or defined in SFFAS 5 (including the development of SFFAS 5) and 49.

SFFAS 5 Par 19, FN 9 (General Definitions)	"Probable" means more likely than not.
SFFAS 5, par 33 (Probable future outflow or other sacrifice of resources)	"Probable" refers to that which [*can reasonably be expected or is believed to be] "more likely than not"*] on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims.
SFFAS 5, par 33, FN15a	In the context of assessing the outcome of matters of pending or threatened litigation and unasserted claims*, "probable" refers to that which is likely, not to that which is more likely than not.*
SFFAS 5, Par 35-36, Contingencies	Probable…more likely than not to occur.
SFFAS 5 DRAFTS: • 9/1/93	"Probable is the likelihood that a transaction or event will be or become true or real ('more likely than not') "
• 5/3/94	Definition: A federal liability is a probable future outflow Probable Future Outflow/Other Sacrifice: Probable future outflow refers to *that which [can reasonably be expected or believed to be*] more likely than not Contingencies: Probable…More Likely Than Not
• 6/27/94	No change.
• 8/2/94	Probable Future Outflow/Other Sacrifice: Probable future outflow refers to *that which [can reasonably be expected or believed to be*] more likely than not. Otherwise – no change.
SFFAS 49, BfC • A30	Statement of Federal Financial Accounting Standards 5 (SFFAS 5), Accounting for Liabilities of the Federal Government, states that "probable" refers to that which a. can reasonably be expected, or b. *is believed to be* more likely than not...
• A31	the "more likely than not" phrase in SFFAS 5 accommodates the assessment of the probability of those uncertainties often associated with P3s due to their long-term nature and project variability.
• A32	*FASAB has defined "probable" as "more likely than not,"* that is, a subjective assessment of probability greater % (51% or more).

Based on comments received from members on SFFAS 5 par. 33, it appears that the meaning of probable can be interpreted differently.

- One way to interpret the underlined text below – they represent alternatives and equate to each other:

"Probable" refers to that which <u>can reasonably be expected</u> or <u>is believed to be more likely than not</u> on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims.

> <u>Meaning</u>
>
> "Probable" refers to that which can reasonably be expected on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims.
>
> **OR**
>
> "Probable" refers to that which is believed to be more likely than not on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims.

- Another way to interpret the underlined text below – they represent alternatives, both qualifying "to be more likely than not":

"Probable" refers to that which <u>can reasonably be expected</u> or <u>is believed</u> to be more likely than not on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims.

> <u>Meaning</u>
>
> "Probable" refers to that which can reasonably be expected to be more likely than not on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims.
>
> **OR**
>
> "Probable" refers to that which is believed to be more likely than not on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims.

Attachment 2: Updated Draft Concepts Statement *Materiality* Based on Pre-ballot 9/24/2019 Version- **Marked**

Federal Accounting Standards Advisory Board

MATERIALITY:

AMENDING STATEMENT OF FEDERAL FINANCIAL ACCOUNTING CONCEPTS (SFFAC) 1, *OBJECTIVES OF FEDERAL FINANCIAL REPORTING*, AND SFFAC 3, *MANAGEMENT'S DISCUSSION AND ANALYSIS*

Statement of Federal Financial Accounting Concepts 9

XXXX, 2019

October 8, 2019

MARKED DRAFT VERSION

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Accounting standards are typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from FASAB or its website:

- Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- Mission Statement: Federal Accounting Standards Advisory Board, exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

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SUMMARY

This Statement of Federal Financial Accounting Concepts (Statement or SFFAC) updates concepts related to the application of materiality in the federal financial reporting environment. Through amendments to SFFAC 1, *Objectives of Federal Financial Reporting,* and SFFAC 3, *Management's Discussion and Analysis*, this SFFAC clarifies implementation of materiality concepts in the issuance of federal financial statements.

A reporting entity considers materiality in the application of specific requirements to information contained in its general purpose federal financial reports. This Statement clarifies the materiality guidance. It defines the users, scope, and factors to consider when applying materiality in the federal environment. This Statement will help federal financial report preparers apply the materiality concepts in federal financial reporting.

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CONCEPTS

AMENDMENTS TO SFFAC 1, *OBJECTIVES OF FEDERAL FINANCIAL REPORTING*

1. This paragraph amends Statement of Federal Financial Accounting Concepts (Statement or SFFAC) 1, *Objectives of Federal Financial Reporting,* by inserting a chapter titled *Materiality* between the current chapter 6*: Qualitative Characteristics of Information in Financial Reports* and chapter 7: *How Accounting Supports Federal Financial Reporting*. The new *Materiality* chapter is as follows:[1]

164a. A reporting entity considers materiality in the application of accounting and reporting requirements. The Federal Accounting Standards Advisory Board (FASAB or "the Board") intends that information presented in accordance with generally accepted accounting principles (GAAP)[12.1] will not contain misstatements, including omissions of information, considered material. Such omissions include information that is necessary for a reasonable financial report user (reasonable user)[2] to understand the effect of particular material transactions, other events, and conditions on the entity's financial statements, notes to the financial statements, and required supplementary information.[3]

> Footnote (FN) 12.1 Such information would include financial statements, notes to the financial statements, and required supplementary information.

164b. A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information.

164c. 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, after quantitative and qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

164d. Misstatements should be considered individually and in the aggregate. Materiality determinations regarding such misstatements should include consideration of both qualitative and quantitative factors. Information that is not considered quantitatively material may be considered qualitatively material if it can reasonably be expected to change or influence the judgment of a reasonable user. Qualitative

[1] The inserted chapter will become chapter 7: *Materiality and* the existing chapters following chapter 6 in SFFAC 1 will be renumbered to accommodate the insertion.

[2] A reasonable financial report user has appropriate knowledge of the federal government's activities and reviews and analyzes the information diligently.

[3] Statement of Federal Financial Accounting Standards 57, *Omnibus Amendments 2019*, eliminates required supplementary stewardship information (RSSI) in the general purpose federal financial report.

considerations include the public accountability[4] of the reporting entity; applicable legal and regulatory requirements; the visibility and sensitivity of government programs, activities, and functions; as well as other factors that may affect a reasonable user's judgment about the information.

164e. Materiality concepts and related factors should be considered when making materiality judgments. While specific qualitative and quantitative thresholds for materiality are not provided, illustrative factors are discussed in paragraphs 164c and 164d of this Statement.

