



Federal Accounting Standards Advisory Board

June 6, 2019

Memorandum

To: Members of the Board

From: Grace Wu, Assistant Director

Through: *Monica R. Valentine*
Monica R. Valentine, Executive Director

Subject: Materiality¹ – Tab C

MEMBER ACTIONS REQUESTED:

- Please review the pre-ballot draft in Attachment 1 and provide your feedback before June 21.

MEMO OBJECTIVE

The meeting objective is to obtain feedback on the pre-ballot draft concepts Statement, *Materiality*. As a reminder, the pre-ballot offers members an opportunity for minor edits but not to make substantive changes.

BRIEFING MATERIAL

The briefing material includes this memorandum and the following attachments. Attachment 1 provides the pre-ballot draft version with suggested edits based on comments received.

Attachment 1: Pre-ballot draft concepts Statement *Materiality*- **Marked**

Attachment 2: Pre-ballot draft concepts Statement *Materiality*- **Clean**

BACKGROUND

At the April 24, 2019 Board meeting, the Board reviewed the comments received on the *Materiality* ED during the comment period and discussed the respondents' suggestions. After carefully considering the comments received, the Board agreed to modify the following guidance originally proposed in the exposure draft:

- To emphasize the importance of materiality to a reporting entity, in the current Statement of Federal Financial Accounting Concepts 1 *Objectives of Federal*

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.

Financial Reporting, a new chapter titled *Materiality* was created and will be inserted between the current chapter 6: Qualitative Characteristics of Information in Financial Reports and chapter 7: How Accounting Supports Federal Financial Reporting.

- The following wording was eliminated from paragraph 164c: “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 deletion avoids the possible misinterpretation that each line would have its own unique quantitative materiality value.
- The term "reasonable financial report user" is now defined in a footnote in the opening paragraph, and the consistent use of this term is clarified throughout the Statement.

The Board also agreed not to reference other existing literature to allow entities broader flexibility in exercising materiality judgments. It is not the Board’s intent to endorse or prioritize other existing literature. In addition, the existing non-authoritative sections of other Statements and the *FASAB Handbook*, where materiality is also discussed, will be updated with a reference to this Statement.

DISCUSSION POINTS

Based on the Board’s discussion at the April 2019 meeting and members’ comments provided on the May 17, 2019 draft staff has made revisions. The updated draft Statement is included in Attachment 1 for your review. Below are the open points for discussion during the June Board meeting.

1. Summary Section

Member Comment: The materiality decisions are made by preparers out of sight of users. I think we should delete this sentence: “It also helps financial statement users improve their understanding and comprehension of federal financial reports.”

Staff Response: Staff believes that a clearer, federal related, and user focused materiality concept would help preparers to prepare better financial statements. This idea is stated in the prior sentence before the sentence in question: “this SFFAC clarifies implementation of materiality concepts in the issuance of federal financial statements.” The sentence in question intends to state that better prepared financial statements will help its users improve their understanding of the financial reports. To clarify, do you agree to revise the last sentence to “Better prepared financial statements would help financial statement users improve their understanding of federal financial reports”?

2. Concepts Paragraph 164d

Member comment: How, specifically, will we address the statement in SFFAS 3, par. 14, “the accounting and reporting provisions of the Board’s recommended standards should be applied to all items that would influence or change the users’ judgment of the entity’s efficiency and effectiveness and its compliance with laws and regulations in a material manner.” I think one can argue that our new concept covers compliance with laws and regulations because we cite legal compliance as a qualitative factor in 164d. But we are silent in this new concept statement about efficiency and effectiveness, which is at the core of the materiality guidance in SFFAS 3. Should we state that public accountability, visibility and sensitivity, etc. encompass the notions of efficiency and effectiveness stated in SFFAS 3?

Staff Response: Paragraph 164d states: “Qualitative considerations factors include the public accountability 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 judgments about the information.” SFFAC 1 has a definition of accountability that includes efficiency and effectiveness assessment. Does the Board believe the notion of efficiency and effectiveness should be added to paragraph 164d?

3. Basis for Conclusion Paragraph A7

Is the quote from the Yellow Book section 6.03 necessary in paragraph A7 or should it be deleted or moved to footnote?

