CSMFO GFOA CalCPA CCMA California Committee on Municipal Accounting

WHITE PAPER ON:

GASB STATEMENT IMPLEMENTATION AND MATERIALITY CONSIDERATIONS

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FOREWORD

Every year, the audit sweeps through municipal finance departments demanding documents, explanations, time for learning and implementing new standards, and the immediate recall of everything that has happened in the organization over the last 365 days. In this cacophony of activity, it is easy for practitioners to lose sight of the fundamental characteristics of solid financial statements: relevance and faithful representation. Relevance, meaning the usefulness of the information to users for understanding and decision making, including items determined to be material without which decisions may be different. Faithful representation comprises the qualities of completeness, objectivity, and freedom from error.

When practitioners lose sight of these pillars, they risk allocating limited staff hours to unnecessary work such as dealing with immaterial items. But how do they make the evaluation on materiality? What are all the considerations? How do they discuss this with the auditors if they have differing opinions? Most importantly, how can this evaluation process be streamlined for efficient implementation without taking the same level of effort on any unnecessary requirements when applying a statement?

This White Paper is intended to:

- Introduce the concept of materiality and provide governments with a tool to leverage the concept
- Provide a helpful guide for practitioners to apply to statement evaluation
- Empower practitioners with the information to make the best decisions appropriate for their facts and circumstances
- Support practitioners in the best practices for statement implementation preparation
- Facilitate the audit by fostering more informed discussions, and aligning expectations earlier in the process

Materiality is a qualitative and a quantitative concept and will require professional judgement by local government practitioners but not leveraging it means that governments are doing work that is not required. We hope this paper will begin a dialogue that results in time savings being realized by state and local governments.

INTRODUCTION

Work in local government today is a field fraught with political complexities and resource constraints, necessitating a balance on a line so fine as to be invisible to the naked eye. There are expectations for greater social responsibility for environmental resources, housing requirements, and the pressures for transparency and integrity seem greater than ever. One of the primary benefits of government work is that neighboring agencies are rarely in direct competition with one another, affording many opportunities to collaborate, mimic, and build upon the work of others. Most of the time this works in our favor, but sometimes it doesn't. Sometimes an agency becomes engaged in political discourse over a topic because it is relevant in a neighboring community, though not in their own. Momentum feeds action whether it be political proclivities, community initiatives, programmatic or facility expansions, or how operations are conducted. These two unique aspects of municipal finance work, a constantly demanding environment and a tendency to progress with our neighbors, can often lead municipal finance practitioners to move expeditiously to problem-solve while inadvertently missing available release levers designed to ease the workload.

This paper proposes that one of the best ways for municipal finance practitioners to take back control over workload and resources is to invest in the upfront work of understanding and applying materiality thresholds. Based on conversations over the last 18 months and reviews of selected financial statements, government finance leaders believe that many governments are not consistently applying the concept of materiality, and some are not applying it at all. Examples have been noted in which governments reported SBITA balances, but it appears, based on an initial review, that the entire balance and accompanying disclosures are not material. By reporting and disclosing immaterial items, a government is unnecessarily allocating valuable staff time and, possibly, complicating financial reports.

The Government Accounting Standards Board (GASB), established in 1984, develops and issues accounting standards with the intention of promoting financial reporting that provides useful information to decision-makers. The process by which they develop standards is transparent and inclusive of feedback, which is why most statements include the concept of materiality, again, a release lever for practitioners. GASB routinely hears concerns from government leaders about the time it takes to complete the financial statements. These leaders want to find ways to produce financial statements with less effort. GASB believes leveraging materiality may help accomplish this objective.

All accounting standards issued by the GASB, including Statements 87, *Leases,* and Statement 96, *Subscription-Based Information Technology Arrangements (SBITAs),* have included a "materiality box" which says, "**The provisions of this Statement need not be applied to immaterial items**". The purpose of the materiality box is to provide government practitioners with the ability to focus on material information. As a result, every lease or SBITA entered into by a government may not need to be reported and/or disclosed in the financial statements. This idea can be extended to every statement ever issued by the GASB.

This White Paper provides a framework for statement evaluation and implementation, within the contexts of materiality, responsibilities and ownership. At the end, additional considerations and resources are provided for the reader's use.

Disclaimer: This White Paper is not authoritative guidance. The views expressed in this Guide are not official positions of the California Society of Municipal Finance Officers (CSMFO), Governmental Accounting Standards Board (GASB), Government Finance Officers' Association (GFOA), California Society of CPAs (CalCPA), or the League of California Cities. Professional judgment is required.

STATEMENT EVALUATION

As accounting standards continue to evolve, it is imperative for finance professionals to stay current and understand how new statements may impact their organization's financial reporting. Evaluating new statements involves more than just technical reading, it requires a strategic approach to determine applicability, assess the financial statement impact, plan for proper implementation, and maintain compliance.

The evaluation process starts when GASB issues a new statement, which is usually one to three years prior to the effective date – do not wait until the effective date to become familiar with the statement. Early evaluation is especially critical if the implementation process will require the use of external resources.

While you may be tempted to defer to your independent auditors at first, consulting and discussing with auditors should take place after you have applied your own professional judgment and have formulated your own initial conclusions. When consulting with your auditor, be prepared to offer your conclusions and the reasoning behind those conclusions before asking them to opine. You may be surprised at how quickly you become a subject matter expert when evaluating new accounting standards!

Know Your Agency's Financial Reporting Structure

- Identify your separate fund or program-level audit reports, where different levels of materiality may be applied
- Identify your auditor's opinion units, those reporting units where different levels of materiality may be applied
- Identify components critical to your agency

Understand the Standard at a High Level

Before diving into technical details, start by gaining a high-level understanding of the new statement. This includes:

- Purpose and objectives of the statement (Why was it issued? What issues does it address?)
- Effective dates and early adoption options, if any
- Scope – Which types of transactions or entities are affected?
- Key changes compared to existing standards

This high-level overview helps you determine if deeper analysis is needed and sets the foundation for planning a more detailed evaluation and implementation strategy.

Why You Should Evaluate New Accounting Standards Before Relying on Your Auditors

1. *Responsibility Lies with Management*

   Under accounting standards and auditing frameworks (like Generally Accepted Auditing Standards (GAAS) and Generally Accepted Government Auditing Standards (GAGAS or “Yellow Book”)), management, not the auditors, is responsible for the preparation and fair presentation of the financial statements, including the application of accounting standards. Auditors assess and test your conclusions, but they do not make them for you, even when the auditors prepare the financial statements.

2. *Demonstrates Competence and Readiness*

   An internal evaluation shows that your organization is proactively managing financial reporting risks. It builds confidence with auditors, oversight bodies, and stakeholders that your team understands the requirements and is capable of applying them appropriately.

3. *Supports Efficient and Timely Implementation*

   Evaluating the standard internally enables you to:

   - Identify what parts of the organization are affected
   - Plan operational changes and timelines
   - Gather the right data in advance

   This leads to fewer surprises and avoids delays during audit time.

4. *Promotes Better Conversations with Auditors*

   Going to your auditors with a well-reasoned position allows for collaborative, informed discussions, rather than passive dependence. It also helps auditors focus on validating your judgment, rather than having to start from scratch or providing informal guidance (which could impair their independence, if not handled carefully).

5. *Reduces Risk of Misstatements or Late Adjustments*

   A thoughtful internal evaluation reduces the risk of material misstatements, rushed decisions, or late-period corrections that can affect audit timelines and financial reporting.

ORGANIZATIONAL ASSESSMENT

At this stage, you're asking:

- Does this apply to my organization?
- What areas of our financial reporting or operations could be affected?
- Who needs to be involved in evaluating and implementing it?

What is "Implementation"?

Implementation of GASB statements begins with understanding the provisions and why they apply or do not apply to your agency. This process and the resulting determinations take place prior to applying the concept of materiality, because there may be future transactions subject to the provisions of the statement and it is important to start with the broader evaluation. The assessment should also include determining whether external or additional internal resources may be needed to assist with the implementation, or if it can be handled with existing resources.

With certain statements, implementation is an ongoing process – new transactions and/or agreements need to be reviewed each year to determine if they are subject to specific accounting rules under the GASB codification. For example, future lease or subscription-based information technology agreements or amendments to existing agreements must be reviewed each year to determine if accounting changes are necessary. That also applies to reviewing future transactions that meet the materiality threshold(s), even if existing circumstances do not necessitate action in the year of implementation.

When the provisions of a particular statement are not applicable to your agency or transactions subject to the provisions of a statement have not met your agency's materiality threshold(s), that does not mean the statement was not implemented. **Your agency has implemented the provisions of a statement when it has been understood and the provisions applied to accounting or reporting/disclosures for all material items, or the impact is deemed to be immaterial and the basis for that determination is documented.**

Documentation of conclusions for each statement is critical to show that the statement was implemented, even if there were no applicable transactions to record or information required to be disclosed. Those documented conclusions will be essential for the recurring assessments required to stay in compliance with the statement.

Determining Materiality

Quantitative + Qualitative = Materiality

Quantitative

- Percent of total assets
- Percent of revenues
- Percent of fund balance

Quantitative

- Legal compliance
- Fraud risk
- Public interest or stakeholder focus

After you understand the requirements of the statement, review your related transactions, balances or disclosures subject to the provisions of the statement. It is at this point that you consider the concept of materiality.

Materiality or significance is a threshold concept in financial reporting that helps determine whether the impact of a new accounting standard, or any other aspect of accounting or financial reporting, is likely to influence the judgements or decisions of users of the financial statements. Both quantitative measures (such as dollar amounts compared to total assets, revenues, or fund balances) and qualitative factors (such as compliance with laws or reputational risks) should be considered. A standard may be applicable in that the government is engaged in or affected by a specific type of transaction or other event, but immaterial if its effect is too small and too unimportant at the fund or entity-wide level, to affect the judgement of reasonable financial statement users, if it were omitted. For example, an agency with a copier lease of minimal value might determine that fulfilling the specific reporting requirements for GASB 87, Leases, would not materially affect overall reporting, while a transit agency with dozens of multimillion-dollar equipment leases might reach the opposite conclusion.

The most common materiality tool that comes to mind for accountants are the capitalization thresholds used to determine which assets get capitalized, i.e., assets under the threshold are expensed instead of being capitalized and depreciated over their estimated useful lifes. See Exhibit B for a case study involving capitalization thresholds.

For applying materiality to other account balances and activities, a government must prepare a calculation to determine a threshold to use. From a quantitative standpoint, materiality is generally calculated as a percentage of a financial statement amount, such as total assets or total revenue depending on the nature of the transaction or event being evaluated. Professional judgment is required to determine which percentage to use, and to which base to apply it. Then, qualitative considerations should be applied, such as the nature of the transactions, the potential for fraud with certain transactions, or the particular focus of the government's financial statement users or other key stakeholders. The quantitative thresholds cannot be solely relied on, as qualitative considerations (items of intense political interest, those indicating fraud or mismanagement) must also be considered before deeming items to be immaterial.

For governments with multiple opinion units, or multiple audit reports for separate funds or program financial statements, materiality thresholds should be established for each audit opinion unit. The auditor's opinion letter identifies all of the opinion units that are covered by their audit opinion; governments can gather their list of opinion units from the letter for purposes of calculating materiality thresholds. A government could have many materiality thresholds beyond those required for financial reporting or could decide to apply the lowest threshold from their calculations to all of their opinion units. Either way, an agency can establish or identify materiality thresholds at any level, but the audit opinion units should also be a consideration when doing so.

Governments should discuss their materiality thresholds and how they were determined with their independent auditors, as part of the discussion regarding internal controls over financial reporting.

