

FASAB Exposure Draft: Questions for Respondents due February 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."

Accounting Firm

Federal Entity (user)

Federal Entity (preparer)

Federal Entity (auditor)

Federal Entity (other)

Association/Industry Organization

Nonprofit organization/Foundation

Other

Individual

X

If other, please specify:

If other, please specify:

Please provide your name.

Name:

Richard C. Culbertson

Please identify your organization, if applicable.

Organization:

Asset Leadership Network

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? Response:

- Partially (if only one choice No.)

b. Please provide the rationale for your answer.

- This is a great opportunity to straighten a lot of confusion about materiality, directly for financial reporting purposes but also indirectly for asset management, operations and auditing. The other areas may focus on full framework of internal control as indicated in the GAO Green Book: effective and efficient operations reliable financial and non-financial reporting and compliance with laws and regulations... This is also a great opportunity to harmonize the GAO Yellow Book (attestations audits, performance audits), the GAO Green Book and 2 CFR PART 200—UNIFORM ADMINISTRATIVE REQUIREMENTS, COST PRINCIPLES, AND AUDIT REQUIREMENTS FOR FEDERAL AWARDS.
- The placement of the addition should apply to more than high level budgets and operational results that apply to those budgets. The reader and others may believe materiality is confined to the section "Relationship of Financial Reporting to Budgeting".

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

FASAB Exposure Draft: Questions for Respondents due February 2019***Materiality***

- Address the multidimensional aspects of materiality in financial reporting, asset management, operations and auditing. These differ but usually have a lot in common, but they should be viewed and used independently. For example, a Government department for accounting purposes, may have a capitalization threshold of \$100,000 but an asset accountability threshold of \$10,000, or for material in inventory or plant maintenance functions much less. It is important that management have the authority and responsibility to manage the materiality concepts and related thresholds. Concurrently management must vigorously comply with and balance the requirement, of GAO Green Book and the GAO Yellow Book, including the protection of assets and minimizing administrative cost. The auditing function should not try to set materiality threshold for those being audited. That is management's responsibility. The auditor can, of course, assess certain issues of effectiveness, efficiency, reliability reporting and compliance with GAAP, laws, regulations, and compliance with internal policy. Materiality is contextual.
- The materiality section should cover how accounting and asset management relate. Organizations must have the freedom to approach these disciplines semi-independently. There is much commonality between the disciplines, but one should not impair the other with unworthwhile, useless or irrelevant work.
- Place the content in another section, other than 191a. Another concept on its own would be worthwhile, as how things are managed from bottom to top depending upon the concept of materiality. The use of materiality concepts impacts an organization at various levels and areas of responsibility, accountability, and mission. For financial accounting reporting purposes at the organization level, materiality thresholds can and should be high, as finite details may not be worthwhile and useful for the readers. Sometimes too much detail is harmful as the reader and the high-level decision maker can get lost in the details.
- There needs to be an expansion on the concept of qualitative materiality. Actively seek qualitatively material information that exposes waste, fraud and abuse and mismanagement. We suggest this can be done by requiring affirmations to compliance with the GAO Blue Book regarding internal controls.

FASAB Exposure Draft: Questions for Respondents due February 2019***Materiality***

The section should harmonize with the Cost Accounting Standards "9903.305 Materiality. An edited version:

In determining whether amounts of cost are material or immaterial, the following criteria shall be considered where appropriate; no one criterion is necessarily determinative:

- (a) The absolute dollar amount involved. The larger the dollar amount, the more likely that it will be material.
- (b) The amount of cost compared with the amount under consideration. The larger the proportion of the amount under consideration to overall cost, the more likely it is to be material.
- (c) The relationship between a cost item and a cost objective.
- (d) If the administrative process is used for internal control purposes, high value negative or positive risk management, a key performance indicator, or protection of high value assets, it is more likely to be material.
- (e) The cumulative impact of individually immaterial items. It is appropriate to consider whether such impacts:
 - (1) Tend to offset one another, or
 - (2) Tend to be in the same direction and hence to accumulate into a material amount.
- (f) The cost of administrative processing shall be considered if the actual administrative cost is excessive in relationship to the benefits from what may be duplicative controls. For example, if an accountability threshold for equipment is \$500 and the annual cost to maintain the accountability is \$450 and the marginal net loss for the lack of finite accountability averages \$10.00 because of other controls in place, the \$500 threshold is too low, and adjustments should be made. There may be other approaches to meet the same outcome with much less administrative cost. On the other hand, it would be reckless, for asset management and operational purposes to just manage items at the same level as the capitalization threshold.