4. Basis for Conclusion Paragraph A10

Member Comment: Immaterial and irrelevant are not synonyms, immaterial covers irrelevant. Irrelevant should be deleted form this sentence: “The Board believes that federal financial reporting should emphasize disclosing material information, not immaterial or irrelevant information.”

Staff Response: Staff agrees that immaterial and irrelevant are not synonyms. Relevant is a broader concept than materiality and the Board is encouraging preparers to avoid including immaterial and irrelevant information in the financial report. Does the Board believe “irrelevant” is necessary in paragraph A10?

5. Basis for Conclusion Paragraph A22

Does the Board believe paragraph A22 is necessary in the Materiality concept Statement, given the Board revisions being proposed to SFFAC 3 and SFFAS 15?

NEXT STEPS

Staff's goal is to ballot before the August 2019 meeting. Members that 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 require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the Board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at (202) 512-7377 or by e-mail at wug@fasab.gov with a cc to ValentineM@fasab.gov.



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

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. [Better prepared financial statements #](#) ~~would also help~~ financial statement users improve their understanding ~~and comprehension~~ of federal financial reports.

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 ~~to provide important information~~ in federal financial ~~reports~~ reporting.

Comment [GW1]:
#1 discussion point

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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 user² (reasonable user) to understand the effect of particular material transactions, other events, and conditions on the entity’s financial statements, required supplementary information (RSI), or required supplementary stewardship information (RSSI).

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

164b. A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it ~~can~~ 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 ~~considerations~~ 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 ~~considerations~~ factors include the public accountability of the reporting entity; applicable legal and regulatory requirements; the visibility and sensitivity of

Comment [GW2]: #2 discussion point

¹ Because the inserted chapter will become chapter 7: *Materiality*, the current chapters after 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 ~~is willing to~~ diligently reviews and analyzes the information diligently.

government programs, activities, and functions; as well as other factors that may affect a reasonable user's judgments about the information.

164e. ~~The materiality~~ concepts and related factors ~~established~~ should be considered when making materiality judgments. ~~While specific~~ qualitative and quantitative thresholds for materiality are not provided, ~~only the example~~ factors discussed in paragraphs 164c and 164d are included in 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 ~~needs~~ 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~~.

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~~ty~~ and unnecessary disclosure by providing only relevant information.
- A2. Currently, materiality is discussed in three Statements: SFFAC 3, *Management's Discussion and Analysis*; SFFAS 1, *Accounting for Selected Assets and Liabilities*; and SFFAS 3, *Accounting for Inventory and Related Property*. The Board ~~believed-concluded~~ 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 presented draft materiality concepts to the note disclosures task force. The task force included federal financial report preparers, auditors, and consultants. Task force members agreed that 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 ~~as-a-result-of-its-improved clarity, detail, and organization~~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. Federal financial report users have different needs compared to users of commercial entity financial reports. The users identified in SFFAC 1 (citizens, Congress, federal executives, and federal program managers) are the users the Board considered in developing this materiality Statement.

A7. The Board considered the guidance in the Government Accountability Office’s 2018 *Government Auditing Standards* (GAS) section 6.03³ when assessing the materiality concepts for the federal environment. Similar to what is stated in GAS 6.03 and noted in paragraph 164f, the needs of the federal government report users generally differ from those of the commercial entity financial report user. In addition, paragraph 164f also discusses some important elements related to the visibility and sensitivity of government programs:

6.03 Standards used in conjunction with GAGAS require the auditors to apply the concept of materiality appropriately in planning and performing the audit.^{FN omitted} Additional considerations may apply to GAGAS engagements that concern government entities or entities that receive government awards. For example, for engagements conducted in accordance with GAGAS, auditors may find it appropriate to use lower materiality levels than those used in non-GAGAS audits because of the public accountability of government entities and entities receiving government funding, various legal and regulatory requirements, and the visibility and sensitivity of government programs.

Comment [GW3]: #2 discussion point

A8. Misstatements are often easier to assess using quantitative considerations. However, magnitude by itself, without regard to the nature of the misstatement and the circumstances in which the judgment about it has to be made, generally is not 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 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.”⁴ The Board has a similar view. Misstatements should be considered individually and in the aggregate.