Once you have established your materiality threshold(s), compare the threshold to the total of your applicable transactions or balances and determine if they meet or exceed the threshold. If not, document that conclusion and consider the new statement implemented without any financial statement impact. If so, then use your judgement to apply your threshold to the individual transactions or items in order to focus on the significant items. In other words, using leases as an example, if the materiality threshold is $100,000 and your total lease liability is $250,000, then review the individual leases that make up the total to determine which items should be reviewed for accounting treatment. In this example, if you have two leases totaling $230,000 and four leases of $5,000 each, you may decide to focus on the two large items and determine the four smaller leases are immaterial.

If the implementation process is complex, do not forget to discuss any critical or unusual decisions with your auditors to see if they have any questions or feedback. Consult your auditor regularly and consider other available resources.

The Importance of Training

Training. Training. Training. Training is not optional; it is a key internal control in financial reporting. It is also a critical component in the effective implementation of GASB standards. These standards are designed to promote transparency, consistency, and accountability in financial reporting by state and local governments. However, their proper application requires a thorough understanding of complex accounting principles, reporting requirements, and compliance expectations.

For all agencies, training ensures that financial staff are equipped with the knowledge and skills needed to accurately interpret and apply GASB standards. New statements are not “plug-and-play”; they often involve judgment calls, coordination across departments, and documentation that only the agency itself can prepare. Auditors test and verify your conclusions; they do not make them for you. Relying on the auditor as a substitute for internal training risks causing independence issues, late adjustments, and avoidable audit findings. This is particularly important when new guidance is introduced or existing standards are updated, as the implications can significantly impact financial statements, audit results, and public trust, including the perception of the governing body.

Small agencies, in particular, may be tempted to downplay training because of resource limitations or the belief that their auditors will “take care of it.” This is a dangerous misconception. Agencies must prioritize gaining basic competency in GASB standards. While small agencies may have fewer resources, they are still held to the same professional standards as larger organizations. Auditors cannot step into management’s role without compromising their objectivity and independence. Moreover, without adequate training, small agencies risk errors in reporting, increased audit findings, and reduced credibility with stakeholders. Such deficiencies fall squarely on the agency, not the auditor. Ensuring even foundational knowledge among finance personnel helps safeguard the agency’s financial integrity and enhances its ability to serve its community responsibly.

Government finance professionals can access training through a variety of organizations and formats. Options range from national associations to local networks, with opportunities to fit different budgets and staffing levels, including:

- **GFOA (Government Finance Officers Association):** Webinars, conferences, and practical implementation resources.

- **AICPA (American Institute of CPAs):** Training on accounting standards and audit-related topics.

- **CalCPA (California Society of CPAs):** Training on accounting standards and audit-related topics.

- **State associations (e.g., CSMFO in California):** Conferences, workshops, webinars, and peer-based learning.

- **GASB (Governmental Accounting Standards Board):** Official pronouncements (statements, implementation guides, etc.) and webinars on new statements.

- **Audit firms and continuing education providers:** Customized in-house training tailored to your agency's needs.

- **Peer networks and regional groups:** Informal sharing of best practices and low-cost or no-cost training opportunities.

Ultimately, adequate training is an investment in the agency's reputation and financial integrity. Excuses such as, "we're too small" or "too busy" do not reduce the expectation of professional standards; it only increases the likelihood of mistakes that will cost more time and resources later.

IMPLEMENTATION CHECKLIST

Below is a suggested checklist for the evaluation of new GASB statements:

Establish:
____ Lead person responsible for overall implementation
____ Workplan (start very early if a potential restatement is involved - plan for a target completion date that is early in your process - ideally, the restatement would be determined prior to the end of the fiscal year of implementation)
____ Communication plan (internal, external, governing body)
____ Plan for documentation
____ Do existing records meet the needs, or will new schedules/documentation be needed?
____ Document decisions made along the way

Gather:
____ Existing policies/procedures
____ Updated materiality thresholds/documentation
____ Relevant transactions (ERP data, third-party reports, agreements, etc.)
____ Implementation resources (e.g. conference presentations, webinars, auditors, GASB, relevant articles, emails, etc.)

Possible Uses of Generative AI, but Verify Conclusions:
____ Leverage/use to streamline the implementation process
____ Use an example (GASB 101) to ensure you understand the statement
____ Use to distill GAAP into plain language
____ Use to analyze specific transactions for applicability

Determine the Impact of the Statement on the Current Year:
____ Document decisions (this is when you bring in your materiality considerations)
____ Discuss conclusions with auditors prior to the year-end audit
____ If implementation involves accounting entries, develop journal entries and determine if new account codes are needed
____ If restatement is required, complete those calculations and prepare disclosures

Compliance Continues on an Annual Basis:
____ Annual review of transactions or agreements with financial reporting checklist
____ Document decisions
____ New decisions
____ Changes to prior decisions, such as for new transactions

Long-Term Plan:
____ Maintain a forward-looking calendar of future GASB statements

EDUCATING YOUR LEADERSHIP AND ELECTED OFFICIALS

Approach

When considering outreach and communication of the impact or potential impact of new statements to the leadership and elected officials of your agency, there are some general guidelines to consider. First, determine the familiarity level of your leadership and elected officials as it pertains to statement implementation and the audit process overall. Knowing this information allows you to hone your material and message to ensure that everyone is provided with equal access to the information. Additionally, anticipate sharing financial statement information early and often - but only after evaluating the complexity and impact of the issue. For example, a particularly complex issue that results in a minor change to the government-wide statement may merit a mention, while an accounting change that affects the government-wide and fund-level statements may require several conversations to explain the change being made and the impact to the agency. Next, you will want to consider how to discuss materiality in the context of GASB statement implementation. Admittedly, this can be a tricky topic to explain as it lacks the clear rules and objective standards that are presumed to exist in the auditing sphere. Materiality is the means through which professional judgement and experience are used to define impacts of significance in the facilitation of fair presentation of financial statements, which is the ultimate purpose of the audit process. Lastly, consider the end users of the financial statements and the information they will be reading; this is likely information that your leadership and elected officials would like to know too.

Communications

Being committed to regular communication and education of your leadership and elected officials regarding your agency's financial statements, consider implementing some of the following process suggestions:

- Utilize finance or audit committee meetings: Usually these meetings include agency leadership and elected officials, so they present a great venue for introducing, reviewing, or presenting the results of changes to the agency's financial statements. Be prepared to share where changes will be seen in the financial statements (statements, disclosures, etc.) and what the change means to the agency's overall financial picture.
- Presentation of the financial statements: At the presentation to the governing body, call out significant changes to the report and what the change means to the agency's overall financial picture. Also, get out ahead of the messaging, especially if the terminology used in the report could be misinterpreted. For example, if a balance or transaction is determined to be immaterial and is included on the Schedule of Uncorrected Misstatements, a member of the public may misinterpret its presence as a lack of accuracy or professional rigor. Management should clearly communicate that such items are the result of applying the materiality

threshold in order to support the timely completion and issuance of financial statements, and that their inclusion does not reflect a lack of attention to accuracy. Rather, the use of materiality is intended to balance precision with timeliness, resulting in financial statements that are fairly stated in all material respects, even if they include immaterial uncorrected differences identified for disclosure purposes. Address this specifically in the presentation to demonstrate that the financial statements prepared by management and the audit were conducted with the highest professional standards and with full transparency.

- Finance department culture: Find ways to make open communication, discussion, and education on the agency's financial statements a norm of the department and agency. This can be done by supporting this type of engagement within the Finance department staff so that they may be empowered to share with others. It may also help when new transactions take place and staff are comfortable asking questions to see if they are subject to special accounting and/or reporting.
- Document your processes: For consistency, continuity, and communication, document when, where, and who will be addressed when it comes to changes in the agency's financial statements.

Additional Considerations

Aside from the general approach and process provided, there are some additional considerations that practitioners should keep in mind when educating leadership and elected officials.

- Audits use terminology that may be specific to GAAP, GAAS and GAGAS, and may use a definition that is not necessarily the same as how the terms are used outside of the accounting profession.

    Uncorrected misstatements – When an auditor notes audit differences or adjustments that are not reflected in the financial statements, they are deemed uncorrected misstatements. Uncorrected misstatements are accumulated on a Schedule of Uncorrected Misstatements. From a non-technical perspective this can sound like mistakes that were ignored or unrecognized. In the scope of a financial audit, however, it is the acknowledgement that figures could have been adjusted to be more precise but would not have changed enough to affect the judgment of a reasonable user of the financial statements. This could be due to materiality and/or timing.

    Implementation - As discussed above, implementation starts with understanding the GASB statement provisions and how they apply or do not apply to your agency. Implementation may not mean the full application of the statement's provisions to financial statements, required supplementary information or supplementary information presented. This may become particularly relevant if another governmental entity implements a new statement in a different, more visible, manner than your government, and your leadership and elected officials are wondering why your implementation did not have the same results. If the provisions of the statement were understood, evaluated, and applied to your agency in a manner appropriate for your agency's operations, then it was implemented regardless of how that looks compared to other governments.

- Differences of opinions between auditors and management can be perceived to be a negative outcome to leadership and elected officials, but this is not necessarily the case. Each party has their own perspective and responsibilities and sometimes these don't align. For example, the auditor will recommend the ideal outcome, while the practitioner has to assess that recommendation in light of costs and benefits. In the end, however, management is responsible for the financial statements and often makes the final decision on how the difference is resolved. Management is not wrong because a difference of opinion arises, but they should document and be prepared to explain their position and reasoning. Documentation in this instance can be very helpful in the eventuality of changing audit firms.
- While it might seem to be ideal to have the financial numbers be "precise" each year, timeliness and other considerations require constant evaluation. The goal of the audit process is confirmation of fair presentation of financial statements so that internal and external users can make informed decisions. In an effort to ensure timely results to ensure informed decisions can be made, there are trade-offs with ensuring that each number is tested and is precise. This is not to say that items with significant financial impact would be overlooked to get a report done on time, but it is important for leadership and elected officials to understand the balance that management must find.

CONCLUSION

This White Paper was developed to provide a helpful guide for practitioners to apply when evaluating new GASB statements. However, it also offers a methodology that can be applied to previously implemented statements to effectuate the same kinds of efficiencies. By applying the concept of materiality to reap the benefits of reducing work, along with other implementation recommendations in this White Paper, governments should experience meaningful time savings when implementing GASB statements.

RESOURCES

EXHIBIT A: Questions and Answers

Provides responses to questions that frequently arise from topics raised in this paper.

EXHIBIT B: Exploration of Modeling & Case Study

While this White Paper was being developed, the GFOA explored the benefits of modeling as applied to materiality and their findings are summarized in this exhibit, which also includes a case study of the City of Newport Beach.

EXHIBIT C: Rethinking Financial Reporting- The Speed We Need: Unlocking the Secrets of the Accelerated ACFR

Outlines three basic principles to guide agencies in completion of their ACFR faster and with the same or even less effort.

EXHIBIT A: Questions and Answers

Q: What if your financial statements include uncorrected misstatements? How do you explain this to your leadership and elected officials?

A: Uncorrected misstatements in an audit represent differences between the reported amounts, classifications, presentations, or disclosures in the financial statements, which have been identified by the auditor, but do not represent a material misstatement. These are most often due to timing differences or revised estimates resulting in corrections being recorded in the next reporting period since they were immaterial to the current reporting period. The financial statements are still fairly presented although additional information becomes available that generates immaterial differences.

Q: How do uncorrected misstatements arise?

A: Uncorrected misstatements are often derived from prioritizing the delivery of timely financial statements over the unnecessary precision of financial statements. While the term uncorrected misstatements seems negative, it merely conveys differences in the audit that were deemed immaterial by both the auditor and management, and do not require a post-closing adjustment to correct the financial statements. Some examples of uncorrected misstatements often encountered are as follows:

- Accounts payable is understated. Management did not accrue small invoices after closing the books, yet an immaterial invoice relating to the past period was discovered by the auditor. The invoice is expensed in the year paid, rather than being recorded as expense and accounts payable in the period being audited.