164f. In applying materiality concepts, the specific needs of a reasonable user should be considered. In the federal government environment, such needs generally differ from those of the commercial entity financial report user. For example, due to the visibility and sensitivity of government programs, the needs of federal government financial report users extend to having the ability to assess the allocation and use of resources in the federal government. Further, compliance with laws, regulations, contracts, and grant agreements is also a significant consideration of the user.[12.2]

> FN 12.2 Information requiring protection from unauthorized disclosure is referred to as "classified national security information." The application of federal financial accounting standards needs to support the legal requirements to protect classified national security information.

164g. To emphasize that materiality should be considered in applying the accounting standards, the Board will place the following notice at the end of each Statement of Federal Financial Accounting Standards (SFFAS):

> The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial. [FN]
>
> FN: Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting,* chapter 7, titled *Materiality,* for a detailed discussion of the materiality concepts.

AMENDMENT TO SFFAC 3, *MANAGEMENT'S DISCUSSION AND ANALYSIS*

2. This paragraph amends SFFAC 3, *Management's Discussion and Analysis*, footnote 10 at paragraph 26 as follows:

> FN 10 Materiality of effects to be discussed should be evaluated in the context of the ~~specific~~ reporting entity~~, not the Government as a whole~~.

[4] SFFAC 1, par. 73 and 74 identify different kinds of accountability. These may be relevant qualitative considerations in determining materiality.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The concepts enunciated in this Statement—not the material in this appendix—should guide the development of standards for specific transactions, events, or conditions.

PROJECT HISTORY

A1. The Board added the note disclosures project to its agenda in October 2017 with the objective of improving the relevance, clarity, consistency, and comparability of disclosures among federal entities. Staff formed a task force to assist the Board with the related research. The Board also conducted a survey on disclosures in which a majority of respondents indicated that materiality-based judgment can assist in eliminating redundant and unnecessary disclosures by providing only relevant information.

A2. Currently, materiality concepts are discussed in three Statements: SFFAC 3; SFFAS 1, *Accounting for Selected Assets and Liabilities;* and SFFAS 3, *Accounting for Inventory and Related Property*. The Board concluded that the clarity, detail, and organization of that guidance could be improved. As such, the Board agreed to update the materiality guidance to assist preparers in making materiality judgments and improving disclosures.

A3. In February 2018, staff provided draft materiality concepts to the note disclosures task force. The task force included federal financial report preparers, auditors, and consultants. Task force members agreed the draft was not significantly different from their understanding of the application of materiality in practice, but it would help in applying materiality concepts in the federal environment by providing more clear, detailed, and organized guidance.

MATERIALITY CONCEPTS

A4. This Statement does not include substantive changes to underlying materiality concepts. Rather, to provide better guidance, this Statement adds important elements, such as a discussion of the needs of reasonable users, a clearer concept of misstatement, and specific federal environment considerations.

A5. In developing this Statement, several sources were considered, including the materiality discussion in the current *FASAB Handbook*, other accounting standards boards' publications, relevant audit standards, and Securities and Exchange Commission (SEC) guidance.

A6. The Board considered the guidance in the Government Accountability Office (GAO)'s *Government Auditing Standards* (GAS)[5] when assessing the materiality concepts for the federal environment. Similar to what is stated in GAS and noted in paragraph 164f, the needs of the federal government report user generally differ from those of the

[5] GAO, *Government Auditing Standards 2018 Revision,* GAO-18-568G (Washington, D.C.: July 31, 2019), 109-110.

commercial entity financial report user. In addition, paragraph164f also discusses some important elements related to the visibility and sensitivity of government programs.

A7. Federal financial report users have different needs compared to users of commercial entity financial reports. The Board considered the users identified in SFFAC 1 (citizens, Congress, federal executives, and federal program managers) in developing this *Materiality* Statement.

A8. Misstatements are often easier to assess using quantitative considerations. However, quantitative considerations (for example, magnitude of the misstatement), without considering the nature of the misstatement and the circumstances in which the judgment about it has to be made, generally do not provide a sufficient basis for a materiality judgment. Thus, misstatements should also be assessed using qualitative considerations to determine if those qualitative considerations can reasonably be expected to change or influence the judgment of a reasonable user. Therefore, this Statement clarifies that materiality should be assessed using both quantitative and qualitative considerations.

A9. The SEC Staff Accounting Bulletin Topic 1.M.1 states, "Even though a misstatement of an individual amount may not cause the financial statements taken as a whole to be materially misstated, it may nonetheless, when aggregated with other misstatements, render the financial statements taken as a whole to be materially misleading."[6] The Board has a similar view. Misstatements should be considered individually and in the aggregate.

A10. Financial statements presented fairly in accordance with GAAP could contain misstatements as long as those misstatements are not material. Additionally, the Board believes materiality-based judgment in federal financial reporting can assist in eliminating redundant and unnecessary disclosures.

A11. This Statement defines materiality in terms of the likelihood[7] that a misstatement, including the omission of information, *could reasonably be expected* to affect the judgment of a reasonable user relying on the information. In SFFAS 1 the Board stated "The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement."[8] The Board considered the use of "probable" when developing the materiality concepts in this Statement. Specifically, the following information was considered:

a. In SFFAS 1, the Board recognized that the word probable is subject to broad interpretation and therefore chose to use "the more stringent criterion ~~[i.e., more~~

[6] The SEC '*Codification of Staff Accounting Bulletins, Topic 1: Financial Statements*'; available online at https://www.sec.gov/interps/account/sabcodet1.htm#M; last accessed July 31, 2019.

[7] "Likelihood" and "threshold" refers to the level of certainty at which missing or incorrect information in financial statements is considered to have an impact on the decision making of reasonable users. A higher likelihood or threshold equates to a greater level of certainty and a lower likelihood or threshold equates to a lower level of certainty.

[8] SFFAS 1, par 13.