A10. Standards do not require perfection. ~~instead, the standards allow~~ Thus, for example, financial statements presented fairly in accordance with GAAP may contain for misstatements as long as they those misstatements are not material. The Board believes that federal financial reporting should emphasize disclosing material information, not immaterial or irrelevant information.

Comment [GW4]: #3 discussion point

A11. This Statement defines materiality in terms of the likelihood that a reasonable user’s judgment would be affected by the misstatement. SFFAS 1 states that materiality depends on whether “omitting or misstating information about the item makes it probable that the judgment of a reasonable person”⁵ would be affected. In SFFAS 1, “probable” is recognized as being “subject to broad interpretation” and does not mean “more likely than not.”⁶ In SFFAS 5, *Accounting for Liabilities of The Federal Government*, “probable”

³ GAO, *Government Auditing Standards 2018 Revision*, GAO-18-568G (Washington, D.C.: Jul 17, 2018), 109-110.

⁴ 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 June 3, 2019.

⁵ SFFAS 1, par.13.

⁶ SFFAS 1, par.127 and 128.

is defined as “more likely than not.”⁷ The Board does not believe “more likely than not” is appropriate in assessing materiality because it would be a lower degree of likelihood compared to the general meaning of “probable” in other sectors and SFFAS 1. Using “probable” in the materiality concepts could lead to unreasonable expectations regarding precision. The Board believes “reasonably expected” is more consistent with current practice and is appropriate in [assessing materiality in](#) the federal government environment ~~when assessing materiality.~~

- A12. 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.
- A13. In certain situations, an entity may have a quantitatively significant balance or activity that would lead to a high quantitative entity-wide materiality amount. If used to assess materiality for the entity’s other balances or activities, such materiality amounts could allow misstatements that would affect reasonable users’ judgments regarding the rest of the entity’s activities. In such cases, qualitative factors could lead to a separate materiality consideration.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

- A14. 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, but subsequently revised to March 11, 2019, due to the partial government shutdown.](#)
- A15. 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).
- A16. 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.
- A17. 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,

⁷ SFFAS 5, par.19, footnote 9.

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.

- A18. 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 SFFAC1 by creating a new chapter 7 titled *Materiality*.
- A19. Based on several respondents' suggestions, the Board modified the following guidance originally proposed in the ED:
- The Board eliminated the following wording from paragraph 164c: "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.
 - 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.
- A20. 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.
- A21. 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.
- A22. [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

Comment [GW5]: #5 discussion point

MD&A.” Therefore, the issuance of this Statement will not affect the materiality thresholds applied to MD&A as stated in SFFAC 3 and SFFAS 15.

BOARD APPROVAL

A23. This Statement was approved for issuance by all members of the Board.

APPENDIX B: ABBREVIATIONS

ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FN	Footnote
GAAP	Generally Accepted Accounting Principles
GAGAS	Generally Accepted Government Auditing Standards
GAO	Government Accountability Office
GAS	Government Auditing Standards
MD&A	Management's Discussion and Analysis
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SEC	Securities and Exchange Commission
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

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SUMMARY

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CONCEPTS

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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 user² (reasonable user) to understand the effect of particular material transactions, other events, and conditions on the entity’s financial statements, required supplementary information (RSI), or required supplementary stewardship information (RSSI).

Footnote (FN)12.1 Such information would include financial statements and notes to the financial statements, required supplementary information, and required supplementary stewardship 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 factors include the public accountability of the reporting entity; applicable legal and regulatory requirements; the visibility and sensitivity of government programs,

¹ Because the inserted chapter will become chapter 7: *Materiality*, the current chapters after 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.

activities, and functions; as well as other factors that may affect a reasonable user's judgments 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, example factors discussed in paragraphs 164c and 164d are included in 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.~~

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 disclosure by providing only relevant information.
- A2. Currently, materiality is discussed in three Statements: SFFAC 3, *Management's Discussion and Analysis*; SFFAS 1, *Accounting for Selected Assets and Liabilities*; and SFFAS 3, *Accounting for Inventory and Related Property*. The Board concluded 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 presented draft materiality concepts to the note disclosures task force. The task force included federal financial report preparers, auditors, and consultants. Task force members agreed that 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. Federal financial report users have different needs compared to users of commercial entity financial reports. The users identified in SFFAC 1 (citizens, Congress, federal executives, and federal program managers) are the users the Board considered in developing this materiality Statement.