- Revenue is overstated. Management accrued revenue for cash receipts in the subsequent period that were earned in the period being audited. However, by the time the audit was concluded, it was determined that an immaterial amount of receipts were not received within 60 days of year-end in accordance with the government's revenue recognition policy and should have been recorded as deferred inflows of resources. The receipt was recorded in the period being audited; however, it should have been deferred and recorded as a revenue in the subsequent period.

- Intangible right-to-use assets and lease liability are understated. The government has a capitalization threshold of $25,000 for recording leased assets, however, it did not record a new immaterial lease transaction. The lease contract is being expensed as paid, rather than capturing the related asset and liability, however, the dollar value of the contract is deemed immaterial.

Q: How do you determine your auditor's opinion units for your application of materiality?

A: You should discuss your application of materiality with your auditors. One starting point could be your auditor's opinion letter which is required to list the opinion units in your audit report. Opinion units start with governmental activities, business-type activities, individual major funds (governmental and enterprise) and nonmajor funds in aggregate, but could include more or less, depending on the structure of your financial statements.

Q: How to determine and document whether or not a GASB statement will have a material effect on your financial statements, both at the initial effective date and on a recurring basis?

A: Consider the use of a tracking spreadsheet to document decisions made and, if applicable, supporting documentation locations [tracking tool spreadsheet]

Q: How can you communicate to users of your financial statements that the government has concluded that there is no material effect as a result of implementing a new GASB statement?

A: In the year of implementation, the Summary of Significant Accounting Principles (note disclosure), the section on "New Accounting Standards Adopted," should state that a newly implemented statement had no material impact on the government's financial statements. This "counts" as having implemented the statement, so the disclosure should not state that the statement has not been implemented because it is immaterial to the government.

Additionally, be consistent regarding treatment of the GAAP between display on the face of the financial statements and the related disclosures. For example, if a government has determined that a pension liability is immaterial, it should not separately display the pension liability on the face of the financial statements and *also* either (1) simply fail to include the required notes and/or RSI, or (2) state in notes and/or RSI that the required notes and/or RSI are omitted because the amount is immaterial. If deemed immaterial, the pension liability should not be reported individually if it is not material. If the liability is "material enough" to warrant separate display, presumably the notes and/or RSI should have been included.

Q: If the agency decides to change the capitalization threshold for capital assets, does that require a restatement to remove the assets that no longer meet that threshold?

A: No. A change in the capitalization threshold is not considered a change in accounting principle. As clarified in the GASB Comprehensive Implementation Guide, question Z.100.2, the requirements of Statement 100 for a change in accounting principle, including the requirement to restate beginning balances, as appropriate, do not apply to such a change.

Q: What am I saving, if I have to do all the work to figure out if something is material?

A: Although the effort may seem excessive in year one, on a go forward basis, you have built the foundation to streamline the annual review moving forward.

For example, if you've developed an inventory schedule of lease agreements in year one, sorted by the overall potential payments under the agreements, you could determine that you need only complete the calculation for agreements over $X, based on your capitalization and/or materiality threshold, which represent 90% of the potential asset or liability, before any discounting is applied. The remaining agreements are documented as not material and will not be evaluated further. On a go forward basis, the annual review process consists of adding new agreements to the inventory, along with amendments to any existing agreements, to see if any adjustments or changes to the process are needed.

As a second example, for the calculation of compensated absences, if the calculation of 100% of employees' unused leave time as of the end of the fiscal year (vacation, sick and other), multiplied by their hourly pay rate plus other salary-related payments is not material, the more detailed calculations required by GASB Statement No. 101 may not be necessary. The effect of those calculations would potentially reduce the compensated absences liability, so the time spent making those calculations might not result in a significant financial benefit.

These two examples could mean potential savings in time spent calculating assets or liabilities, time spent developing, reviewing and posting journal entries, as well as a reduction in the time spent reviewing agreements and other associated documents. Of course, your own facts and circumstances have to be reviewed and applied to any situation.

While not an overall time savings, streamlined review in outlying years also means that staff has time for other work that either required overtime or that no one was able to get to before.

Q: What if all other agencies complete the implementation of a GASB Statement and we do not?

A: We all have to think about changing the mindset and taking control of the financial reporting process. If you have completed the analysis of the GASB Statement and determined that the effects of the statement are not material to your agency, that means you have implemented the Statement. The analysis may have to occur on an annual basis to ensure new transactions do not need to be recorded under the provisions of the Statement, but that does not mean you are implementing it at that time. It means you are applying the provisions of the Statement to the new transaction. The Statement was already implemented in a prior year.

Q: What if the auditor does not agree with our materiality threshold or our conclusions that something is not material or not subject to a GASB Statement?

A: This is why the White Paper emphasizes the need to communicate early and often with your auditor. You do not want to find out during the year-end preparation of the financial statements and disclosures that the auditor does not agree that you did not record XXX or you've omitted a disclosure they think is required.

Once you have decided to start developing a materiality threshold(s), having the discussion with the auditor early will ensure any potential problems during the audit can be resolved before they become roadblocks. Although the auditor's calculation of audit materiality will most certainly differ from your agency's calculations, and the auditor will usually not share the details of their calculations. However, the auditor can discuss why they feel the agency's threshold(s) may not be appropriate. After deliberation and reconsideration on both sides, that conversation should then lead to a threshold or methodology that works for all.

Q: What if I am not the Finance Director; how can I start this discussion in my agency?

A: Share the idea with your supervisor or Director, depending on the formality in your organization. Bring this paper with you and ask how materiality is considered in the development of the agency's financial reporting. Even if the concepts contained here are not fully adopted, it is still a step in the right direction to be talking openly as a department about how these practices are addressed.

Q: What if others in my agency want ALL the assets listed?

A: Educate them on the difference between the purpose of asset capitalization for financial reporting versus inventories or asset management.

EXHIBIT B: Exploration of Modeling & Case Study

Materiality Matters

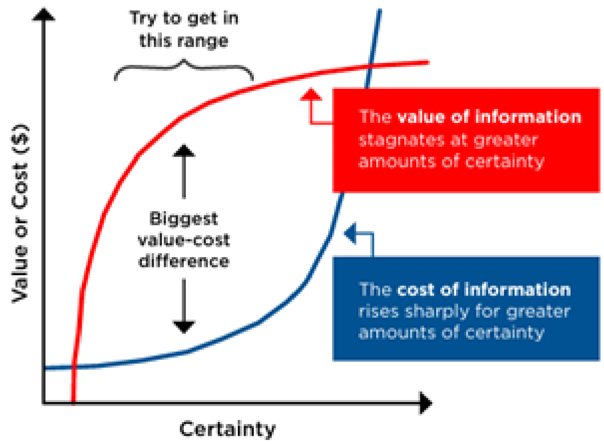
Materiality in the context of governmental financial reporting is as follows: *"Information is considered material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements."* Preparers of the financial statements often face an overwhelming volume of transactions and complex standards. A thoughtful assessment of what is material and what is not material is essential for focusing the preparer's time and effort where it matters most.

This case study introduces a key concept that underpins effective materiality decisions: the value of information. It then explores how models such as the "Pareto distribution" can help governments focus on the transactions that truly drive financial reporting outcomes. The discussion then turns to how materiality can be operationalized through thresholds, the use of estimates, and balancing quantitative and qualitative considerations, while highlighting the importance of collaboration with auditors. Finally, a case study of the City of Newport Beach demonstrates how applying these principles in practice can reduce workload, improve efficiency, and maintain transparency.

Value of Information[1]

A key principle in assessing materiality is the value of information. Information has value if it reduces uncertainty about a consequential decision or affects the behavior of those making the decision.[2] Users of financial reports, such as bond market participants or local officials, seek to reduce uncertainty about a government's financial condition. For example, bond investors may want to reduce uncertainty about whether a government's debt is a sound investment, while local officials may want to reduce uncertainty about whether tax increases are needed.

More information can reduce uncertainty, but the incremental benefit tends to decrease as additional information is gathered, while the cost of obtaining that information rises. At some point, additional information may not provide enough reduction in uncertainty to influence decisions, making it unnecessary to capture every detail. Preparers must therefore find the optimal point where information is neither excessive nor insufficient.



This optimal range, where there is the biggest value-cost difference, is what we might call the "goldilocks zone". It represents the level at which information provides meaningful decision-making value without incurring disproportionate cost (not too little, not too much), as illustrated in the diagram above.[3] The goldilocks zone will vary from government to government and from topic to topic.

Using Models to Guide Materiality

Models help us make sense of complex issues … and the issues involved in materiality can be complex. One particularly useful model is the Pareto distribution, which shows that a small number of items often drive the majority of impact. This principle underlies the familiar 80/20 rule, where 20 percent of items produce 80 percent of the effect.

This is important for financial reporting because in a Pareto-distributed dataset a small number of items make up the large majority of the reported dollar amount. This means the preparer can focus on the larger items and minimize or ignore the smaller ones. Here are examples of items in a financial report that are often Pareto distributed.

- **Capital Assets.** City of Burbank raised its capitalization threshold from $5,000 to $10,000. As a result, the city removed 343 capital assets from its books, worth a total of $2 million. But compared to the city's $1.25 billion in total capital assets, this is a relative drop in the bucket at 0.16% of the total. In terms of workload, that's 343 fewer assets for the finance department to track. Note, however, that removing or retiring the assets previously recorded that do not meet the new capitalization threshold is optional.

- **Leases.** In Newport Beach, leases over $1 million account for more than 90 percent of total lease value while representing only 33 percent of the total number of leases. Leases under $1 million comprise less than 10 percent of dollar value but over 20 percent of the total leases.

- **Accruals**. The dollar value of accrued accounts payable is often driven by a small number of high-cost transactions, such as capital projects, while lower-value accruals have minimal impact.

Not all data is Pareto distributed. The practice of "Rethinking Materiality" is still developing, and additional models will be identified to guide decisions where Pareto principles do not apply.

Operationalizing Materiality

When it comes to operationalizing materiality decisions, we first should think about how to quantify the impact. This is where a model like the Pareto distribution is invaluable. In some cases, a threshold could be established, below which items won't be reported. This is what Burbank did by raising its threshold and it is what Newport Beach's lease data suggests could be an appropriate strategy. Another option would be to accept estimated values for lower dollar items. This could be a good strategy for accruals: data is gathered to report high value items precisely, but smaller value items are estimated less precisely. All of these examples could save hours of preparers' time without changing reported numbers in a way that would change the decisions of users of the report.

Quantitative measures must be considered alongside qualitative factors. For example, legal requirements, public expectations for transparency on certain topics, or other issues may render an item material even when the numbers alone suggest it is immaterial.

While decisions about materiality rest with the preparer, preparers must collaborate with auditors to fully implement those decisions.

To illustrate these concepts, we examine how the City of Newport Beach applied materiality to its lease portfolio. This case study demonstrates how analyzing distributions, establishing thresholds, and collaborating with auditors can reduce workload, improve efficiency, and maintain financial statement integrity. The case study also highlights the interplay of fund-level versus government-wide materiality.

Case Study: Newport Beach Rethinks Materiality on Leases

Complying with GASB 87 can be challenging for agencies managing a high volume of leases. The standard requires calculating present values, maintaining amortization schedules, and tracking lease data, which can be burdensome. This burden could be reduced by excluding leases with immaterial amounts.

