State Accounting Office of Georgia
Fiscal Leadership for Georgia

Statewide Accounting Policy & Procedure

Accounting Manual Reference:		**Effective Date:**	07/01/2009
Section:	Materiality	**Revision Date:**	06/30/2011
Sub-section:	Not Applicable		

Index:

Policy:
Financial information that is prepared by individual reporting organizations for inclusion in the State's financial statements as reported in the State's BCR or CAFR must be reliable and relevant in keeping with the financial reporting objectives defined by the Governmental Accounting Standards Board (GASB) in Concepts Statement No. 1, *Objectives of Financial Reporting*. See the *Fiscal Management Objectives* section of the Accounting Policy Manual for a discussion of the objectives of financial reporting. Therefore, financial information provided for financial statement preparation must not contain any material errors of omission or other material misstatements. Any material misstatements known by reporting organizations to exist in the accounting records must be corrected in the financial statements. Under no circumstances should an intentional misstatement be recorded or reported, regardless of materiality. Additionally, to ensure the reliability and relevance of financial statements, materiality alone should not be used as the rationale for failing to correct an error or omission.

With that in mind, professional judgment must be exercised by reporting organizations to prevent the inefficient use of State resources for recalculating, revising, adjusting or reclassifying activity recorded in the accounting records that is clearly insignificant for financial reporting purposes. The thresholds provided below are guidelines to assist with the quantitative assessment of materiality for post-closing adjustments and not day-to-day transactions. A reporting organization should quantitatively assess materiality both at the individual transaction level and in the aggregate, because a number of individually immaterial adjustments could sum to an aggregate amount that is material to the reporting organization's fund balance or net assets.

The reporting organization must also consider that the full assessment of materiality is not just quantitative. It is also dependent on the nature of the item. An item resulting from routine transactions may seem too small to be material, yet could be considered material if it arose in abnormal circumstances. Essentially, materiality must be assessed from the viewpoint of a financial statement user. An item is material if it is probable that a user's judgment or interpretation of the reported information would be changed or influenced by an omission or misstatement. Examples of qualitative assessments are provided in the *Background and Discussion* section below.

The SAO, at its discretion, may modify or disregard reporting adjustments or note disclosure data when determining what is material or immaterial for presentation in the government-wide BCR or CAFR. Only adjustments that are considered material to the fair presentation of the State's financial statements will be reported. Materiality is determined on a case-by-case basis in compliance with Section 7.4 of the GASB Comprehensive Implementation Guide (2009-2010). At the individual reporting organization level, materiality concepts may be applied to standalone financial statements or CAFRs, but must not be applied to standalone BCRs.

Threshold Guidelines:

Description	Quantitative Threshold Guideline	Comments Regarding Post-closing Adjustments (does not apply to day-to-day transactions)
Governmental activities (including internal service funds) – aggregate total all adjustments	3% of Net Assets	Adjustment is required for a reporting organization if aggregate governmental activities adjustments on a standalone basis equal or exceed 3% of its standalone governmental activities net assets.
Business-type activities (including proprietary funds) – aggregate total all adjustments	3% of Net Assets	Adjustment is required for a reporting organization if aggregate business-type activities adjustments on a standalone basis equal or exceed 3% of its standalone business-type activities net assets.
Aggregated component units – aggregate total all adjustments	3% of Net Assets	Adjustment is required for a reporting organization if aggregate component unit adjustments on a standalone basis equal or exceed 3% of its standalone component unit activities net assets.
Fiduciary fund net assets – aggregate total all adjustments	3% of Net Assets	Adjustment is required for a reporting organization if aggregate fiduciary fund adjustments on a standalone basis equal or exceed 3% of its standalone fiduciary fund net assets.
General fund – aggregate total all adjustments	3% of Fund Balance	Adjustment is required for a reporting organization if aggregate general fund adjustments on a standalone basis equal or exceed 3% of its standalone general fund balance.
Georgia State Financing and Investment Commission Fund – aggregate total all adjustments	3% of Fund Balance	Adjustment is required for GSFIC if aggregate GSFIC capital projects fund adjustments equal or exceed 3% of its capital projects fund balance.
Nonmajor governmental funds – aggregate total all adjustments	3% of Fund Balance	Adjustment is required for a reporting organization if aggregate nonmajor fund adjustments for each fund on a standalone basis equal or exceed 3% of each of its standalone nonmajor fund balances.

