Federal Accounting Standards Advisory Board

August 7, 2019

Memorandum

MEMBER ACTIONS REQUESTED:
• Please review the updated pre-ballot draft in attachment 1 and provide your feedback before August 23.

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

MEEETING OBJECTIVE

The meeting objective is to review and approve the updated pre-ballot draft concepts statement, *Materiality*. As a reminder, the pre-ballot offers members an opportunity for minor edits but not substantive changes.

BRIEFING MATERIAL

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

The briefing material includes this memorandum and the following attachments:

Attachment 1: Updated Pre-ballot Draft Concepts Statement *Materiality*- **Marked**
Attachment 2: Updated Pre-ballot Draft Concepts Statement *Materiality*- **Clean**

BACKGROUND

At the June 26, 2019 Board meeting, members reviewed a *Materiality* pre-ballot draft and made the following major changes:

- Eliminated the following statement from the summary section: "It also helps financial users improve their understanding and comprehension of federal financial reports." The Board noted the proposed statement may help the Board and preparers assess materiality, but including such a statement about the effect on users may be inaccurate.

[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.

- Removed the references to Required Supplementary Stewardship Information (RSSI) from paragraph 164a. Instead, staff added a footnote noting SFFAS 57, *Omnibus Amendments 2019*, eliminates RSSI in the general purpose federal financial report.

- Added a footnote to paragraph 164d, a reference to the SFFAC 1, *Objectives of Federal Financial Reporting*, to identify different kinds of accountability and relevant qualitative considerations.

- Removed from the basis for conclusions the quoted material from the Government Auditing Standards, section 6.03.

The Board also agreed to update the pre-ballot draft by adding new paragraphs (A12 – A13) in the basis for conclusions to discuss the different materiality definitions used in other standards-setters' current and proposed guidance. The Board noted using "could reasonably be expected" in its materiality definitions is better suited in the federal financial reporting environment. Attachment 1 provides the updated pre-ballot draft version with suggested edits based on member comments received.

PROJECT PHASE

The materiality project is nearing the end of the resolution phase where the Board is reviewing a pre-ballot draft statement.

NEXT STEPS

Staff's goal is to provide a ballot draft before the end of the August 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.

Mr. Patrick McNamee's Dissent to the Issuance of Materiality Concept Statement August 9, 2019

Mr. McNamee dissents to the issuance of this Statement. He believes that the Board should defer action on this Statement until the ASB completes its project on materiality. Then the Board should seek public input on the implications of differences between the definitions of materiality in federal financial accounting concepts and auditing standards applied in the federal government.

The minutes of the June 2018 Board meeting reflect that one Board member "suggested adapting language used by both the Auditing Standards Board and the International Auditing and Assurance Standards Board. Both boards utilize 'reasonably be expected' in their discussions surrounding materiality. The Board acknowledged the merits of using similar wording in the materiality ED." Mr. McNamee believes this discussion indicates the potential benefits of alignment between the auditing and accounting definitions of materiality and the need for further due process before determining it would be in the public interest to have different definitions.

Paragraph A13 of this Statement presents the Board's basis for accepting the possibility that materiality definitions will differ for preparers ("could reasonably be expected") and auditors ("substantial likelihood") of federal financial statements. Mr. McNamee believes this basis is insufficiently articulated in light of the history of the development of this Statement.

At its June 2018 meeting, the Board shifted from using the term "substantial likelihood" to "could reasonably be expected". The minutes of that meeting state, "Various members expressed concern that materiality required a higher threshold of certainty than "substantial likelihood" communicated and stressed the importance of making this clear to readers." The Board now asserts the terms do not differ significantly in substance. It then appears to contradict that assertion, speculating that "could reasonably be expected" may represent a lower threshold than "substantial likelihood". Mr. McNamee believes the Board needs to explain clearly why its thinking has changed since June 2018 to mitigate potential adverse consequences that could arise from preparers and auditors using different definitions of materiality.

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

PRE-BALLOT DRAFT

AUGUST 7, 2019

MARKED 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, 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.

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 is 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 regard to 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 that a reasonable user's judgment would be affected by a 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"[7] would be affected.

a. In SFFAS 1, "probable" is recognized as being "subject to broad interpretation" and the Board believes that "probable" reflects a higher likelihood than "more likely than not."[8]

b. In SFFAS 5, *Accounting for Liabilities of The Federal Government*, "probable" is defined as "more likely than not."[9] The Board does not believe "more likely than not" is appropriate in assessing materiality because it conveys a lower degree of likelihood compared to the general meaning of "probable" in other sectors and SFFAS 1.

c. The Board also does not believe "probable" is appropriate because using "probable" in the materiality concepts could lead to unreasonable expectations regarding precision.