Comment [GW1]: One member: "I continue to struggle with how more likely than not, which represents a fairly low threshold of 51 percent, can be "more stringent" than probable, which is interpreted as "virtual certainty." I believe "more stringent" in para. 128 is not modifying the likelihood threshold of more likely than not. Rather, it is modifying the entire loss recognition requirement. A loss recognition requirement using a (less stringent) lower threshold of non-payment likelihood (of more likely than not or 51 percent) is going to yield greater losses being recognized than a higher threshold of non-payment (of probable/virtual certainty). This greater loss recognition could be characterized as "more stringent." For this reason, I think the entire sentence, with highlighted text, and maybe both sentences from para. 128 must be quoted for A11(a) to be accurate. "

GW: SFFAS1 para. 127 and 128:

"127. In the case of loss recognition on receivables, the Board believes that there should be a definitive guideline for recognizing government credit losses. The word probable is subject to broad interpretation (often being interpreted as meaning a virtual certainty of occurrence) and could allow for belated recognition of losses.
128. The Board proposed the more stringent criterion of more likely than not, which requires the recognition of losses when there is more than a 50 percent chance that some receivables will not be collected. In recommending the more likely than not criterion, the Board's intent is to achieve unbiased, consistent, and reliable loss recognition in federal government accounting."

~~narrowly defined]~~ of more likely than not – when there is more than a 50 percent chance" of occurrence.[9]

b. In SFFAS 5, *Accounting for Liabilities of The Federal Government*, "probable" is referred to as "that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic~~,~~ with the exception of pending or threatened litigation and unasserted claims. For those claims, "probable" implies that the future confirming event or events are likely to occur…."[10]

The Board does not believe "more likely than not" is appropriate in assessing the overall application of materiality because it conveys a lower degree of likelihood compared to the general meaning of "probable" and "can reasonably be expected." The Board also does not believe "probable" (in the context of the more narrowly defined usage in SFFAS 1) is appropriate because using "probable" in the materiality concepts could lead to unreasonable expectations regarding precision.

A12. In arriving at the materiality definition in paragraph 164b, the Board also observed that materiality definitions vary among other standard-setters' current and proposed guidance. Some of the materiality definitions include:

a. The International Accounting Standards Board (IASB) uses "*could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make.*"[11] *[Emphasis added]*

b. The Financial Accounting Standards Board (FASB) uses "*probable that the judgment of a reasonable person relying upon the report would have been changed or influenced*."[12] *[Emphasis added]*

c. The Public Company Accounting Oversight Board (PCAOB) uses substantial likelihood in the following context: "…there are certain accounts or disclosures for which there is *a substantial likelihood that misstatements of lesser amounts than the materiality level established for the financial statements as a whole would influence the judgment of a reasonable investor*."[13] *[Emphasis added]*

d. In addition, the Audit Standards Board (ASB) currently uses "Misstatements, including omissions, are considered to be material if, individually or in the aggregate, they *could reasonably be expected to influence economic decisions of users that are taken based on the financial statements*." The ASB has proposed to use "Misstatements, including omissions, are considered to be material if there is *a substantial likelihood that, individually or in the aggregate,*

[9] SFFAS 1, par.127 and 128.
[10] SFFAS 5, par.33.
[11] IASB *Definition of Material (Amendments to IAS 1 and IAS 8)*, October 2018.
[12] FASB Concepts Statement No. 8 *Qualitative Characteristics of Useful Financial Information*, August 2018.
[13] PCAOB Auditing Standard No. 11 *Consideration of Materiality in Planning and Performing an Audit*, August 2010.

they would influence the judgment of a reasonable user made based on the financial statements."[14] *[Emphasis added]*

A13. Prior to the exposure of the proposed materiality concepts the Board discussed whether to use "substantial likelihood" or "could reasonably be expected" in its materiality definition with respect to the level of certainty that the judgment of a reasonable user would be changed or influenced . The Board noted that "substantial likelihood" had not been previously used by FASAB and would require a specific definition that could inhibit the preparer's judgment when applying materiality. Ultimately, the Board proposed "could reasonably be expected" in its exposure draft and received positive feedback on it from the respondents.

A14. As the Board stated in SFFAS 1, "The Board may refer to the pronouncements and statements issued by other standard setting bodies in deliberating accounting standards for the federal government. However, the Board is not bound by these pronouncements and statements, especially when accounting standards promulgated for other sectors[15] are not relevant to the federal government."[16] Due to the public accountability of government entities, various legal and regulatory requirements, and the visibility and sensitivity of government programs, the materiality thresholds in federal practice may be different from those in the commercial practice. The Board concluded that "could reasonably be expected" provides for a reasonable level of assurance while providing for sufficient capacity to accommodate the distinguishing characteristics of the federal environment.

Comment [GW2]: One member: "what is the reasonable level of assurance in reference to? I also do not understand the meaning of the rest of the sentence."

A15. The Board recognizes the differences in terms used to define materiality, and expects that federal financial statement preparers use a common materiality definition as provided in this concept Statement. The Board also recognizes the possibility that the definitions of materiality may be applied differently by ~~among~~ the preparers and auditors ~~of federal financial statements~~. The Board considered the merits of convergence with the audit literature, but concluded that aligning the materiality definitions was not essential because materiality in terms of financial statement reporting is different from the financial statement audit perspective. The Board also discussed the possibility of waiting for the ASB materiality standards to become final before proceeding with its final materiality concepts. The Board agreed that the final outcome of the ASB standards would not change the Board's current stance on using "could reasonably be expected" in its definition of materiality. It was also noted that an unusual precedent could be set by the Board by waiting for the outcome of another standard setting body to develop its guidance before setting the Board's guidance. Each standard-setter sets its standards for the unique characteristics of its jurisdiction. The Board concluded that using "could reasonably be expected" is appropriate in assessing materiality in the federal financial reporting environment.

A16. The Board does not provide specific quantitative or qualitative considerations in this Statement. Both quantitative and qualitative considerations are typically entity specific. Other existing literature already provides detailed guidance on materiality

[14] On June, 2019, the ASB issued an exposure draft of a proposed Statement on Auditing Standards, *Amendments to the Description of the Concept of Materiality.*

[15] Sectors refer to the commercial sector, state and local government sector, etc.

[16] SFFAS 1, par.126.

considerations. Materiality considerations could vary depending on whether the reporting entity is a sub-component, component, or the government-wide reporting entity.

A17. In certain situations, an entity may have a quantitatively significant balance or activity that would lead to a quantitatively high entity-wide materiality threshold. If applied to the entity's other balances or activities, such elevated materiality amounts could influence a reasonable user's judgment regarding the rest of the entity's activities. In such cases, qualitative factors should be considered to determine whether separate materiality considerations are warranted. Materiality may vary by financial statement, line item, or group of line items within that entity.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

A18. The Board issued the exposure draft (ED) on October 15, 2018, with comments originally requested by January 23, 2019. In light of the partial government shutdown during the comment period, some departments and agencies may not have been able to respond by the deadline; therefore, FASAB extended the comment deadline to March 11, 2019.