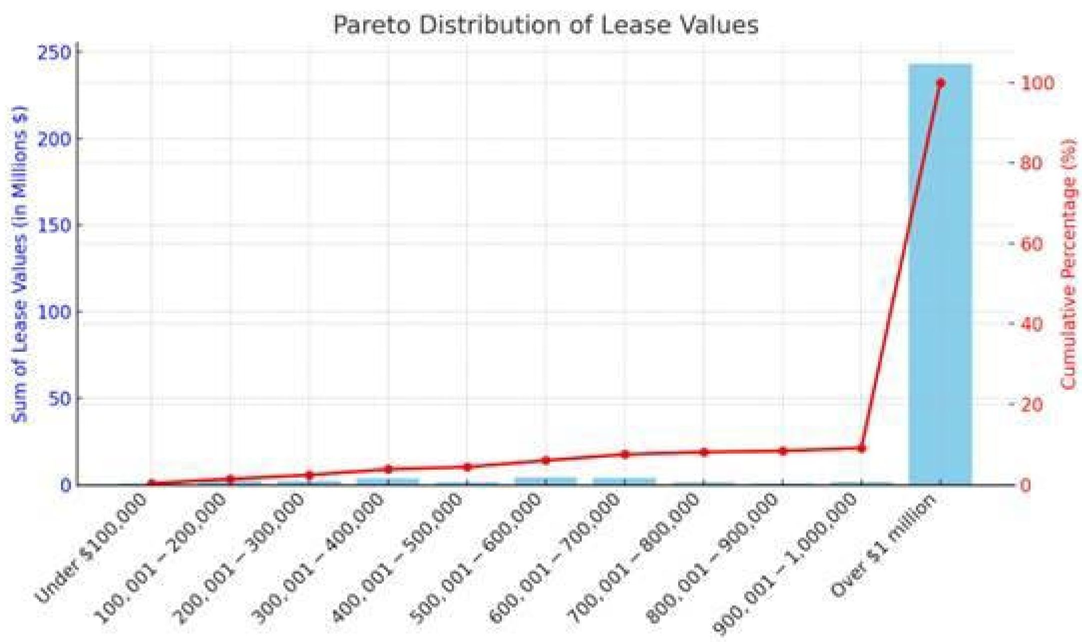
The City of Newport Beach had 141 leases totaling $268 million. Without a materiality threshold, many low-dollar leases were capitalized and were amended annually; for example, in 2025, approximately 50 leases required updates due to changes in terms. Each amendment demands detailed review and recalculation of lease values and amortization schedules, placing a significant administrative burden on staff during the year-end close.

To address this, the City examined the distribution of lease values to assess whether establishing a capitalization threshold could reduce workload while maintaining compliance with GASB 87.

The table below stratifies the 141 leases by individual lease value. As we pointed out earlier, the City's data is Pareto distributed.

Individual Lease Value Range	Sum of Values	Number of Leases
Under $100,000	$1,048,176.73	31
$100,001 - $200,000	2,880,400.78	20
$200,001 - $300,000	2,609,513.12	11
$300,001 - $400,000	3,888,888.80	11
$400,001 - $500,000	1,480,463.80	3
$500,001 - $600,000	4,367,193.51	8
$600,001 - $700,000	4,069,105.20	6
$700,001 - $800,000	1,483,816.96	2
$800,001 - $900,000	827,973.00	1
$900,001 - $1,000,000	1,934,371.68	2
Over $1 million	243,438,157.50	46
Total	**$268,028,061.08**	**141**

To better visualize this concentration, the following Pareto chart shows the distribution of leases by value.



Notably, 46 leases over $1 million account for over 90% of the total lease value, while 62 leases under $300,000 represent just 2.4% ($6.5 million) of the portfolio. Approximately 68% of these leases are recorded in a Special Revenue Fund (a major fund for reporting purposes), with the remainder in the General Fund.

The City consulted with their auditors on whether a $300,000 capitalization threshold would create audit issues, such as impacting the ability to issue an unmodified opinion. While a $300,000 threshold did not affect the General Fund or the government-wide financial statements, it would have caused the excluded leases in the Special Revenue Fund to exceed the fund's materiality threshold. Therefore, a $300,000 threshold was not acceptable.

The City then considered a $200,000 threshold, which would eliminate the need to monitor 51 leases while still capturing the majority of total lease value. Under this threshold, the aggregate value of excluded leases in the Special Revenue Fund remained well within the fund's materiality threshold, making it acceptable from an audit perspective.

However, the excluded leases exceeded the Clearly Trivial Threshold (CTT). The CTT is a much lower-level set by auditors during audit planning to determine the point below which misstatements are so small and inconsequential that they do not need to be accumulated or evaluated further during the audit. While not all immaterial misstatements are clearly trivial, all clearly trivial misstatements are immaterial. The key difference is that materiality identifies what is significant enough to influence users of the financial statements, whereas the clearly trivial threshold, established by auditors during planning, serves as a practical tool for excluding inconsequential misstatements from further consideration.

Since the excluded leases exceed the CTT, disclosure in the auditor's letter to those charged with governance is required under SAS No. 114. The language that appeared in the SAS 114 letter is below:

"The City applies a capitalization threshold for lease receivables consistent with its accounting policies. As a result, certain lease receivables below the threshold—totaling approximately $1.86 million—were not recorded. These amounts are not considered material to the financial statements."

This disclosure appeared in the section of the letter addressing "uncorrected and corrected misstatements." Auditors have discretion in how such misstatements are disclosed, so the presentation may vary from firm to firm.

The City was comfortable with this disclosure because the $200,000 threshold is a practical policy that supports timely financial reporting. It is estimated to save 40–50 staff hours during year-end close, allowing staff to focus on implementing new accounting standards and finalizing the financial statements in a timely manner. The disclosure ensures transparency without affecting overall financial statement integrity, as the excluded leases are not material.

Conclusion

The Newport Beach case study shows that materiality is more than a compliance requirement—it is a practical tool for efficiency, clarity, and transparency. By focusing on the value of information and applying models such as the Pareto distribution, governments can identify thresholds that reduce administrative burden without sacrificing integrity. Materiality decisions should balance quantitative thresholds with qualitative factors and be developed in consultation with auditors.

When approached strategically, materiality allows governments to concentrate on what truly matters: providing decision-useful information, streamlining reporting, and strengthening financial management. In this way, materiality evolves from a technical accounting concept into a lever for better governance.

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[1] This section adapted from "Why GFOA is Rethinking Financial Reporting" published by the Government Finance Officers Association, 2024.

[2] This idea has existed since the 1950s as part of a field of mathematics called "decision theory," as described in: Hubbard, D. (2014). How to measure anything (3rd ed.). Wiley.

[3] Illustration courtesy of Doug Hubbard.

RETHINKING FINANCIAL REPORTING

THE SPEED WE NEED

Unlocking the Secrets of the Accelerated ACFR

ABOUT THE AUTHORS

- **Shayne Kavanagh**, Senior Manager of Research, GFOA
- **Todd Buikema**, Assistant Director for Publications, GFOA

CONTRIBUTORS

- **Christopher Quinn**, CFO, Town of Mooresville, North Carolina
- **Darlene Wildes**, CPA, Deputy City Auditor, City of Columbus, Ohio
- **Jessica Jones**, CPA, CLGFO, Finance Director, City of Concord, North Carolina
- **Jay Kahn**, Director of Finance & Operations/CSBO, Lake Bluff Elementary School District 65, Illinois
- **Korrie Johnson**, Assistant Finance Director, City of Fridley, Minnesota
- **Melanie S. Keeton**, CPA, Deputy Finance Director, City of San Antonio, Texas
- **Jennifer Becker**, Financial Services Director, City of Burbank, California

ABOUT GFOA

The Government Finance Officers Association (GFOA) represents over 21,000 public finance officers throughout the United States and Canada. GFOA's mission is to advance excellence in government finance. GFOA views its role as a resource, educator, facilitator, and advocate for both its members and the governments they serve and provides best practice guidance, leadership, professional development, resources and tools, networking opportunities, award programs, and advisory services.

ABOUT RETHINKING FINANCIAL REPORTING

Local government is in a time of constrained resources, declining trust, and rapid change. This has prompted GFOA to launch a "rethinking" of several aspects of public finance, including **Rethinking Financial Reporting**. For example, in a time of decreasing trust in government, we should ask if lengthy, technical financial reports that take significant time to compile, undergo lengthy audit processes, and, as a result, are often published many months in arrears are the most effective way to build trust with government's most important constituency: the public. In a time of declining resources, we should ask if the finance officer's time is well spent producing these reports, if, in fact, these reports are not the best way to provide accountability to the public. Time spent on general purpose external financial reports is time not spent on other forms of decision support and public engagement. Simply put, this time is lost opportunity cost that could otherwise be used to build trust. Rethinking Financial Reporting is a fact-based examination into the costs and benefa1its of the current model of financial reporting and how we can decrease the former and increase the latter.

USE OF GENERATIVE ARTIFICIAL INTELLIGENCE IN THIS REPORT

Generative Artificial Intelligence (AI) tools, primarily ChatGPT4, were used to help develop the report. Primary uses of the AI tools include:

- Development of ideas for the outline of the report
- Generation of text for a few specific purposes. Text generated directly from generative AI is clearly labeled as such in the report where the contribution from AI is material. Examples of immaterial contributions would be suggestions from AI on wording choices, grammar, etc.
- Review of final report and to give suggestions to make language more accessible for the intended audience.

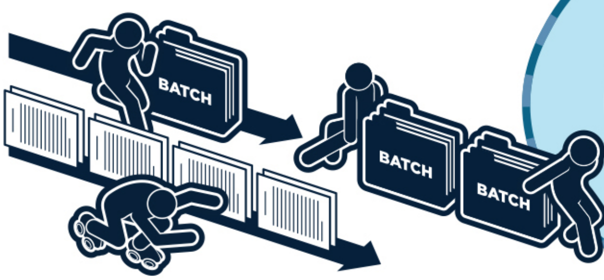
GFOA acknowledges the limitations of AI-generated information, including potential biases and other limitations of generative artificial intelligence. All data, ideas, etc. from ChatGPT4 that were used in the report were independently verified/validated by the author(s) and not taken at face value.

THE SPEED WE NEED
UNLOCKING THE SECRETS OF THE ACCELERATED ACFR

Many local governments struggle to complete their annual comprehensive financial report (ACFR) on time and with an acceptable amount of effort. However, by thinking of ACFR production as a process, local governments can take advantage of timeless principles for process efficiency, completing the ACFR faster and with the same or even less effort.

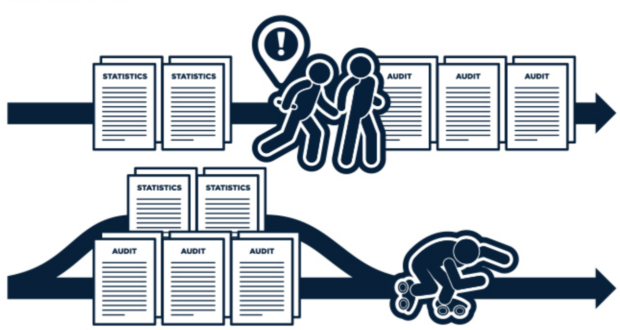
MODULARIZATION & CONTINUOUS FLOW

Avoid batch processing and achieve a continuous flow for work through the process. Continuous flow contributes to a steady rhythm of work. Both continuous flow and rhythm contribute to avoiding backlogs and bottle necks.



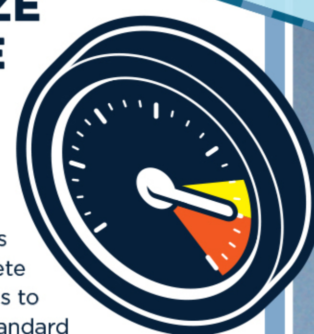
VISUALIZE THE PROCESS

Making the process visual clarifies roles of all parties, including external auditors. It also identifies points where work is handed from one party to the next. Hand-offs are a major point of potential process failure and delay. Visualizing helps you find and eliminate unnecessary sequential processing of work and replaces it with parallel or para-linear processing.



STANDARDIZE TO MINIMIZE VARIATION

The major theme here is to reduce defects in order to minimize rework. Rework essentially doubles the time it takes to complete a task because the task has to be done twice. Develop standard operating procedures to minimize the variation in the process, which helps reduce errors. You can go a step further by creating dedicated error proofing tools, based on the standard operating procedures.