SEC Staff Accounting Bulletin: No. 99 – Materiality provides excellent guidance on materiality.

ASTM E 2279 regarding the Guiding Principles of Property Asset Management combines portions of the Cost Accounting Standards and SEC requirements and defines: materiality, n—magnitude of an omission or misstatement of accounting data that misleads financial statement

FASAB Exposure Draft: Questions for Respondents due February 2019***Materiality***

readers or decision makers; materiality is judged both by relative amount and by the nature of the item.

Discussion—For example, even a small theft by the president of a company is material. If an item is material, it should be disclosed in the body of the financial statements or footnotes (Securities and Exchange Commission Staff Accounting Bulletin). In determining whether items or amounts of cost are material or immaterial, the following quantitative and qualitative criteria should be considered where appropriate but no one criterion is necessarily determinative: (1) the absolute dollar amount involved, (2) the relationship between a cost item/occurrence and a cost objective, (3) the criticality of an item in terms of importance or use, (4) the cumulative impact of individually immaterial items, and (5) the cost of administrative processing (Federal Acquisition Regulations).

- 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.

Disagree. The concept of materiality and the proper use of materiality should be its own high-level concept document and expansion of the concept and the accountability for disclosure of material information. Frequently, organizations do not want to provide material information. Transparency is good and drives prioritization, accountability and self-correction. Materiality having its own concept will improve performance. Understanding the concept of materiality, if approached correctly, is liberating. Concurrently, material information must be disclosed. Negative or embarrassing material information must be disclosed.

Other Comments:

There should be no expectation or excuse to indicate that some Government work deserves lower thresholds than commercial or non-government work. That may bias the use of thresholds. Government work needing lower thresholds may have been true in the past but not now in that most organizations use some form of the COSO Internal Control Framework. The internal control framework, if used properly, should drive for optimization of thresholds based upon facts, circumstances and valuations.

The concept of materiality includes quantitative and qualitative considerations.

Qualitative information may inform stakeholders just as much or more than quantitative information. Some examples:

The requirements for the self-disclosure of qualitatively material information should be further expanded upon including some common expectations. With single audits there may not be enough auditing to provide reasonable assurance for all stakeholders.

FASAB Exposure Draft: Questions for Respondents due February 2019

Materiality

Some examples of material information that should have been self-disclosed and explained but was not:

- See GAO Study **CONTRACTOR BUSINESS SYSTEMS**
<https://www.gao.gov/assets/700/696801.pdf>

Table 4: Deficiencies Identified Between Fiscal Years 2015 and 2017 for Completed DOD Contractor Business System Reviews

Agency	Business system	Reviews completed	Reviews where significant deficiencies were found	Percentage of reviews where significant deficiencies were found
Defense Contract Audit Agency	Accounting	3	0	0%
	Estimating	9	7	78%
	Material Management and Accounting	12	9	75%
Defense Contract Management Agency	Purchasing	330	260	79%
	Property Management	2,934	26	1%
	Earned Value Management	891	9	1%

Source: GAO analysis of data from Defense Contract Management Agency functional offices and Defense Contract Audit Agency | GAO-19-212

Only two DoD contractor business systems provide reasonable assurance of compliance to Government regulations. Considering the large amount of money and resources going through the DoD business systems, the lack of assessments should be a concern to stakeholders. This chart provides significant key performance indicators (KPIs).