A19. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the *Federal Register*, FASAB News, the Journal of Accountancy, Association of Government Accountants Topics, the CPA Journal, Government Executive, the CPA Letter, the Financial Statement Audit Network, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A20. The Board did not rely on the number of respondents in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised. The respondents' significant comments and Board response are summarized below.

A21. FASAB received 19 responses from preparers, users of federal financial information, and professional associations. Nearly all respondents agreed with the proposed materiality concepts and their placement in a concepts statement. The placement in a concepts statement provides broad flexibility when exercising materiality judgments, while also providing consistency across standards without overriding existing materiality guidance. In addition, respondents also agreed that this guidance is not significantly different from their current application of materiality in practice.

A22. Some respondents suggested creating a separate chapter in SFFAC 1 regarding materiality due to its importance. After carefully considering the comments received and the fact that materiality concepts may affect a reporting entity at various levels and areas of responsibility, accountability, and mission, the Board decided to place the materiality guidance in SFFAC 1 by creating a new chapter 7 titled *Materiality.*

A23. Based on several respondents' suggestions, the Board modified the following guidance originally proposed in the ED:

a. The Board eliminated the following wording from paragraph164c: "Therefore, misstatements of relatively small amounts could have a material effect on the financial statements. For example, an amount that is not quantitatively material with respect to a very large line item may be material with respect to a smaller line item.” This avoids the misinterpretation that each line would have its own unique quantitative materiality value.

b. The Board defined the term "reasonable financial report user (reasonable user)" in footnote 2 to ensure consistency and clarity of its use throughout the guidance.

A24. Some respondents suggested providing detailed quantitative and qualitative guidance or references to other existing literature for materiality considerations. The Board concluded that its emphasis on the importance of evaluating both quantitative and qualitative factors in the determination of materiality, without providing specifics, allows entities broader flexibility in exercising materiality judgments. References to existing literature would not be valuable, as it is not the Board’s intent to endorse or prioritize these sources. As such, no specific reference to other existing literature is provided.

A25. Several respondents asked about the effect of this guidance on the existing non-authoritative sections of other Statements and the *FASAB Handbook,* where materiality is also discussed. For example, there is a materiality discussion in the Introduction sections of SFFAS 1 and SFFAS 3 and in the Foreword section of the *FASAB Handbook*. These sections are considered non-authoritative guidance and will be updated with a reference to this Statement.

A26. Additionally, the Board observed that existing concepts and standards discuss materiality in the context of management’s discussion and analysis (MD&A). SFFAC 3’s Figure 1: Schematic Diagram of a Sample General Purpose Federal Financial Report states:

> The assertions and report on control called for by the Federal Managers Financial Integrity Act (FMFIA or Integrity Act) would not be stated in full in MD&A. They would be reported in a discrete section of the GPFFR or incorporated in the GPFFR by reference. They are within the scope of MD&A because highly important aspects of systems, compliance, and internal controls should be discussed in MD&A. “Highly important” in this context may imply a higher threshold than “materiality” for the financial statements.

SFFAS 15, *Management’s Discussions and Analysis,* paragraph 5 states:

> Because MD&A must be concise if it is to be useful, management must select the most important matters to discuss. This means that some items that are material to the financial statements, notes, and other sections of the GPFFR may not be discussed in MD&A.

The issuance of this Statement does not affect the materiality considerations applied to MD&A as stated in SFFAC 3 and SFFAS 15.

BOARD APPROVAL AND DISSENT

A27. This Statement was approved for issuance by XX members of the Board. One member dissented. The written ballots are available for public inspection at FASAB's office. The dissent of the member who opposed the issuance of this Statement is presented in paragraphs A28 through A31.

A28. Mr. McNamee dissents to the issuance of this Statement. This statement defines materiality as, "A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could *reasonably be expected* that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information." [*Emphasis added*.] The Board has used the same words, "reasonably be expected," in SFFAS 5, paragraph 33, to define the term "probable":

> "Probable" refers to that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims.

A29. Mr. McNamee believes this provision of SFFAS 5 establishes that, for federal financial reporting, "reasonably be expected" has the same meaning as "more likely than not~~.~~" " and is thus ~~Mr. McNamee agrees with the Board's conclusion in this statement that "more likely than not" is not appropriate in assessing the overall application of materiality because it conveys a lower degree of likelihood compared to the general meaning of "probable" in other sectors. Extending that conclusion, Mr. McNamee believes that if "more likely than not" is~~ not a suitable gauge of materiality in federal financial reporting~~, then neither is "reasonably be expected", as it has been construed in SFFAS 5~~.

A30. The Board quotes this provision of SFFAS 5 in paragraph A11 of this basis for conclusions, but it does not address its apparent inconsistency with the intended meaning of "reasonably be expected" in this statement. Rather, it goes on to say that, "'more likely than not' conveys a lower degree of likelihood compared to the general meaning of… 'can reasonably be expected.'" Mr. McNamee believes the Board should state explicitly that this statement defines "reasonably be expected" differently than SFFAS 5 does.

~~A29.~~A31. In deliberations prior to issuing the exposure draft of this statement, the Board considered using the term "substantial likelihood" in its definition of materiality. Mr. McNamee believes "substantial likelihood" is preferable to "reasonably be expected" in defining materiality for federal financial reporting, given the latter term's being synonymous with "more likely than not." Using "substantial likelihood" in the Board's definition of materiality would also have the advantage of achieving alignment with the auditing standards if the Auditing Standards Board adopts its proposal to revise its definition of materiality to use "substantial likelihood".

~~A30.~~A32. In paragraph A12, the Board cites as a reason for not using the term "substantial likelihood" is "that [term] had not been previously used by FASAB and would require a specific definition that could inhibit the preparer's judgment when applying materiality. Mr. McNamee observes that other standards setters - including the PCAOB and, in its exposure draft, the Auditing Standards Board – do not define "substantial likelihood," and he questions why it would be necessary for FASAB to do so. If, however, the Board believes it is necessary to define the words it uses to communicate the degree of certainty associated with materiality, then Mr. McNamee believes defining the term "substantial likelihood" would be clearer than creating a new definition of "reasonably be expected".

~~A31.~~A33. Mr. McNamee believes the Board should not issue this statement. It should expose for public comment a new proposed concepts statement incorporating the term "substantial likelihood" in its definition of materiality.