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[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] SFFAS 1, par.13.

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

[9] SFFAS 5, par.19, footnote 9.

A12. In arriving at its definition, the Board also observed materiality definitions vary among other standards-setters' current and proposed guidance. Some examples include:

a. The International Accounting Standards Board utilizes the term "could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make" in its definition.

b. The Financial Accounting Standards Board utilizes "probable that the judgment of a reasonable person relying upon the report would have been changed or influenced."

c. The Public Company Accounting Oversight Board utilizes "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."

d. In addition, the Audit Standards Board (ASB) currently uses "could reasonably be expected to influence economic decisions of users." The ASB has proposed to use "substantial likelihood that, individually or in the aggregate, they would influence the judgment of a reasonable user made based on the financial statements."[10]

A13. The Board recognizes the possibility that the definitions of materiality may be different between the preparers and auditors of federal financial statements. Although the terms may differ, the Board concluded they do not differ significantly in substance. 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.[11] Among those terms, the Board concluded that "could reasonably be expected" may represent a lower threshold than "probable" and "substantial likelihood" and is appropriate in assessing materiality in the federal financial reporting environment.

A14. 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.

A15. 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

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[10] On June 5, 2019, the ASB issued an exposure draft of a proposed Statement on Auditing Standards, *Amendments to the Description of the Concept of Materiality.*

[11] This is consistent with GAO's materiality threshold discussion in GAO GAS section 6.03.

A16. 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.

A17. 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).

A18. 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.

A19. 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.

A20. 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.*

A21. 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.

A22. 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.

A23. 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.

A24. 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

A25. 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
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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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

PRE-BALLOT DRAFT

AUGUST 7, 2019

CLEAN VERSION

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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, 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.

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 is 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 regard to 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 that a reasonable user's judgment would be affected by a 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"[7] would be affected.

a. In SFFAS 1, "probable" is recognized as being "subject to broad interpretation" and the Board believes that "probable" reflects a higher likelihood than "more likely than not."[8]

b. In SFFAS 5, *Accounting for Liabilities of The Federal Government*, "probable" is defined as "more likely than not."[9] The Board does not believe "more likely than not" is appropriate in assessing materiality because it conveys a lower degree of likelihood compared to the general meaning of "probable" in other sectors and SFFAS 1.

c. The Board also does not believe "probable" is appropriate because using "probable" in the materiality concepts could lead to unreasonable expectations regarding precision.

[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] SFFAS 1, par.13.
[8] SFFAS 1, par.127 and 128.
[9] SFFAS 5, par.19, footnote 9.

A12. In arriving at its definition, the Board also observed materiality definitions variy among other standards-setters' current and proposed guidance. Some examples include:

a. The International Accounting Standards Board utilizes the term "could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make" in its definition.

b. The Financial Accounting Standards Board utilizes "probable that the judgment of a reasonable person relying upon the report would have been changed or influenced."

c. The Public Company Accounting Oversight Board utilizes "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."

d. In addition, the Audit Standards Board (ASB) currently uses "could reasonably be expected to influence economic decisions of users." The ASB has proposed to use "substantial likelihood that, individually or in the aggregate, they would influence the judgment of a reasonable user made based on the financial statements."[10]

A13. The Board recognizes the possibility that the definitions of materiality may be different between the preparers and auditors of federal financial statements. Although the terms may differ, the Board concluded they do not differ significantly in substance. 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.[11] Among those terms, the Board concluded that "could reasonably be expected" may represent a lower threshold than "probable" and "substantial likelihood" and is appropriate in assessing materiality in the federal financial reporting environment.

A14. 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.

A15. 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

[10] On June 5, 2019, the ASB issued an exposure draft of a proposed Statement on Auditing Standards, *Amendments to the Description of the Concept of Materiality.*

[11] This is consistent with GAO's materiality threshold discussion in GAO GAS section 6.03.

A16. 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.

A17. 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).

A18. 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.

A19. 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.

A20. 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.*

A21. 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.

A22. 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.

A23. 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.

A24. 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

A25. 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
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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