- There is a large multi-state public utility corporation --- publicly traded, that receives Government grant funds. This utility is focusing on growth in a state that is slow growth. One state utility has a rate base per customer over twice as much as a sister company Both operating essentially under the same type of location, laws and regulations. What is the top priority spending to expand the rate base or spending occurs only when verifiably necessary? Are there internal control deficiencies, and unreasonable and imprudent cost?
- Same corporation in its 10-K management claims it has adopted the COSO Internal Control Framework (GAO Green Book), which includes compliance with laws and regulations. Upon a basic review of some fundamentals, it was discovered that this corporation was using the wrong testing pressure for testing plastic pipes. The construction code standard, for low pressure lines, is 3 pounds per square inch, Federal Department of Transportation regulations requires not more than 50 pounds per square inch and this utility's internal policy required 90 pounds per square inch (essentially this is destructive testing of assets and dangerous to employees). This practice appears to have been in place at least since 1970. 1970 was when the Federal regulation that applies to gas utilities requiring not more than 50 pounds per square inch was published.

What does this indicate for the internal controls, including safety of employees, quality assurance functions and operations of this publicly traded corporation? What does it indicate of the six state utility commissions and others that this was not caught and corrected long ago? This is qualitatively material information for each responsible organization. Material weakness and significant deficiencies should be self-disclosed as well as corrective actions.

FASAB Exposure Draft: Questions for Respondents due February 2019

Materiality

- “People do not do what you expect but what you inspect.” (Lou Gerstner) There must be sufficient internal and external audits. The lack of internal and external audits is qualitatively material information. Required self-disclosures prompts self-correction and self-improvement.

The public and other stakeholders need to know for example:

- Performance against high level Key Performance Indicators is qualitatively material information. If the organization does not use Key Performance Indicators that is material information.
- The organization's maturity level in the use of the GAO Green Book, levels 1-5 in accomplishing objectives in the areas of: 1) Effective and efficient operations; 2) Reliable reporting; 3) Compliance with laws and regulations...

TABLE 1 Five Maturity Levels

Description		Definition	Descriptive Terms
1.0	Basic	Processes that are chaotic, undocumented, and inconsistent, typically the starting point of a process.	Start of process, processes having basic framework, duties are assigned, and task performers are identified.
2.0	Structured	Processes that have been defined and are understandable, documented, and capable of being repeated.	Defined, documented, capable of being repeated, understandable, implemented.
3.0	Consistent	Processes that are prescribed and consistently performed at the organizational level with consistent results.	Established and prescribed, consistently performed, consistent results obtained.
4.0	Managed	Processes that are systematic, have process performance established, and are predictable.	Systematic, calculated, regulated, metrics applied, objectives established, continuous improvement.
5.0	Optimizing	Processes that are embedded within an organization and are supported through all levels of management.	Habitual, perpetual, inherent quality, recurrent, culturally embedded, supported throughout all levels of the organization.

FASAB Exposure Draft: Questions for Respondents due February 2019***Materiality***

From (ASTM E2452)

See Appendix A1 for further criteria of the maturity levels.

- Use of International Management Systems Standards (Office of Management and Budget (OMB) Circular A-119, "Federal Participation in the Development and Use of Voluntary Consensus Standards and in Conformity Assessment Activities," <https://www.federalregister.gov/documents/2016/01/27/2016-01606/revision-of-omb-circular-no-a-119-federal-participation-in-the-development-and-use-of-voluntary>

Please provide answers to the following for your organization. Has your organization adopted the following international consensus standards?

- ISO 9000 Quality Management Y/N, Certification Y/N
 - ISO 55000 Asset Management Y/N, Certification Y/N
 - ISO 31000 Risk Management Y/N
 - Other Consensus Standards used, certified or intending to use within the next year.
- Maturity level of the system for recognition, policy promulgation and implementation of applicable legal and regulatory requirements.
- Maturity level of the ethics, compliance and whistleblower system. Are all submissions recorded, independently investigated and appropriate actions taken? Is the system used to improve performance of the organization?
- Maturity level of the Corrective Action Request system to improve or correct the integrity or quality of operations and activities?
- List three of the most significant positive and negative recognitions occurrences, or awards or penalties within the last year.