APPENDIX B: ABBREVIATIONS

ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FN	Footnote
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GAS	Government Auditing Standards
GPFFR	General Purpose Federal Financial Report
MD&A	Management's Discussion and Analysis
SEC	Securities and Exchange Commission
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

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Sallyanne Harper

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Federal Accounting Standards Advisory Board

MATERIALITY:

AMENDING STATEMENT OF FEDERAL FINANCIAL ACCOUNTING CONCEPTS (SFFAC) 1, *OBJECTIVES OF FEDERAL FINANCIAL REPORTING*, AND SFFAC 3, *MANAGEMENT'S DISCUSSION AND ANALYSIS*

Statement of Federal Financial Accounting Concepts 9

XXXX, 2019

October 8, 2019

CLEAN DRAFT VERSION

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Accounting standards are typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from FASAB or its website:

- Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- Mission Statement: Federal Accounting Standards Advisory Board, exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

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SUMMARY

This Statement of Federal Financial Accounting Concepts (Statement or SFFAC) updates concepts related to the application of materiality in the federal financial reporting environment. Through amendments to SFFAC 1, *Objectives of Federal Financial Reporting,* and SFFAC 3, *Management's Discussion and Analysis*, this SFFAC clarifies implementation of materiality concepts in the issuance of federal financial statements.

A reporting entity considers materiality in the application of specific requirements to information contained in its general purpose federal financial reports. This Statement clarifies the materiality guidance. It defines the users, scope, and factors to consider when applying materiality in the federal environment. This Statement will help federal financial report preparers apply the materiality concepts in federal financial reporting.

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CONCEPTS

AMENDMENTS TO SFFAC 1, *OBJECTIVES OF FEDERAL FINANCIAL REPORTING*

1. This paragraph amends Statement of Federal Financial Accounting Concepts (Statement or SFFAC) 1, *Objectives of Federal Financial Reporting,* by inserting a chapter titled *Materiality* between the current chapter 6*: Qualitative Characteristics of Information in Financial Reports* and chapter 7: *How Accounting Supports Federal Financial Reporting*. The new *Materiality* chapter is as follows:[1]

164a. A reporting entity considers materiality in the application of accounting and reporting requirements. The Federal Accounting Standards Advisory Board (FASAB or "the Board") intends that information presented in accordance with generally accepted accounting principles (GAAP)[12.1] will not contain misstatements, including omissions of information, considered material. Such omissions include information that is necessary for a reasonable financial report user (reasonable user)[2] to understand the effect of particular material transactions, other events, and conditions on the entity's financial statements, notes to the financial statements, and required supplementary information.[3]

> Footnote (FN) 12.1 Such information would include financial statements, notes to the financial statements, and required supplementary information.

164b. A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information.

164c. 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, after quantitative and qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

164d. Misstatements should be considered individually and in the aggregate. Materiality determinations regarding such misstatements should include consideration of both qualitative and quantitative factors. Information that is not considered quantitatively material may be considered qualitatively material if it can reasonably be expected to change or influence the judgment of a reasonable user. Qualitative

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[1] The inserted chapter will become chapter 7: *Materiality and* the existing chapters following chapter 6 in SFFAC 1 will be renumbered to accommodate the insertion.

[2] A reasonable financial report user has appropriate knowledge of the federal government's activities and reviews and analyzes the information diligently.

[3] Statement of Federal Financial Accounting Standards 57, *Omnibus Amendments 2019*, eliminates required supplementary stewardship information (RSSI) in the general purpose federal financial report.

considerations include the public accountability[4] of the reporting entity; applicable legal and regulatory requirements; the visibility and sensitivity of government programs, activities, and functions; as well as other factors that may affect a reasonable user's judgment about the information.

164e. Materiality concepts and related factors should be considered when making materiality judgments. While specific qualitative and quantitative thresholds for materiality are not provided, illustrative factors are discussed in paragraphs 164c and 164d of this Statement.

164f. In applying materiality concepts, the specific needs of a reasonable user should be considered. In the federal government environment, such needs generally differ from those of the commercial entity financial report user. For example, due to the visibility and sensitivity of government programs, the needs of federal government financial report users extend to having the ability to assess the allocation and use of resources in the federal government. Further, compliance with laws, regulations, contracts, and grant agreements is also a significant consideration of the user.[12.2]

> FN 12.2 Information requiring protection from unauthorized disclosure is referred to as "classified national security information." The application of federal financial accounting standards needs to support the legal requirements to protect classified national security information.

164g. To emphasize that materiality should be considered in applying the accounting standards, the Board will place the following notice at the end of each Statement of Federal Financial Accounting Standards (SFFAS):

> The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial. [FN]
>
> FN: Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting,* chapter 7, titled *Materiality,* for a detailed discussion of the materiality concepts.

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A9. The SEC Staff Accounting Bulletin Topic 1.M.1 states, "Even though a misstatement of an individual amount may not cause the financial statements taken as a whole to be materially misstated, it may nonetheless, when aggregated with other misstatements, render the financial statements taken as a whole to be materially misleading."[6] The Board has a similar view. Misstatements should be considered individually and in the aggregate.

A10. Financial statements presented fairly in accordance with GAAP could contain misstatements as long as those misstatements are not material. Additionally, the Board believes materiality-based judgment in federal financial reporting can assist in eliminating redundant and unnecessary disclosures.

A11. This Statement defines materiality in terms of the likelihood[7] that a misstatement, including the omission of information, *could reasonably be expected* to affect the judgment of a reasonable user relying on the information. In SFFAS 1 the Board stated "The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement."[8] The Board considered the use of "probable" when developing the materiality concepts in this Statement. Specifically, the following information was considered:

a. In SFFAS 1, the Board recognized that the word probable is subject to broad interpretation and therefore chose to use "the more stringent criterion of more likely than not – when there is more than a 50 percent chance" of occurrence.[9]

[6] The SEC '*Codification of Staff Accounting Bulletins, Topic 1: Financial Statements*'; available online at https://www.sec.gov/interps/account/sabcodet1.htm#M; last accessed July 31, 2019.

[7] "Likelihood" and "threshold" refers to the level of certainty at which missing or incorrect information in financial statements is considered to have an impact on the decision making of reasonable users. A higher likelihood or threshold equates to a greater level of certainty and a lower likelihood or threshold equates to a lower level of certainty.

[8] SFFAS 1, par 13.