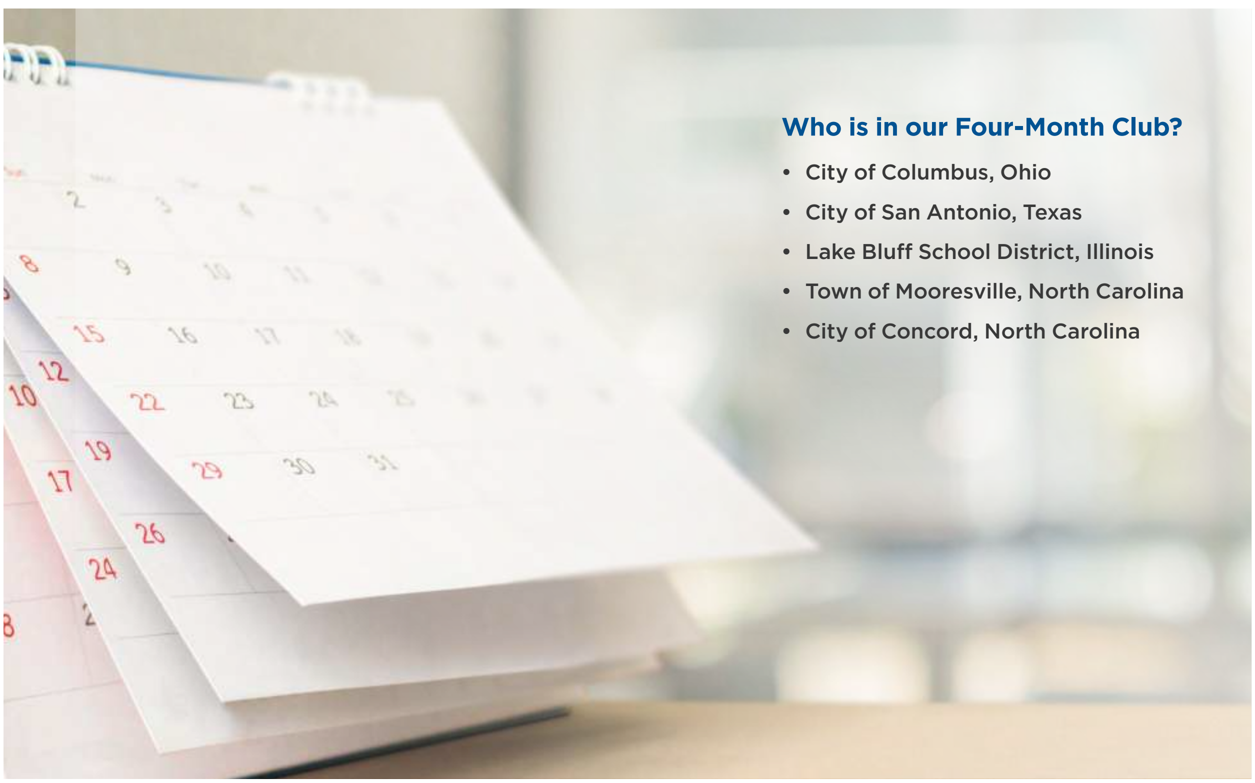


Many local governments struggle to complete their annual comprehensive financial report (ACFR) on time and with an acceptable amount of effort. This paper shows how local governments can complete their ACFR *faster* and with *the same or even less effort*. Our goal is to help public finance officers avoid burnout while pursuing the profession's goals of rapid, high-quality financial reporting — and perhaps free up time to focus on the many other tasks vying for their attention outside of financial reporting.

How will we achieve this ambitious goal? By thinking of ACFR production as a process. By doing so, we can take advantage of timeless principles for process efficiency like Six Sigma and Lean. These methods have been widely used in the private and public sectors for many years but, to our knowledge, have rarely been applied to local government financial reporting.

This paper shows how local governments can complete their ACFR *faster* and with *the same or even less effort*.

Further, we identified several local governments that complete their ACFR in four months or less after the end of the fiscal year.* We'll refer to them as the "Four-Month Club." We discovered their secrets, which often parallel the lessons of Lean and Six Sigma, and we will share them with you. We also worked with other governments featured in this report that are not (yet) in the Four-Month Club but are actively working to improve their processes.



Who is in our Four-Month Club?

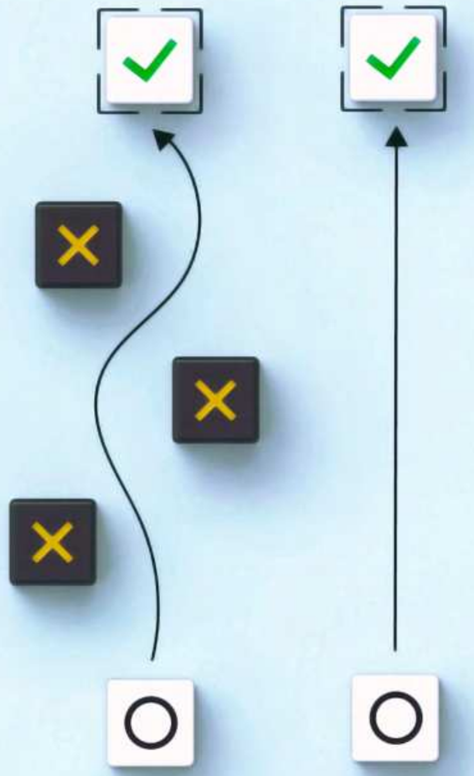
- City of Columbus, Ohio
- City of San Antonio, Texas
- Lake Bluff School District, Illinois
- Town of Mooresville, North Carolina
- City of Concord, North Carolina

*Six months after the fiscal year is the standard that most local governments are held to.

We will present our findings within three basic principles:

PRINCIPLE 1:	**PRINCIPLE 2:**	**PRINCIPLE 3:**
Modularization and Continuous Flow	Visualize the Process	Standardize to Minimize Variation

Before we dive into the details, let's briefly discuss how this report fits within GFOA's larger Rethinking Financial Reporting project. Lean and Six Sigma are continuous improvement methods in which many small changes to a process can add up to a big difference over time. This report also takes existing financial reporting guidelines and requirements as a given and shows how to produce your ACFR faster within those constraints. Other projects within Rethinking Financial Reporting are examining how to change the constraints and allow discontinuous improvements (immediate leaps) in financial reporting.



Why do you want to be faster?

We shared our goal for writing this paper. But why would you, a local government finance officer, want to be faster? We asked the Four-Month Club:

- ✓ **Meet filing deadlines with ease and less stress.**
- ✓ **Free up time to work on other things.**
- ✓ **Get information to management faster so they can use it for planning.**
- ✓ **Lower audit fees.**
- ✓ **Impress the bond market, which supports lower borrowing costs.**
- ✓ **Catch errors earlier so they can be fixed.**

PRINCIPLE 1

Modularization and Continuous Flow

As the old joke goes: *What is the best way to eat an ACFR? One bite at a time.* That means we should break the preparation of the ACFR into bite-sized pieces (modularization) and then make progress at a continuous pace or rhythm (continuous flow).

Modularization

The great value of modularization is that it allows you to identify modules of the ACFR that can be started sooner than others. The Four-Month Club found several such elements, which we grouped into three categories. As one member put it, "Things that don't require all of the final numbers to be in" are great candidates for starting early.

A. Preliminary Audit Work and Internal Control Testing

You can schedule a preliminary audit well before year-end to detect and resolve problems early. Even better, schedule the audit work during a time when the finance department is less burdened with competing priorities, so the findings can be addressed right away.

Performing internal control testing during interim periods, rather than waiting for year-end, helps distribute the workload more evenly throughout the year. This not only eases year-end pressure but also enhances oversight and control.

Documents such as bank statements, investment summaries, receivables, and payables can be collected, reconciled, and made available for auditing during the preliminary audit work. This can reduce audit procedures at year-end.

B. Single Audit Compliance Testing

Auditors can conduct single audit compliance testing during interim periods. Prepare a draft Schedule of Expenditures of Federal Awards (SEFA) before the fiscal year ends. Doing so can help you identify major programs and flag any missing information, allowing you to work with grant and program staff to get that information in advance.

The draft SEFA should include both actual and projected federal expenditures through year-end. Identifying major programs early allows you to obtain the Compliance Supplement, which outlines compliance testing performed by the auditors. This preparation allows early detection of compliance issues that can be addressed before testing begins. When auditors complete compliance testing during the interim period, it reduces year-end workload and enables completion of the ACFR and the SEFA at the same time.

C. Introductory and Statistical Sections

Many parts of the statistical section — such as population trends and the list of major taxpayers — do not rely on audit results. These sections can be completed early to free up time for working on sections that do depend on audit results.

Continuous Flow

Besides finding discrete modules that can be completed quickly, our first principle calls for "continuous flow processing." This can be contrasted with "batch processing" — or waiting until work accumulates and then processing it all at once. This can seem efficient to an individual because it allows them to get into a rhythm. However, it slows the overall process because the next step can't begin until the entire batch is complete. Moving work along to the next step in smaller pieces allows each step to begin earlier, thereby improving overall efficiency.

We've identified four areas where achieving continuous flow processing could be particularly powerful.

A. Grants and Capital Projects

Conduct regular reviews with operations staff to monitor the status of grants and capital projects. This ensures timely billing, settlements, and project closeouts, preventing a backlog at fiscal year-end.

B. Preparing Conversion Entries During the Year

Make adjustments throughout the year for critical items — like debt and capital assets — to maintain accuracy and reduce the need for year-end corrections. For infrequent items — such as debt issuance — perform the relevant accounting for both the fund and government-wide financial statements at the time of the event to avoid a year-end backlog.

For example, when a capital bond is issued, the following adjustment is made in the capital projects fund on the date of issuance:

Capital projects fund	DR	CR
Cash	$5,100	
Expenditures — bond issuance costs	300	
Other financing sources — bond issuance		$5,000
Other financing sources — original issue premium		400
(Issuance of long-term debt)		

In the government-wide conversion fund, the following adjustment would be made on the date of issuance:

Government-wide conversion fund	DR	CR
Other financing sources — bond issuance	$5,000	
Other financing sources — original issue premium	400	
Bonds payable		$5,000
Premium — bonds payable		400
(Reclassification of bond issuance from other financing sources to liabilities for government-wide reporting)		

When a debt service payment is made in the debt service fund, a corresponding adjustment to reduce bonds payable should be made in the government-wide conversion fund.