Appendix A Maturity Levels

Attribute	Level 1 -- Basic	Level 2 -- Managed
	Processes are generally ad hoc and chaotic; success primarily depends on heroics	Projects of the organization ensure requirements are managed and processes are planned, performed, measured, and controlled
Performance	Not Performed, or ad-hoc; cannot repeat successes	Partially performed; successes repeatable
Threshold	Negligence averted; processes only implemented to avert negative outcomes	Standards, process descriptions, and procedures may be quite different in each specific instance of the process
Environment	Unstable; frequently exceed budget and schedule	Some tracking of cost and schedule; visibility of major milestones
Benefits	Not aware of the benefits	Very high-level framework provides a consistent reference in executing the organization's objectives
Who	Individual heroics	Multifunctional responsibility
When	Typically, not performed, or erratic	Performed inconsistently or late
Process	No consistent process; ad hoc responses to problems	Formal process; standard processes understood and improved over time
Expertise	Limited or no expertise with certification	Some knowledge and skills and limited certification
Tools	No tools applied	Basic tools applied inconsistently
Comments	The work is generally not very reliable, but it may suit the needs at the time. There is not much understanding of the importance of the work. The work is probably inconsistent with others doing like work. Without the heroics or hero, failure is likely. There is very limited assurance. There may be high self-confidence. They are likely to be a laggard in adopting of innovations. No self-assessment or third-party assessments.	Outcome is better than level one and are performed more effectively and efficiently, more reliable and more compliant. Limited assurance. They are generally a late adopter of innovations.

Appendix A Maturity Levels

Attribute	Level 3 -- Defined	Level 4 -- Quantitative and Predictive
Level Description	Processes are understood at the organizational level; standard organizational processes, standards, tools, and methods exist that are tailored for use on the projects	Sub processes are selected that significantly contribute to overall process performance and they are controlled using quantitative techniques; quantitative objectives for quality and process performance are established; special causes of variation are detected and corrected as appropriate
Performance	Formally performed	Acknowledged contributor
Threshold	Processes are qualitatively predictable, but not quantitatively controlled	Metrics and goals around these metrics have been communicated throughout the organization
Environment	Budgeted for and Consistently applied across the organization	Predictability: management can identify ways to adjust and adapt without loss of quality; budget a priority
Benefits	Organization has the necessary competence and capabilities to meet basic mission and audit requirements	Organization has laid the baseline to quantitatively and qualitative assess its performance against mission and has a vision for improvement.
Who	Functional specialists	Organization has identified and trained cross functional or core team to interface with and maintain the property management system
When	Performed consistently and on time	Ongoing activity
Process	Formal process; standard processes understood and improved over time	Formal process drives performance
Expertise	Metrics and goals around these metrics have been communicated throughout the organization	Knowledgeable and experienced professional staff with appropriate certifications
Tools	Standard tools available and applied periodically	Standard tools applied consistently
Comments	Better internal controls than Level 2 and more assurance of meeting objectives. They are equally likely to be early adopter of innovations and a late adaptor of innovations.	Better internal controls than Level 3 and more assurance of meeting objectives. More likely to be an innovator or early adopter than a late adaptor of innovations.

Appendix A Maturity Levels

Attribute	Level 5 -- Optimizing
Level Description	The organization focuses on continually improving process performance through both incremental and technological improvements
Performance	Culturally embedded
Threshold	Processes are concerned with addressing common causes of process variation and changing the process
Environment	Agile and innovative, based on continuous improvement; budget incorporated into planning
Benefits	Benefits fundamentally important to success; assets meet mission requirements, and budget resources are appropriate for mission needs
Who	Extended team including external specialists
When	Seamless part of business processes
Process	Continuously improving processes
Expertise	Empowered senior level expertise and staff certified at highest levels
Tools	Use of advanced tools and methods
Comments	Outcome is better than Level 4 and are performed more effectively and efficiently, more reliable and more compliant. Achieves reasonable assurance by third party validation. Much more likely to be an innovator or early adopter than a late adopter or a laggard. Recognizes additional paths to improvement.