Description	Quantitative Threshold Guideline	Comments Regarding Post-closing Adjustments (does not apply to day-to-day transactions)
Trial balance reporting adjustments (used only for reporting purposes; not recorded to accounting records by the reporting organization, unless posted in the fiscal period subsequent to the reporting period)	$100,000	Adjustments less than the threshold are not generally made to the trial balance. Some adjustments may be approved by SAO, for example, to reflect the current year portion of a split pay period that spans two fiscal years but is charged by the payroll system entirely to the next fiscal year.
Payable/expenditure accruals	$100,000	Vouchers processed early in the next year must be assessed to ensure proper cutoff of estimated payables for the current year. If a reporting organization’s cumulative total to accrue is below the threshold, then accrual adjustments are not required.
Receivable/revenue accruals	$100,000	Revenues earned must be assessed to ensure the proper cutoff of estimated receivables for the current year. If a reporting organization’s cumulative total to accrue is below the threshold, then accrual adjustments are not required.
Petty cash/contingent funds	$100,000	No accrual adjustment is required for unreimbursed invoices if the aggregate amount for the reporting organization is less than the threshold.
Unrecorded year-end bank deposits	$100,000	Adjustments below the threshold for cash and equivalents are not required at year-end unless specifically directed to adjust by SAO.
Inventories	$100,000	Inventory adjustments that total less than the threshold do not need to be recorded. Also, items in supply cabinets for daily use by employees do not need to be recorded as inventory.
Prepaid Items	$100,000	Prepaid item adjustments that total less than the threshold do not need to be recorded. Also, items such as annual dues and subscriptions do not need to be recorded as prepayments.
Due to/from	$100,000	Adjustments below the threshold for inter-organization or component unit due to/due from are not required at year-end unless specifically directed to adjust by SAO.

Description	Quantitative Threshold Guideline	Comments Regarding Post-closing Adjustments (does not apply to day-to-day transactions)
Prior period adjustments – general fund	$100,000	SAO recommends that prior period adjustments less than the threshold be corrected through current year operations by debiting or crediting an appropriate revenue or expenditure account rather than by adjusting fund balance.
Prior period adjustments – other funds and government-wide entries	$100,000	Using the general fund prior period adjustment threshold as a maximum guide, reporting organizations should use professional judgment in assessing other prior period adjustments. For those assessed to be clearly insignificant, SAO recommends correcting through current year operations rather than by adjusting fund balance.
Capital assets/accumulated depreciation beginning balance (governmental activities only)	$100,000	Net beginning balance adjustments less than the threshold should be offset to expense rather than to equity as a prior period net assets adjustment.
Capital assets – impairment (governmental activities)	$100,000 for equipment / $250,000 for all other types	When assessing the potential impairment of capital assets for governmental activities, reporting organizations do not need to apply the requirements of GASB Statement No. 42 to individual assets with gross values less than the threshold.
Capital assets – impairment (proprietary and fiduciary funds)	Case-by-Case	The threshold for capital asset impairments for proprietary/fiduciary funds should be assessed on a case-by-case basis in consultation with SAO.
Pollution remediation obligations (PRO) – per site	$100,000	If the PRO for an individual site is below this threshold, without considering expected recoveries, then the reporting organization does not need to record the PRO unless the aggregated PRO threshold is met.
Pollution remediation obligations – aggregated at the individual reporting organization level	$1,000,000	With the concurrence of SAO, aggregate PRO's below this threshold do not need to be recorded.