Debt service fund	DR	CR
Expenditures — debt service — principal	$200	
Expenditures — debt service — interest	100	
Cash		$300
(To record debt service payment on bonds)		

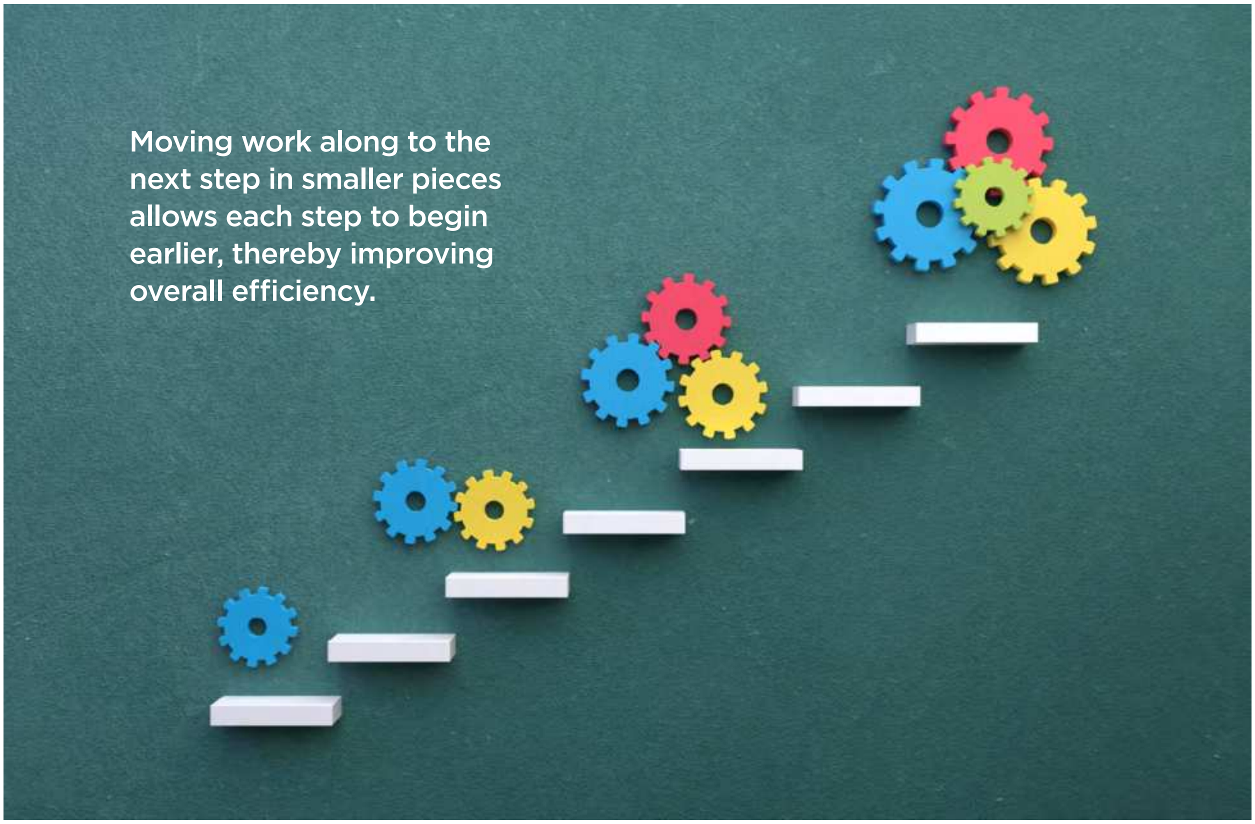
Government-wide conversion fund	DR	CR
Bonds payable	$200	
Expenditures — debt service — principal		$200
(Reclassification of debt service principal expenditure to reduction of related liability for government-wide reporting)		

While not shown here, governments could also accrue monthly interest on long-term debt in the government-wide conversion fund and reduce the accrual when the interest payment is made.

When capital assets are purchased in a governmental fund, a corresponding adjustment should be made to capitalize the purchase in the government-wide conversion fund.

Capital projects fund	DR	CR
Expenditures — capital outlay	$1,000	
Cash		$1,000
(To record expenditures for purchase of land and construction of new building)		

Government-wide conversion fund	DR	CR
Land	$700	
Construction in progress	300	
Expenditures — capital outlay		$1,000
(Reclassification of expenditure to capital assets for government-wide reporting)		



When capital assets are sold or disposed of, the historical cost and accumulated depreciation on the capital asset should be removed from the capital asset ledger, and the corresponding gain or loss on the sale or disposal should be recorded.

C. Reconciling Accounts

Maintain a clean balance sheet by reconciling cash and investment accounts monthly. In addition, other balance sheet accounts, such as accounts receivable and accounts payable, should be reconciled throughout the year. Periodic reconciliations of subledgers to the general ledger can identify issues that can be corrected in a timely manner. Regularly (e.g., quarterly) review reconciling items to remove stale-dated items, including outstanding checks and pending goods receipts. This helps minimize year-end issues.

Regular reviews of actual results against the budget ensure proper line-item reporting of transactions and the prompt booking of accruals. This helps maintain financial accuracy and readiness for year-end. For governments involved in large construction projects, ensuring that retainage is accrued as invoices are received allows for proper expenditure and capital asset (e.g., construction in progress) reporting.

Ensure that due to/from and transfers in/out accounts between funds remain balanced throughout the year.

Reconcile subsystems — like payroll and revenue systems — monthly to prevent discrepancies and streamline end-of-year processes.

D. Interim Statement Review

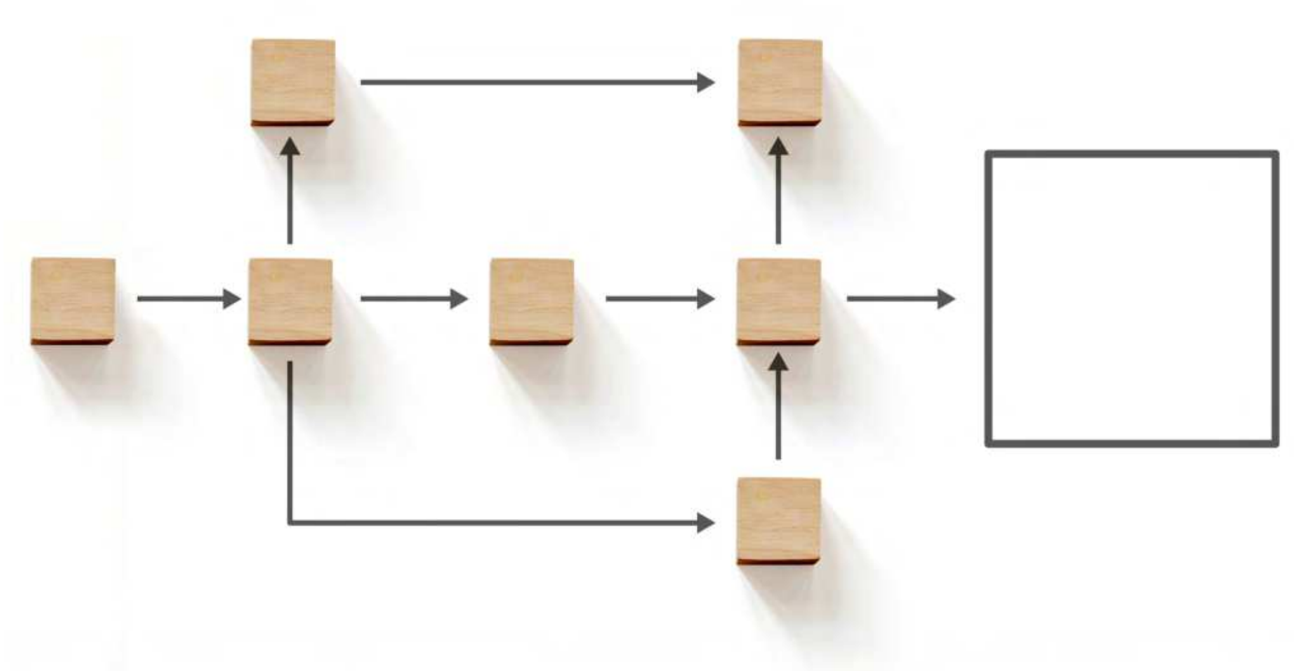
Ensuring the accuracy of interim statements brings you that much closer to an accurate year-end statement. For example, if a midyear statement is accurate, then only six months remain to be accounted for. Conducting monthly budget-to-actual analyses for all legally adopted funds supports sound financial management and more accurate reporting. This is especially important as you approach year-end.

For example, accurate budget-to-actual analysis depends on reliable data about the money the government may need to pay vendors. That information is also critical to financial statements in other ways. Encouraging timely submission and processing of invoices throughout the year helps avoid a last-minute rush to gather this data at year-end.

An important complement to continuous flow processing is maintaining a rhythm throughout the year. This means spacing out tasks — so they're not too close together but not too far apart. "Not too far apart" keeps people engaged in the task, while "not too close together" provides a buffer for slippage in the schedule. For example, reconciling accounts monthly helps maintain a clean balance sheet, enabling the finance officer to address variances as they arise and complete the year-end close in a timely manner.

Finally, we should acknowledge the insidious consequences of interruptions. Processing complex work, like an ACFR, is best done in long, uninterrupted blocks of time so that workers can get into a productive flow state. Research shows that once interrupted, it can take up to 25 minutes to regain focus. This problem is not unique to ACFR processing. It applies to any complex analysis or financial task. You can find strategies for reducing interruptions in GFOA's **"Interruptions: How to Tame One of the Worst Office Productivity Killers."**

To conclude our discussion of Principle 1, the primary objective is to avoid backlogs and bottlenecks. Batch processing is notorious for causing inefficiencies. Think of a pipeline — a steady flow of material through the pipe is far more manageable than forcing everything through at once.



PRINCIPLE 2

Visualize the Process

If the process is invisible, it is hard to manage — so make it visible. There are many ways to do this. A process map, like a flowchart, is a classic way and can be especially helpful in large governments with many participants. In smaller governments, more economical tools may be better. For example, a simple checklist is great for documenting and providing reminders for critical steps that might otherwise be missed. You can see an example of **San Antonio's checklist here**.

No matter the format, there are several key objectives for visualizing the process.

First, clarify roles in the process and the timelines for tasks. This includes external auditors.

Clarifying roles and timeliness is a prerequisite for the second objective, which is to identify handoffs in a process. Handoffs occur when work is transferred from one person to another. In a relay race, the baton is most likely to be dropped during the handoff between runners. It is no different in a work process. Process improvement methods — like Lean and Six Sigma — focus on handoffs, as they are especially prone to errors and delays.

Process visualization helps identify tasks where handoff errors are a big risk. Handoffs can occur within the finance department when multiple staff members work on the ACFR. Risks also occur with handoffs between the local government and its external auditor. Information required from other departments — such as estimates for accounts payable or accounts receivable — presents a handoff risk as well. A final example is actuarial valuations for pensions and other post-employment benefits.

There are many ways to reduce these risks.

- For external auditors, build timeline goals into the auditor's contract. Members of the Four-Month Club stress the importance of setting timeline expectations with their external auditors. The City of Columbus includes in its Request for Proposals that the audit be completed within 90 days. That requirement is included in the final contract.
- Provide the information that actuaries need early in the process to reduce the risk of their work delaying final production of the ACFR.
- For governments with larger finance teams, identify tasks that can be assigned entirely to a single person. For example, the City of Columbus assigns the production of statistical tables to a single individual, eliminating handoffs in this part of the process.

When a task doesn't depend on the completion of the previous one, there is an opportunity for parallel processing.

The third objective of visualizing the process is to find opportunities for parallel or paralinear processing. Parallel processing is doing two tasks at the same time. Paralinear processing is starting one task first but starting the second before the first one is complete.

A common process efficiency opportunity uncovered by Lean and Six Sigma analyses is unnecessary sequential processing — waiting for one task to be finished before starting the next. When a task doesn't depend on the completion of the previous one, there is an opportunity for parallel processing.

For example, one member of the Four-Month Club develops the statistical section paralinearly with the audit. They start on the stats section after the audit begins but well before it is completed. They have even visualized these opportunities in their work plan, using a special color code to highlight tasks that can begin before other tasks are finished.

In another example, one finance department was waiting to request data from component units until the finance department was ready to process it. The department then had to wait a long time for the component units to provide the data. Now, the finance department requests the data in advance, allowing the department to work on other tasks while the component units work on the data request.

The fourth objective is exception processing — deciding how to identify and manage nonstandard items that arise during ACFR production. Items that don't fit the standard approach can disrupt the entire process if there is no plan to deal with them.

Component units often fall into this category. These legally separate organizations — whether they are other governments or nonprofits — may issue their own financial statements. They may also be audited by different auditors and follow a different fiscal year from the primary government. Coordinating with component units on due dates is critical to issuing financial statements in a timely manner.

A final objective is load balancing. Visualizing the process (including the time required for different tasks) can help you find unbalanced workloads and make the best use of available talent. For example, one member of the Four-Month Club maintains a list of specific tasks to be done for the ACFR. Each task is given to a member of the finance team. The finance department carefully manages team members' workloads to ensure ACFR tasks are completed before the deadline.