[9] SFFAS 1, par.127 and 128.

b. In SFFAS 5, *Accounting for Liabilities of The Federal Government*, "probable" is referred to as "that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims. For those claims, "probable" implies that the future confirming event or events are likely to occur…."[10]

The Board does not believe "more likely than not" is appropriate in assessing the overall application of materiality because it conveys a lower degree of likelihood compared to the general meaning of "probable" and "can reasonably be expected." The Board also does not believe "probable" (in the context of the more narrowly defined usage in SFFAS 1) is appropriate because using "probable" in the materiality concepts could lead to unreasonable expectations regarding precision.

A12. In arriving at the materiality definition in paragraph 164b, the Board also observed that materiality definitions vary among other standard-setters' current and proposed guidance. Some of the materiality definitions include:

a. The International Accounting Standards Board (IASB) uses "*could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make*."[11] *[Emphasis added]*

b. The Financial Accounting Standards Board (FASB) uses "*probable that the judgment of a reasonable person relying upon the report would have been changed or influenced*."[12] *[Emphasis added]*

c. The Public Company Accounting Oversight Board (PCAOB) uses substantial likelihood in the following context: "…there are certain accounts or disclosures for which there is *a substantial likelihood that misstatements of lesser amounts than the materiality level established for the financial statements as a whole would influence the judgment of a reasonable investor*."[13] *[Emphasis added]*

d. In addition, the Audit Standards Board (ASB) currently uses "Misstatements, including omissions, are considered to be material if, individually or in the aggregate, they *could reasonably be expected to influence economic decisions of users that are taken based on the financial statements*." The ASB has proposed to use "Misstatements, including omissions, are considered to be material if there is *a substantial likelihood that, individually or in the aggregate, they would influence the judgment of a reasonable user made based on the financial statements*."[14] *[Emphasis added]*

A13. Prior to the exposure of the proposed materiality concepts the Board discussed whether to use "substantial likelihood" or "could reasonably be expected" in its materiality definition with respect to the level of certainty that the judgment of a reasonable user

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[10] SFFAS 5, par.33.

[11] IASB *Definition of Material (Amendments to IAS 1 and IAS 8),* October 2018.

[12] FASB Concepts Statement No. 8 *Qualitative Characteristics of Useful Financial Information*, August 2018.

[13] PCAOB Auditing Standard No. 11 *Consideration of Materiality in Planning and Performing an Audit,* August 2010.

[14] On June, 2019, the ASB issued an exposure draft of a proposed Statement on Auditing Standards, *Amendments to the Description of the Concept of Materiality.*

would be changed or influenced . The Board noted that “substantial likelihood” had not been previously used by FASAB and would require a specific definition that could inhibit the preparer’s judgment when applying materiality. Ultimately, the Board proposed “could reasonably be expected” in its exposure draft and received positive feedback on it from the respondents.

A14. As the Board stated in SFFAS 1, “The Board may refer to the pronouncements and statements issued by other standard setting bodies in deliberating accounting standards for the federal government. However, the Board is not bound by these pronouncements and statements, especially when accounting standards promulgated for other sectors[15] are not relevant to the federal government.”[16] Due to the public accountability of government entities, various legal and regulatory requirements, and the visibility and sensitivity of government programs, the materiality thresholds in federal practice may be different from those in the commercial practice. The Board concluded that “could reasonably be expected” provides for a reasonable level of assurance while providing for sufficient capacity to accommodate the distinguishing characteristics of the federal environment.

A15. The Board recognizes the differences in terms used to define materiality, and expects that federal financial statement preparers use a common materiality definition as provided in this concept Statement. The Board also recognizes the possibility that the definitions of materiality may be applied differently by the preparers and auditors. The Board considered the merits of convergence with the audit literature, but concluded that aligning the materiality definitions was not essential because materiality in terms of financial statement reporting is different from the financial statement audit perspective. The Board also discussed the possibility of waiting for the ASB materiality standards to become final before proceeding with its final materiality concepts. The Board agreed that the final outcome of the ASB standards would not change the Board’s current stance on using “could reasonably be expected” in its definition of materiality. It was also noted that an unusual precedent could be set by the Board by waiting for the outcome of another standard setting body to develop its guidance before setting the Board’s guidance. Each standard-setter sets its standards for the unique characteristics of its jurisdiction. The Board concluded that using “could reasonably be expected” is appropriate in assessing materiality in the federal financial reporting environment.

A16. The Board does not provide specific quantitative or qualitative considerations in this Statement. Both quantitative and qualitative considerations are typically entity specific. Other existing literature already provides detailed guidance on materiality considerations. Materiality considerations could vary depending on whether the reporting entity is a sub-component, component, or the government-wide reporting entity.

A17. In certain situations, an entity may have a quantitatively significant balance or activity that would lead to a quantitatively high entity-wide materiality threshold. If applied to the entity’s other balances or activities, such elevated materiality amounts could influence a reasonable user’s judgment regarding the rest of the entity’s activities. In such cases, qualitative factors should be considered to determine whether separate materiality considerations are warranted. Materiality may vary by financial statement, line item, or group of line items within that entity.

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[15] Sectors refer to the commercial sector, state and local government sector, etc.

[16] SFFAS 1, par.126.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

A18. The Board issued the exposure draft (ED) on October 15, 2018, with comments originally requested by January 23, 2019. In light of the partial government shutdown during the comment period, some departments and agencies may not have been able to respond by the deadline; therefore, FASAB extended the comment deadline to March 11, 2019.

A19. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the *Federal Register*, FASAB News, the Journal of Accountancy, Association of Government Accountants Topics, the CPA Journal, Government Executive, the CPA Letter, the Financial Statement Audit Network, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A20. The Board did not rely on the number of respondents in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised. The respondents' significant comments and Board response are summarized below.

A21. FASAB received 19 responses from preparers, users of federal financial information, and professional associations. Nearly all respondents agreed with the proposed materiality concepts and their placement in a concepts statement. The placement in a concepts statement provides broad flexibility when exercising materiality judgments, while also providing consistency across standards without overriding existing materiality guidance. In addition, respondents also agreed that this guidance is not significantly different from their current application of materiality in practice.

A22. Some respondents suggested creating a separate chapter in SFFAC 1 regarding materiality due to its importance. After carefully considering the comments received and the fact that materiality concepts may affect a reporting entity at various levels and areas of responsibility, accountability, and mission, the Board decided to place the materiality guidance in SFFAC 1 by creating a new chapter 7 titled *Materiality.*

A23. Based on several respondents' suggestions, the Board modified the following guidance originally proposed in the ED:

a. The Board eliminated the following wording from paragraph164c: "Therefore, misstatements of relatively small amounts could have a material effect on the financial statements. For example, an amount that is not quantitatively material with respect to a very large line item may be material with respect to a smaller line item." This avoids the misinterpretation that each line would have its own unique quantitative materiality value.

b. The Board defined the term "reasonable financial report user (reasonable user)" in footnote 2 to ensure consistency and clarity of its use throughout the guidance.