Background and Discussion:
The GASB, Financial Accounting Standards Board (FASB), and Securities and Exchange Commission (SEC) all recognize that some assessment of materiality is appropriate for financial reporting purposes. Each statement issued by the GASB includes the following guideline: "The provisions of this Statement need not be applied to immaterial items." The challenge is to determine whether an item that appears to be immaterial from a quantitative aspect is actually material based on qualitative factors.

The FASB indicates in its Concepts Statement No. 2 that magnitude by itself, without regard to the nature of the item and the circumstances in which the judgment has to be made, will not generally be a sufficient basis for a materiality judgment. The GASB links materiality to the concept of reliability by stating in its Concepts Statement No. 1, that nothing material should be omitted from the information necessary to faithfully represent the underlying events and conditions, nor should anything be included that would cause the information to be misleading. Likewise, materiality is linked to relevance in GASB Concepts Statement No. 1 which indicates that information is relevant if it can make a difference in a user's assessment of a problem, condition, or event.

The GASB addresses materiality at the financial statement level in its Comprehensive Implementation Guide (2009-2010, Chapter 7, Section 7.4). Governmental activities, business-type activities, and each major fund are considered to be quantitatively material. The guide states: "Some information is required to be reported because of its *quantitative* significance; other information may be required for *qualitative* reasons rather than its monetary significance. Materiality determinations, both quantitative and qualitative, made in preparing financial statements should be responsive to, and consistent with, those requirements. That is, requirements in Statement 34 to provide separate financial statements or information are based on the belief that particular reporting units are "material."… In all cases, *qualitative* materiality aspects should be appropriately considered."

Given the nature of materiality, significant professional judgment is required when making an assessment. From a quantitative standpoint, not only must individual items be assessed, but the aggregate of individually immaterial items must also be considered when deciding if an amount is material to the financial statements. Even though materiality judgments are primarily quantitative, it is important to also consider the qualitative aspects when making an assessment. Qualitative factors could turn a quantitatively small misstatement into a material issue. Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 99 (SAB 99), *Materiality*, provides a comprehensive discussion of qualitative factors that can affect a materiality assessment. The following considerations (not all inclusive) are listed in SAB 99:

- Whether the misstatement arises from an item capable of precise measurement or whether it arises from an estimate and, if so, the degree of imprecision inherent in the estimate.
- Whether the misstatement masks a change in earnings or other trends.
- Whether the misstatement hides a failure to meet consensus expectations for the entity.
- Whether the misstatement changes a loss into income or vice versa.
- Whether the misstatement concerns a segment or other portion of the entity's business that has been identified as playing a significant role in the entity's operating results.
- Whether the misstatement affects the entity's compliance with regulatory requirements.
- Whether the misstatement affects the entity's compliance with loan covenants or other contractual requirements.
- Whether the misstatement has the effect of increasing management's compensation – for example, by satisfying requirements for the award of bonuses or other forms of incentive compensation.
- Whether the misstatement involves concealment of an unlawful transaction.

References:
Authoritative:
GASB Comprehensive Implementation Guide (2009-2010), Chapter 7, *Basic Financial Statements and Management's Discussion and Analysis*, Section 7.4

Non-authoritative:
The following references are in the "Other Sources" category of the GAAP hierarchy:

- GASB Concepts Statement No. 1, *Objectives of Financial Reporting*, paragraphs 64–65
- FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*, paragraphs 123–132
- FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, paragraph 63
- SEC Staff Accounting Bulletin No. 99, *Materiality*

Definitions:
Materiality (FASB – Concepts Statement No. 2 Glossary) – The magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

Relevant – Information can make a difference in a user's assessment of a problem, condition, or event.

Reliable – Information is verifiable, free from bias, faithfully represented, and comprehensive.

Reporting Organization – An organization of state government (state organization) as defined by OCGA 50-5B-4 – Without limitation, any agency, authority, department, institution, board, bureau, commission, committee, office, or instrumentality of the State of Georgia: The term shall not include any entity of local government, including, but not limited to, a county, municipality, consolidated government, board of education, or local authority, or an instrumentality of any such entity.