A critical part of load balancing for a finance department is "meeting time" versus "maker time". Inefficient and overly frequent meetings have a reputation as productivity killers. However, a less appreciated consequence for the ACFR is that workers will be most efficient when they have long, uninterrupted blocks of time to do the work. Consider how you can structure daily work schedules to both allow for sufficient collaboration time (meetings) and sufficient individual uninterrupted time on task to maximize productivity. You can learn more about strategies for achieving this in GFOA's [Meetings: Going from Waste of Time to Worth the Time].

Load balancing is not just relevant for larger finance departments. Even in smaller departments, visualizing the process helps plan the full scope of the finance department's work and balance ACFR tasks alongside other responsibilities. Many people in small finance departments have both managerial and maker responsibilities — they oversee ACFR processing while also doing the work.

A manager's schedule is often characterized by frequent but short meetings throughout the day. A maker's schedule, however, requires long, uninterrupted blocks of time to optimize productivity. If you are both a manager and a maker, consider structuring your schedule to fulfill managerial responsibilities while also creating large blocks of time to process the ACFR. The GFOA report on meetings referenced earlier can help.

PRINCIPLE 3

Standardize to Minimize Variation

Standardization reduces the variation a task is subject to. When a process is more variable, the output it produces is also more variable. Greater variability increases the likelihood of unacceptable deviations from the desired quality. These deviations are known as ***defects***.

Defects require ***rework***. Rework is a costly form of waste in a process. Redoing a task consumes both time and money.

Abraham Lincoln is reported to have said, "If I had five minutes to chop down a tree, I'd spend four minutes sharpening the axe." The equivalent for finance departments is to develop standard operating procedure (SOP) documents for ACFR production.

In the City of San Antonio, Texas, SOPs include linked Excel workbooks for loading all reported funds from the combining statements through to the government-wide statements. Staff provide preformatted financial information for the funds, already rounded to the nearest dollar to eliminate footing issues. You can download several examples of San Antonio's SOPs, including:

- A calendar for ACFR production.
- The standard operating procedures for printing the ACFR, which provides a great example of documenting steps and including references to relevant software interactions that staff will need to use.
- Listing of the various year-end adjusting journal entries needed.
- A spreadsheet template that is used to determine "major funds."

Additionally, there are SOPs for specific year-end accruals and allowances, such as the GASB 33 sales tax catch-up, municipal court revenues, and departmental templates and SOPs for pollution remediation, leases, and SBITA calculations.

One of the great but underappreciated advantages of SOPs is their usefulness for creating error-proofing techniques. These techniques help identify deviations from the SOP and prevent errors from being passed along to the next step in the process. This could happen by either disallowing the error (e.g., software that blocks invalid data entry) or by alerting the worker to deviations so issues can be corrected before moving forward.

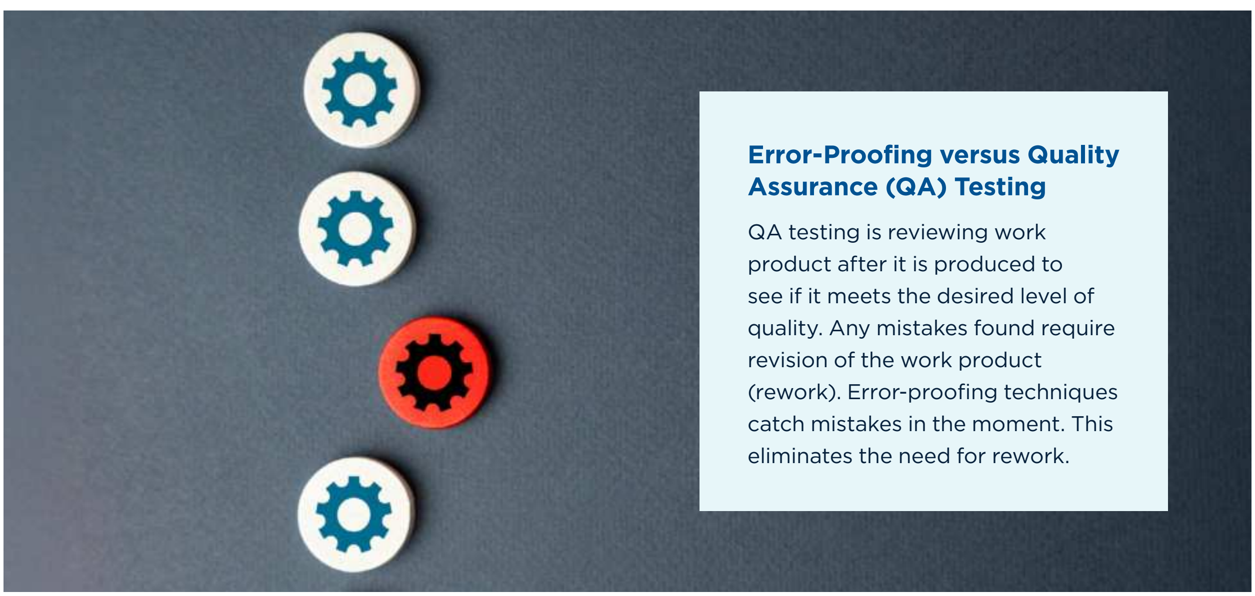
Members of the Four-Month Club use several types of error-proofing techniques, which we will discuss below. You can also dive into the problem of rework and how to fix it with error-proofing in GFOA's **"[Rework: Doing Double for Nothing and How to Fix it](#)."**

A good place to start is to provide staff with a roadmap for the ACFR process. There are several ways to do this, but we will focus on the simple checklist.

In his book, *The Checklist Manifesto*, Atul Gawande shows how checklists have made a profound difference in fields like medicine and air travel. For example, a study that introduced surgery safety checklists at eight hospitals showed a 36% reduction in major complications and a 47% reduction in deaths after the introduction.[1]

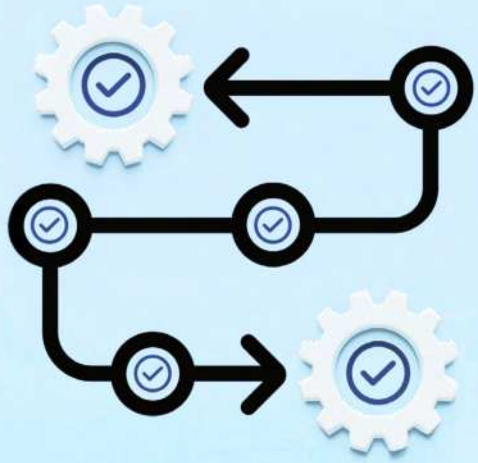
Checklists help identify critical items in a process that are at risk of being overlooked, forgotten, or delayed. For an ACFR, you could develop an audit checklist with critical steps for categories such as accounts payable, accounts receivable, payroll, cash, and more. This checklist could also include due dates, assignments, and other useful notes. You can see an example from the **City of Fridley and the City of Concord**.

A checklist can be supported by templates for performing the tasks it outlines. The **City of Fridley** has templates for bank reconciliations, capital assets, net position calculation, major program calculation, and converting fund statements to government-wide statements.



Error-Proofing versus Quality Assurance (QA) Testing

QA testing is reviewing work product after it is produced to see if it meets the desired level of quality. Any mistakes found require revision of the work product (rework). Error-proofing techniques catch mistakes in the moment. This eliminates the need for rework.



Software contributes to error-proofing by reducing the parts of the process that require manual intervention. Computers excel at performing a task the same way every time.

These examples are all relatively low tech, involving little more than standard office productivity software. However, more sophisticated software can also help. Software contributes to error-proofing by reducing the parts of the process that require manual intervention. Computers excel at performing a task the same way every time. Variation in how a task is performed is a source of potential error.

The Town of Mooresville benefits from software that manages the compilation of the final ACFR document. Once the software is set up, compiling the document becomes easier and faster, with little to no variation between the Town's requirements and what the software produces.

Before implementing its software, the Town of Mooresville spent at least a week double-checking page numbers, making sure totals and notes matched across various statements, and ensuring the Management Discussion and Analysis (MD&A), statistical schedules, and budget-to-actual statements aligned with the core financial statements. The Town went through at least a dozen drafts before reaching a version it was comfortable releasing.

A great error-proofing technique is to cross-check numbers that appear in several places within the ACFR. For instance, figures in the MD&A should match those in the government-wide financial statements. A formula or algorithm can automatically check that they are equal.

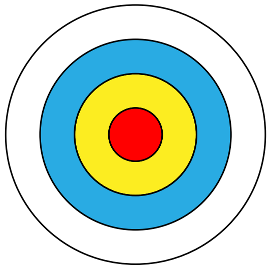
The City of Columbus uses software that cross-checks numbers across the MD&A, financial statements, notes, and statistical section. For example, if a number in the financial statements is updated, the software ensures that the same number is updated elsewhere in the document. A dashboard alerts ACFR preparers to potential inconsistencies.

Your efforts to error-proof the process should evolve with experience. Have a debrief of the ACFR process each year. Review what went well and what could be better at the end of the audit — internally with staff and externally with auditors. Incorporate lessons learned into your SOPs for next year's audit.

Lean process improvement identifies several sources of potential waste in business processes — many of which we've already covered. One area we have not yet addressed is overproduction or overprocessing. This is doing more work than necessary to meet the needs of the ACFR user.

The best example is spending time on a higher level of precision than required. A measure (such as a dollar amount) can be accurate without being precise.

The Target in Our Game



We can illustrate this concept with a carnival game. Imagine you can win a prize by hitting a target with a BB gun. Take a look at our target illustration to the right. Let's suppose the rules are that you need 50 points to win the prize and you get four shots. Hitting the red dot is worth 15 points, the yellow ring is worth 10 points, the blue ring is worth five points, and the white ring is worth zero. Obviously, you should aim for the red dot to maximize your score.

Now, imagine the rules have changed. You still get four shots and need 50 points to win. However, the red dot and yellow ring are both worth 10 points, while the blue and white rings are both worth zero — but you also earn 10 more points if you make all four hits in less than six seconds. Thus, if you have four tries, it is not enough to simply hit the target area — you must also hit fast enough to earn sufficient points to reach the goal.

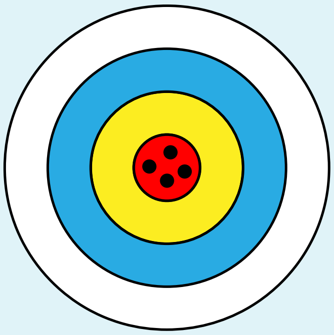
There is a strong case to be made that preparing an ACFR is more like the second of our carnival game scenarios than the first. The sooner the ACFR is completed, the better. There is not unlimited time to hit the mark. Also, there is a set accuracy threshold to meet. Can users of financial statements use them to make decisions with confidence? Going beyond this threshold adds little or no value for the user.

This brings us to the difference between precision and accuracy. Let's illustrate this in the diagram below using the results from our second carnival game. The result on the left is highly accurate and precise because the shots are right on the mark. The result on the right is still highly accurate because all four shots are in the goal area, earning the same total points. However, they are less precise because they are not all right on the mark. Nevertheless, the results on the right are more likely to win the game because they can be achieved more quickly, with less time spent aiming.

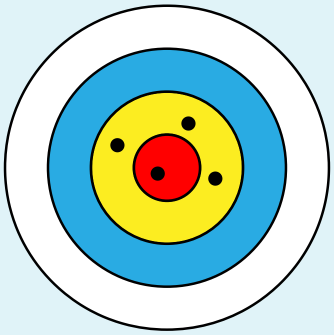
Now, let's look at some real-life applications of this concept to ACFRs. Think of these as ways to land within at least the yellow ring while staying under the time limit.

Imagine you are playing a carnival game where a prize can be won by hitting the target with a BB gun...