A7. The Board considered the guidance in the Government Accountability Office's 2018 *Government Auditing Standards* (GAS) section 6.03³ when assessing the materiality concepts for the federal environment. Similar to what is stated in GAS 6.03 and noted in paragraph 164f, the needs of the federal government report users generally differ from those of the commercial entity financial report user. In addition, paragraph 164f also discusses some important elements related to the visibility and sensitivity of government programs:

6.03 Standards used in conjunction with GAGAS require the auditors to apply the concept of materiality appropriately in planning and performing the audit.^{FN omitted} Additional considerations may apply to GAGAS engagements that concern government entities or entities that receive government awards. For example, for engagements conducted in accordance with GAGAS, auditors may find it appropriate to use lower materiality levels than those used in non-GAGAS audits because of the public accountability of government entities and entities receiving government funding, various legal and regulatory requirements, and the visibility and sensitivity of government programs.

A8. Misstatements are often easier to assess using quantitative considerations. However, magnitude by itself, without regard to the nature of the misstatement and the circumstances in which the judgment about it has to be made, generally is not 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 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."⁴ The Board has a similar view. Misstatements should be considered individually and in the aggregate.

A10. Standards do not require perfection. Thus, for example, financial statements presented fairly in accordance with GAAP may contain misstatements as long as those misstatements are not material. The Board believes that federal financial reporting should emphasize disclosing material information, not immaterial or irrelevant information.

A11. This Statement defines materiality in terms of the likelihood that a reasonable user's judgment would be affected by the misstatement. SFFAS 1 states that materiality depends on whether "omitting or misstating information about the item makes it probable that the judgment of a reasonable person"⁵ would be affected. In SFFAS 1, "probable" is recognized as being "subject to broad interpretation" and does not mean "more likely than not."⁶ In SFFAS 5, *Accounting for Liabilities of The Federal Government*, "probable"

³ GAO, *Government Auditing Standards 2018 Revision*, GAO-18-568G (Washington, D.C.: Jul 17, 2018), 109-110.

⁴ 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 June 3, 2019.

⁵ SFFAS 1, par.13.

⁶ SFFAS 1, par.127 and 128.

is defined as “more likely than not.”⁷ The Board does not believe “more likely than not” is appropriate in assessing materiality because it would be a lower degree of likelihood compared to the general meaning of “probable” in other sectors and SFFAS 1. Using “probable” in the materiality concepts could lead to unreasonable expectations regarding precision. The Board believes “reasonably expected” is more consistent with current practice and is appropriate in assessing materiality in the federal government environment.

- A12. 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.
- A13. In certain situations, an entity may have a quantitatively significant balance or activity that would lead to a high quantitative entity-wide materiality amount. If used to assess materiality for the entity’s other balances or activities, such materiality amounts could allow misstatements that would affect reasonable users’ judgments regarding the rest of the entity’s activities. In such cases, qualitative factors could lead to a separate materiality consideration.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

- A14. 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..
- A15. 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).
- A16. 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.
- A17. 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

⁷ SFFAS 5, par.19, footnote 9.

guidance. In addition, respondents also agreed that this guidance is not significantly different from their current application of materiality in practice.

- A18. 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 SFFAC1 by creating a new chapter 7 titled *Materiality*.
- A19. Based on several respondents' suggestions, the Board modified the following guidance originally proposed in the ED:
- The Board eliminated the following wording from paragraph 164c: "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.
 - 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.
- A20. 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.
- A21. 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.
- A22. 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." Therefore, the issuance of this Statement will not affect the materiality thresholds applied to MD&A as stated in SFFAC 3 and SFFAS 15.

BOARD APPROVAL

A23. This Statement was approved for issuance by all members of the Board.

APPENDIX B: ABBREVIATIONS

ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FN	Footnote
GAAP	Generally Accepted Accounting Principles
GAGAS	Generally Accepted Government Auditing Standards
GAO	Government Accountability Office
GAS	Government Auditing Standards
MD&A	Management's Discussion and Analysis
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SEC	Securities and Exchange Commission
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

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