FASAB Exposure Draft: Questions for Respondents due January 23, 2019

Materiality

Please select the type(s) of organization responding to this exposure draft. If you are not responding on behalf of an organization, please select "individual."

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Federal Entity (user)			
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Please provide your name.

Name: **Joanne Gasparini, Acting Deputy Chief Financial Officer**

Please identify your organization, if applicable.

Organization: **Social Security Administration (SSA)**

Q1. The Board proposes materiality concepts providing a discussion of users, scope, and factors to consider in the federal government environment. Refer to paragraph 1.

a. Do you agree or disagree with the proposed materiality section? Please provide the rationale for your answer.

SSA Response: We agree, with the exception of paragraph 191c, that updates and clarification are needed to the proposed materiality section. The proposed materiality section provides additional clarity for applying the concept of materiality to financial statements by expanding on the concept of misstatements when considering the needs of key users in the Federal environment. Additionally, the Board emphasizes the importance of evaluating both quantitative and qualitative factors in the determination of materiality, without providing specifics, which allows entities broader flexibility in exercising materiality judgments.

Regarding paragraph 191c, we agree with the first two sentences provided:

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

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Our concerns center on the last three sentences (as shown below) of paragraph 191c.

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

Per our reading, it appears the proposed language indicates that the materiality basis from a quantitative perspective could be different for every line on the financial statements. If our interpretation is correct, we believe additional information is necessary, such as providing examples and additional information on how to make these determinations. If our interpretation is incorrect, we ask that the language be updated to avoid any possible confusion. (Please note, we offer proposed updated language under Q1b below.)

We understand from the sentence, "Consequently, after quantitative and qualitative factors are considered…," materiality may vary by statement or line items. We also agree that materiality differs based on qualitative factors (such as fraud), even if amounts do not meet the quantitative basis value. However, the next sentence, "Therefore, misstatements of relatively small amounts…" with the example provided in the last sentence of paragraph 191c, could be interpreted that each line would have its own unique quantitative material value. This interpretation is of concern, if the quantitative materiality value were to fluctuate on a financial statement for every line item. We would also question, as to how would we establish this quantitative basis?

Currently, GAO Financial Audit Manual (FAM) Section 230.9 provides guidance on using either Total Assets or Total Expenses, as a benchmark for quantitative materiality. This benchmark provides a starting point to establish a materiality threshold on a quantitative basis. However, if the materiality value changes from line to line, what would be the basis, other than perhaps the use of percentage changes (which raises a question of the starting value to evaluate the change)? In addition, should the quantitative value be subject to change line by line? For example, if an entity has Total Assets of $100 billion, with Property, Plant, Equipment valued at $5 million at the end of one year and later discovers that the full $5 million was an error and the value should be zero, would this be a quantitative material difference, requiring restatement? From an individual line item perspective, the quantitative basis would be a 100 percent error; however, the likely impact on the reader would be minimal, given the relative value to the Total Assets and the related quantitative basis of the Total Assets. While qualitative factors may cause the error to be material, it is problematic to evaluate each line separately from a quantitative perspective.

We understand that each financial statement, due to the different purposes and information provided, could potentially have its own quantitative materiality threshold, if that is the intended interpretation of the proposed language. The GAO FAM guidance does provide options (the larger of the values) to use Assets or Expenses as a benchmark; thus, indicating that the quantitative value may depend on the overall type of activity (or statement) being reviewed. However, we believe having a different quantitative materiality threshold for different line items on the same statement would be problematic.

While our interpretation of this guidance may be incorrect, we want to ensure that it is clear to the reader that materiality can vary according to each agency's determination when considering all factors (quantitatively and qualitatively).

Please see our proposed updated language under the next sub-question (Q1b).

b. Do you have any suggestions that would enhance the section?

SSA Response: As discussed above, we propose the following three options for updating paragraph 191c.

Option 1 (SSA preferred) – "Materiality should be evaluated in the context of the specific reporting entity, and should consider both quantitative and qualitative factors. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size and nature of the misstatement."

This option would remove the potentially confusing language regarding quantitative materiality varying by statement and line item(s) and would stress the consideration of both quantitative and qualitative factors. This option allows materiality to be based on non-quantitative values.

Option 2 – "Materiality should be evaluated in the context of the specific reporting entity, and should consider both quantitative and qualitative factors. 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."

Option 2 would not include the sentence with the example discussing strictly quantitative basis (last sentence of paragraph 191c). This option, we believe is valid when evaluating all factors and that material items could vary in size based on qualitative factors. However, this language may still be confusing to the reader. If this language is considered too vague, we offer the following option:

Option 3 – "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. Therefore, misstatements of relatively small amounts (that do not exceed the quantitative value basis) could have a material effect on the financial statements, if qualitative factors would affect the reader's opinion of the financial statements."

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This option provides more information on how small dollar misstatements could still be material based on qualitative factors. (If that is the intent of the language.)

Q2. The Board proposes placing the materiality concepts in Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting.* Refer to paragraph A14.

Do you agree or disagree with the placement within concepts and specifically in SFFAC 1? Please provide the rationale for your answer.

SSA agrees. The placement of the proposed materiality concepts in an SFFAC provides broader flexibility when exercising materiality judgments, while also providing consistency across standards, without overriding existing materiality guidance.

While we agree with the placement in SFFAC 1, we question the placement in paragraph 191. This materiality paragraph is in the section of SFFAC 1 that discusses the financial reporting and the budget, which does not seem to relate directly to the discussion around materiality. We suggest creating a materiality section in SFFAC 1 and inserting this language (requires adjustment of paragraph numbering).