High Accuracy, High Precision



High Accuracy, Low Precision



If the yellow and red areas of the target are worth the same, then the results on both targets are equally accurate. The results on the left, however, are more precise. If you can get more points toward winning the prize by going faster, then you should sacrifice precision for speed.

Get Comfortable With Estimates

Use historical trends as a foundation for revenue and expense accruals. This allows for a faster, less time-intensive estimation process in which trend-informed estimates form your accrual number. You can also review the current year's operations as part of the accrual estimation. This keeps estimates reflective of actual conditions. You can make adjustments to accruals at year-end if discrepancies from the norm are significant. This allows for flexibility and responsiveness in financial reporting without the need for excessive precision during the fiscal year.

In the City of San Antonio, year-end estimates are established for hotel occupancy taxes, municipal court revenues, and EMS transportation revenues based on historical trends, including actual revenues from earlier in the year. Departments estimate year-end expense accruals for goods and services that were received but not yet billed. Those estimates are only changed if the actual invoices result in a variance significant enough to misrepresent the fund's activities.

Materiality Thresholds

Christopher Quinn from the Town of Mooresville observed: "Accountants often believe that numbers should be exact. Significant delays in producing the ACFR often happen due to an unwillingness to make estimates and understand that these do not need to be exact. Understanding the effects of materiality is critical."

To illustrate this, GFOA selected local governments at random from the long-term participants in the GFOA Certificate of Achievement for Excellence in Financial Reporting Program and looked at their 2023 and 2013 ACFRs to find their capitalization thresholds. The findings showed over 70% of the thresholds disclosed had not been updated in at least 10 years.*

This means that these local governments have, in effect, reduced their thresholds over time because inflation decreases the real monetary value of the threshold. When adjusted for inflation, the thresholds have lost between 30% and 60% of their value, depending on the inflation assumptions used.[2] In any case, the declines are not trivial. Long-term declines in real-dollar thresholds used for capitalization speak to a cautious philosophy of judging materiality.

The City of Burbank illustrates the benefits of a more selective approach to materiality. The City raised its asset capitalization threshold from $5,000 to $10,000 — it's first increase since 2004. Raising the threshold led to the removal of 343 capital assets from the City's books. These assets had a total value of $2 million, compared to the City's $1.25 billion in total capital assets — a relative drop in the bucket at 0.16% of the total. In terms of workload, however, that is 343 fewer capital assets that needed to be tracked, physically audited, retired or replaced, and reported on. Since the City has one accountant dedicated to capital assets, that's a big savings for the City, not to mention for the departments responsible for tagging and maintaining the equipment.

Round Your Numbers

Though not as important as the issues just mentioned, rounding statements to millions or thousands can help avoid unnecessary precision.

*Given the number of local governments we selected, there is about a 99.99% chance that true population measure is greater than 50%, providing strong support for the position that most local governments tend toward cautious judgments.

Where Should You Start?

We have described several strategies to help accelerate your ACFR, but where are the highest leverage opportunities for ***your*** process? One way to find them is to conduct an “Eight Wastes Scavenger Hunt.”

One key idea in Lean process improvement is that all processes include some form of waste. Thus, improving a process starts with identifying waste and eliminating it. Lean identifies eight forms of waste, often remembered by the acronym D.O.W.N.T.I.M.E. Below, we’ve defined each of these forms of waste.

Although these categories were originally developed for physical manufacturing, they apply well to knowledge work too. We’ve provided an example of each type of waste within the ACFR process. Look for these forms of waste in your process. Each one represents an opportunity for improvement.

1. **Defects: Errors or mistakes that require rework.**

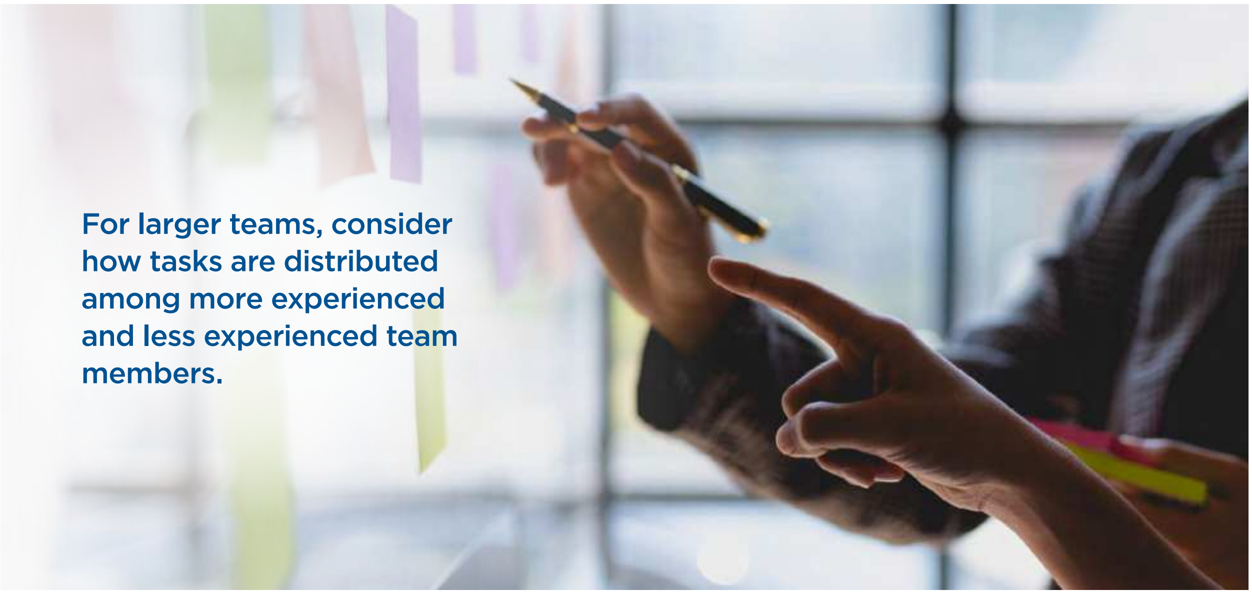
   We saw how defects in the final ACFR document production forced Mooresville to go through several versions before reaching one that could be released.

   Where in your process are defects leading to rework?

2. **Overproduction: Producing more than what is needed or producing it before it is needed.**

   A prime example is materiality thresholds that are set too low, leading to unnecessary reporting of items. We saw how the City of Burbank saved time by raising its capitalization threshold.

   Where in your process are you producing more information than the end user needs — or producing it too soon?



3. **Waiting: Idle time when resources are not in use, such as waiting for information or approvals.**

   This is often a consequence of batch processing or botched handoffs.

   A common example is waiting on audit results. We saw how members of the Four-Month Club worked to understand the handoffs with auditors and then designed the audit schedule and contract to minimize the waste of waiting.

   Waiting can also arise from unnecessary sequential processing. One government found that it was requesting component unit financial data only after prior steps in the ACFR process were done and the finance department was ready to process data. They have since initiated the request for data before the finance department is ready for it, so the data will be available closer to the time the department needs it. This is an example of making a sequential process into a parallel process: A) The request is made. B) The component unit works on it. C) In the meantime, the finance department is doing other things.

   Where are the longest wait times in your process?

4. **Non-Utilized Talent: Underutilizing employees' skills, talents, or knowledge.**

   In an ACFR process, workloads or tasks distributed inefficiently are common culprits.

   We saw how the Four-Month Club focused on load balancing in both small and large finance departments. For larger teams, consider how tasks are distributed among more experienced and less experienced team members. A common process improvement technique is to: A) Assign standard, easier-to-process transactions to less experienced workers. B) Route unusual transactions to more experienced workers.

   Also, don't overlook small yet mighty productivity killers, like inefficient meetings and frequent interruptions.

   Where do you have opportunities to better balance workloads or make better use of available skills and abilities?

5. **Transportation: Unnecessary movement of materials between processes.**

   Another way to think about this is too many handoffs. We saw how San Antonio assigned the entire statistical section to one person to avoid handoffs.

   Where in your process are there many back-and-forths among participants, and how could they be reduced?

In ACFR processing, the biggest risk of motion waste stems from steps that are performed only once per year, making it easy for participants to forget them.

6. **Inventory: Work product that is not being processed.**

   In an ACFR process, this waste occurs whenever there is a backlog of information.

   For example, waiting until the end of the fiscal year to determine capital asset changes can lead to considerable time spent sorting out what should be capitalized, which can lead to errors.

   The City of Concord, North Carolina, avoids capitalization backlogs by capitalizing eligible purchases throughout the year, including construction in progress. This saves time at year-end when other tasks need to be done.

7. **Motion: Unnecessary movements by people.**

   In knowledge work, this type of waste primarily occurs when employees spend too much time searching for information or switching between screens and software applications.

   In ACFR processing, the biggest risk of motion waste stems from steps that are performed only once per year, making it easy for participants to forget them. As a result, they must search for reminders on how to perform the tasks.

   We saw how the Four-Month Club widely used SOPs and checklists to avoid this waste. Similarly, San Antonio included hyperlinks in its SOPs to help workers quickly access the correct spreadsheets.

   Where in your process are people searching for instructions or moving between different systems or applications?

8. **Extra Processing: Performing more work or adding more features than what is required by the end user.**

   The biggest instance of this waste in the ACFR is over-precision. We saw how members of the Four-Month Club are comfortable using reasonable estimates in many aspects of the ACFR. This concept can be broadened to include any information in the ACFR that is not used by the end user.

   Where are you providing more information or more precise numbers than are needed?

Together, these eight forms of waste offer a roadmap for improvement. Work with your finance team to spot them in your own process. Doing so will highlight your best opportunities to apply the three principles outlined earlier and accelerate your ACFR.

Conclusion

We have identified three principles to help you accelerate your ACFR. Let's recap these principles and their major themes. Knowing these principles and themes will help you develop your own techniques for accelerating your ACFR process and go beyond the examples provided by the Four-Month Club.

The first principle is **"Modularization and Continuous Flow."** A key theme is to avoid batch processing and achieve a continuous flow of work. Continuous flow contributes to a steady rhythm, which helps prevent backlogs and bottlenecks.

The second principle is **"Visualize the Process."** Making the process visual clarifies roles of all parties, including external auditors. It also identifies points where work is handed off from one party to another. Handoffs are a major point of potential process failure and delay.

Visualizing helps eliminate unnecessary sequential processing, replacing it with parallel or paralinear processing. Visualizing enables better workload balancing among finance team members and between ACFR production and other finance department work.

Finally, visualizing can help you design a way to handle issues that don't fit standard processing, with component units being one common example. Routing out these exceptions to a different subprocess can keep the main workflow humming along.

The third and final principle is **"Standardize to Minimize Variation."** The key objective is to reduce defects to minimize rework. Rework doubles the time it takes to complete a task because the task must be repeated.

Developing SOPs helps minimize variation in the process, which helps reduce errors. Going a step further, you can create dedicated error-proofing tools based on these SOPs to enhance efficiency and accuracy.

ENDNOTES

[1] Chew T. S. (2011). The checklist manifesto: How to get things right. *Clinical Medicine*, 11(3), 296–297. https://pmc.ncbi.nlm.nih.gov/articles/PMC4953332/#:~:text=In%20January%202009%2C%20the%20results,to%207%25%20using%20this%20checklist.

[1] Local governments purchase a basket of goods that is quite different from that contained in CPI. We used two different inflation indices that are intended to better capture the cost pressures faced by local governments. Northern Illinois University, Center for Governmental Studies. (2025). Illinois Municipal Price Index (MPI). Retrieved February 1, 2025, from https://www.cgs.niu.edu/resources/municipal-pricing.shtml. U.S. Bureau of Economic Analysis. (2025). State and Local Consumption Expenditures & Gross Investment (SLCE). Federal Reserve Bank of St. Louis. Retrieved February 1, 2025, from https://fred.stlouisfed.org/series/SLCE.

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203 N. LaSalle Street, Suite 2700
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