A24. Some respondents suggested providing detailed quantitative and qualitative guidance or references to other existing literature for materiality considerations. The Board concluded that its emphasis on the importance of evaluating both quantitative and qualitative factors in the determination of materiality, without providing specifics, allows entities broader flexibility in exercising materiality judgments. References to existing literature would not be valuable, as it is not the Board's intent to endorse or prioritize these sources. As such, no specific reference to other existing literature is provided.

A25. Several respondents asked about the effect of this guidance on the existing non-authoritative sections of other Statements and the *FASAB Handbook,* where materiality is also discussed. For example, there is a materiality discussion in the Introduction sections of SFFAS 1 and SFFAS 3 and in the Foreword section of the *FASAB Handbook*. These sections are considered non-authoritative guidance and will be updated with a reference to this Statement.

A26. Additionally, the Board observed that existing concepts and standards discuss materiality in the context of management's discussion and analysis (MD&A). SFFAC 3's Figure 1: Schematic Diagram of a Sample General Purpose Federal Financial Report states:

> The assertions and report on control called for by the Federal Managers Financial Integrity Act (FMFIA or Integrity Act) would not be stated in full in MD&A. They would be reported in a discrete section of the GPFFR or incorporated in the GPFFR by reference. They are within the scope of MD&A because highly important aspects of systems, compliance, and internal controls should be discussed in MD&A. "Highly important" in this context may imply a higher threshold than "materiality" for the financial statements.

SFFAS 15, *Management's Discussions and Analysis,* paragraph 5 states:

> Because MD&A must be concise if it is to be useful, management must select the most important matters to discuss. This means that some items that are material to the financial statements, notes, and other sections of the GPFFR may not be discussed in MD&A.

The issuance of this Statement does not affect the materiality considerations applied to MD&A as stated in SFFAC 3 and SFFAS 15.

BOARD APPROVAL AND DISSENT

A27. This Statement was approved for issuance by XX members of the Board. One member dissented. The written ballots are available for public inspection at FASAB's office. The dissent of the member who opposed the issuance of this Statement is presented in paragraphs A28 through A31.

A28. Mr. McNamee dissents to the issuance of this Statement. This statement defines materiality as, "A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could *reasonably be expected* that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information." [*Emphasis added*.] The Board has used the same words, "reasonably be expected," in SFFAS 5, paragraph 33, to define the term "probable":

> "Probable" refers to that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims.

A29. Mr. McNamee believes this provision of SFFAS 5 establishes that, for federal financial reporting, “reasonably be expected” has the same meaning as “more likely than not” ” and is thus not a suitable gauge of materiality in federal financial reporting.

A30. The Board quotes this provision of SFFAS 5 in paragraph A11 of this basis for conclusions, but it does not address its apparent inconsistency with the intended meaning of “reasonably be expected” in this statement. Rather, it goes on to say that, “’more likely than not’ conveys a lower degree of likelihood compared to the general meaning of… ‘can reasonably be expected.’” Mr. McNamee believes the Board should state explicitly that this statement defines “reasonably be expected” differently than SFFAS 5 does.

A31. In deliberations prior to issuing the exposure draft of this statement, the Board considered using the term “substantial likelihood” in its definition of materiality. Mr. McNamee believes “substantial likelihood” is preferable to “reasonably be expected” in defining materiality for federal financial reporting, given the latter term’s being synonymous with “more likely than not.” Using “substantial likelihood” in the Board’s definition of materiality would also have the advantage of achieving alignment with the auditing standards if the Auditing Standards Board adopts its proposal to revise its definition of materiality to use “substantial likelihood”.

A32. In paragraph A12, the Board cites as a reason for not using the term “substantial likelihood” is “that [term] had not been previously used by FASAB and would require a specific definition that could inhibit the preparer’s judgment when applying materiality. Mr. McNamee observes that other standards setters - including the PCAOB and, in its exposure draft, the Auditing Standards Board – do not define “substantial likelihood,” and he questions why it would be necessary for FASAB to do so. If, however, the Board believes it is necessary to define the words it uses to communicate the degree of certainty associated with materiality, then Mr. McNamee believes defining the term “substantial likelihood” would be clearer than creating a new definition of “reasonably be expected”.

A33. Mr. McNamee believes the Board should not issue this statement. It should expose for public comment a new proposed concepts statement incorporating the term “substantial likelihood” in its definition of materiality.

APPENDIX B: ABBREVIATIONS

ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FN	Footnote
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GAS	Government Auditing Standards
GPFFR	General Purpose Federal Financial Report
MD&A	Management's Discussion and Analysis
SEC	Securities and Exchange Commission
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

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Attachment 4: Proposed Draft Language for Basis for Conclusion Paragraphs A11 – A15

A11. This Statement defines materiality in terms of the likelihood[1] that a misstatement, including the omission of information, *could reasonably be expected* to affect the judgment of a reasonable user relying on the information. The Board ultimately concluded that “could reasonably be expected” was the appropriate level of certainty to use in determining whether a misstatement would affect the judgment of a reasonable user. When developing the materiality definition in paragraph 164b, the Board considered the terms “probable” and “more likely than not” currently used in existing FASAB pronouncements, as alternatives to “could reasonably be expected”. The Board noted inconsistencies throughout FASAB guidance in the meaning of “probable.” “Probable” was used ~~to~~in the context of recogniz~~e~~ing ~~the~~ a liability. Liabilities are only ~~as~~ one element of the financial ~~statements~~. ~~not the financial statements~~ statements. The Board does not believe it would be appropriate to apply “probable” as used to define liabilities in to the overall materiality of the statements as a whole. The Board also does not believe “more likely than not” (more than a 50 percent chance of occurrence[2]) is appropriate in assessing the overall application of materiality because that degree of likelihood is too low of a threshold and conveys a lower degree of likelihood compared to “can reasonably be expected” used by certain other standard-setters. Therefore, the Board concluded that both “probable” and “more likely than not” were not appropriate to be used in the materiality definition. ~~In SFFAS 1 the Board stated “The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.”[3] The Board considered the use of “probable” when developing the materiality concepts in this Statement. Specifically, the following information was considered:~~

~~a. In SFFAS 1, the Board recognized that the word probable is subject to broad interpretation and therefore chose to use “the more stringent criterion [i.e., more narrowly defined] of more likely than not – when there is more than a 50 percent chance” of occurrence.[4]~~

~~b. In SFFAS 5, *Accounting for Liabilities of The Federal Government*, “probable” is referred to as “that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic, with the exception of pending or threatened litigation and unasserted claims. For those claims, “probable” implies that the future confirming event or events are likely to occur….”[5]~~

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[1] “Likelihood” and “threshold” refers to the level of certainty at which missing or incorrect information in financial statements is considered to have an impact on the decision making of reasonable users. A higher likelihood or threshold equates to a greater level of certainty and a lower likelihood or threshold equates to a lower level of certainty.

