



## Generally Accepted Accounting Principles and You – Materiality

Part 4 of 4

By H. Frank Sauls, Jr.

We have examined several fundamental aspects of accounting principles: historical cost, the matching principle, and conservatism. The last cornerstone is materiality.

Materiality is broadly defined in accounting terminology as “the inclusion or omission of an item influencing or changing the judgment of a reasonable person.” In short, the item must make a difference in order to be evaluated. Being accountants, we look at the dollar value. The larger the dollar amount, the more closely the transaction will be evaluated in order to determine if it is properly classified and presented.

Without materiality, the accountant’s job would require that every transaction be looked at individually and in total to evaluate its impact on the financial presentations. This would greatly increase the cost of obtaining the financial statements. This increased cost would go beyond the cost effective point that any cost benefit analysis would indicate as acceptable. It would also extend the time required to provide the information beyond the acceptable level.

Materiality allows the accountant to concentrate his evaluation on large transactions individually and in total. He can then provide additional levels of assurance that those items will not cause judgment errors by management or a third party review of the financials. This allows for the levels of confidence in financial statements needed by management and outside sources to successfully evaluate operations and make informed management decisions. After all, financial statements are just one of a number of tools that a well-trained manager will use in running a company.

Now you know four of the cornerstones of accounting: historical cost, the matching principle, conservatism, and materiality and why they are used. Next time you look at a financial statement, think about the different areas that we have discussed and a whole new world of understanding about the company should open before your eyes.

This series of articles about GAAP can be found at [www.apbcpa.com](http://www.apbcpa.com).

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