[2] SFFAS 1, par.128

~~[3] SFFAS 1, par 13.~~

~~[4] SFFAS 1, par.127 and 128.~~

~~[5] SFFAS 5, par.33.~~

~~The Board does not believe "more likely than not" is appropriate in assessing the overall application of materiality because it conveys a lower degree of likelihood compared to the general meaning of "probable" and "can reasonably be expected." The Board also does not believe "probable" (in the context of the more narrowly defined usage in SFFAS 1) is appropriate because using "probable" in the materiality concepts could lead to unreasonable expectations regarding precision.~~

A12. Prior to the exposure of the proposed materiality concepts, the Board also discussed whether to use "substantial likelihood" or "could reasonably be expected" in its materiality definition. The Board noted that "substantial likelihood" had not been previously used by FASAB and would require a specific definition that could inhibit the preparer's judgment when applying materiality. Due to the public accountability of government entities, various legal and regulatory requirements, and the visibility and sensitivity of government programs, the materiality thresholds in federal practice may be different from those in the commercial practice. Each standard-setter sets its standards for the unique characteristics of its constituency. The Board concluded that, for purposes of this Statement, "could reasonably be expected" is based on whether a reasonable person would expect that a misstatement would affect the judgment of a reasonable user, and therefore ~~that~~ "could reasonably be expected" allows appropriate flexibility and judgment in considering the specific facts, circumstances, size, and nature of the misstatement when assessing whether a misstatement is material. It also accommodates the distinguishing characteristics of the federal environment. Ultimately, the Board proposed "could reasonably be expected" in its exposure draft and received positive feedback on it from the respondents.

~~A12.~~A13. In arriving at the materiality definition in paragraph 164b, the Board also observed that materiality definitions vary among other standard-setters' current and proposed guidance. Some of the materiality definitions include:

a. The International Accounting Standards Board (IASB) uses "*could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make*."[6] *[Emphasis added]*

b. The Financial Accounting Standards Board (FASB) uses "*probable that the judgment of a reasonable person relying upon the report would have been changed or influenced*."[7] *[Emphasis added]*

c. The Public Company Accounting Oversight Board (PCAOB) uses substantial likelihood in the following context: "…there are certain accounts or disclosures for which there is *a substantial likelihood that misstatements of lesser amounts than the materiality level established for the financial statements as a whole would influence the judgment of a reasonable investor*."[8] *[Emphasis added]*

d. In addition, the Audit Standards Board (ASB) currently uses "Misstatements, including omissions, are considered to be material if, individually or in the aggregate, they *could reasonably be expected to influence economic decisions*

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[6] IASB *Definition of Material (Amendments to IAS 1 and IAS 8)*, October 2018.

[7] FASB Concepts Statement No. 8 *Qualitative Characteristics of Useful Financial Information*, August 2018.

[8] PCAOB Auditing Standard No. 11 *Consideration of Materiality in Planning and Performing an Audit*, August 2010.

of users that are taken based on the financial statements." The ASB has proposed to use "Misstatements, including omissions, are considered to be material if there is *a substantial likelihood that, individually or in the aggregate, they would influence the judgment of a reasonable user made based on the financial statements*."[9] *[Emphasis added]*

~~A13. Prior to the exposure of the proposed materiality concepts the Board discussed whether to use "substantial likelihood" or "could reasonably be expected" in its materiality definition with respect to the level of certainty that the judgment of a reasonable user would be changed or influenced . The Board noted that "substantial likelihood" had not been previously used by FASAB and would require a specific definition that could inhibit the preparer's judgment when applying materiality. Ultimately, the Board proposed "could reasonably be expected" in its exposure draft and received positive feedback on it from the respondents.~~

~~A14. As the Board stated in SFFAS 1, "The Board may refer to the pronouncements and statements issued by other standard setting bodies in deliberating accounting standards for the federal government. However, the Board is not bound by these pronouncements and statements, especially when accounting standards promulgated for other sectors[10] are not relevant to the federal government."[11] Due to the public accountability of government entities, various legal and regulatory requirements, and the visibility and sensitivity of government programs, the materiality thresholds in federal practice may be different from those in the commercial practice. The Board concluded that "could reasonably be expected" provides for a reasonable level of assurance while providing for sufficient capacity to accommodate the distinguishing characteristics of the federal environment.~~

~~A15.~~A14. The Board recognizes the differences in terms used to define materiality, and expects that federal financial statement preparers use a common materiality definition as provided in this concept Statement. The Board also recognizes the possibility that the definitions of materiality may be applied differently by ~~among~~ the preparers and auditors ~~of federal financial statements~~. The Board considered the merits of convergence with the audit literature, but concluded that aligning the materiality definitions was not essential because materiality in terms of financial statement reporting is different from the financial statement audit perspective. The Board also discussed the possibility of waiting for the ASB materiality standards to become final before proceeding with its final materiality concepts. The Board agreed that the final outcome of the ASB standards would not change the Board's current stance on using "could reasonably be expected" in its definition of materiality. It was also noted that an unusual precedent could be set by the Board by waiting for the outcome of another standard setting body to develop its guidance before setting the Board's guidance. ~~Each standard-setter sets its standards for the unique characteristics of its jurisdiction. The Board concluded that using "could reasonably be expected" is appropriate in assessing materiality in the federal financial reporting environment..~~

[9] On June, 2019, the ASB issued an exposure draft of a proposed Statement on Auditing Standards, *Amendments to the Description of the Concept of Materiality.*

~~[10] Sectors refer to the commercial sector, state and local government sector, etc.~~

~~[11] SFFAS 1, par.126.~~