Government Audit Materiality (Part One): How and Why is It Different from Corporate Audit Materiality – A Theoretical Matrix on Three Materiality Differences and Corresponding Contextual Reasons

Yining Zhou

Southern Cross Business School, Southern Cross University

Southern Cross University Riverside Campus, Tweed Heads, NSW, 2485, Australia

E-mail: zhou_neil@yahoo.com

Received: July 31, 2011 Accepted: August 29, 2011 Published: January 1, 2012

doi:10.5539/ijef.v4n1p80 URL: http://dx.doi.org/10.5539/ijef.v4n1p80

Abstract

This research is to explore materiality concept in government audit. Based on a case study on a local government audit office, this research discovers that: in judging material information, government audit differs significantly from corporate audit on three aspects, 'tight materiality thresholds', 'focus on qualitative considerations', and 'income and expenditure as materiality-focused subjects'. And furthermore, it argues that these sharp differences result from inherent contextual situations in government audit: pressure from public accountability; high auditor status; power in collecting evidence; and public stakeholder interests. The outcome of the research conveys a message: materiality is contextual. It is uneasy, unreasonable and unnecessary to copy directly from corporate materiality models or guidelines to government audit; rather, the study on governmental context itself is necessary and unavoidable in developing government audit materiality guidelines.

Keywords: Government audit, Materiality, Audit standards, Corporate audit, Materiality threshold

1. Introduction

The research is built up with this question: regarding materiality judgment, in what aspects does government audit differ from corporate audit, and why these differences happen? To answer this question, the research adopts a case-study approach grounded on primary data including direct observation and interviews from government auditors from a Chinese city.

There are two main objectives of this study. From a theoretical perspective, I seek to develop the understanding on how governmental context shapes materiality judgment. Prior empirical research observes that auditors adopt different materiality thresholds across industries within the context of corporate audit (e.g., Iselin & Iskanda 2000; Acito, Burks & Johnson 2009). In a survey research, Relmond & VanDaniker (1994) extend the observation to an inter-contextual scope: government auditors tend to adopt much stricter materiality level than corporate auditors. But prior research does not provide an answer on why this 'tightness' in materiality judgment occurs in government audit, nor identify other different aspects on materiality between the two audit contexts. By observing and reasoning these differences, this study not only contributes to the literature on governmental auditing, but also enriches the theories on contextualizing accounting concepts and standards.

The other objective of this research is of the practice perspective. Compared to the corporate audit materiality models well documented in prior research and widely applied in practice, government audit materiality guidance is not only lacking, or vague if any, but also little studied (Relmond & VanDaniker 1994). In corporate audit, practical materiality models have been well developed, studied and widely applied, in terms of quantitative models (such as 5% rule), or in clear identification on qualitative characteristics provided by SEC. But in government audit, it is lack of guidelines, theoretical works and conclusive reviews for government audit materiality. Addressing this point, Relmond & VanDaniker (1994) indicate the needs to review and develop guidelines on government audit materiality, because "government auditors do not agree on an appropriate base for calculating materiality", and "current practice varies widely". The situation of lacking government audit materiality guidance is significant in China. Chinese National Audit Office firstly introduced the concept of audit materiality in 2003 to China government audit (Chinese Audit Principles and Standards 2003); however the national office has not yet provided even a guideline or a conceptual framework for assessing materiality.This situation also reflects on inadequate support from academic field, for example, very few research papers regarding government audit materiality have appeared in Chinese literature. Thus, the research results may contribute to the development of government audit standards setting, especially for Chinese government audit standards.

2. Literature Review

2.1 The Concept of Materiality

The concept of materiality can be traced from a British case in 1867 in which the judge concluded that 'no misstatement or concealment of any material fact ought to be permitted' (Holmes, 1972, p. 46). Holmes (1972, p.46) also refers to the 1895 British Companies Act, which defines materiality as 'every contract or fact is material which would influence the judgment of a prudent investor in determining whether he would subscribe for the share or debenture offered by the prospectus'.

The Financial Accounting Standards Board (FASB)'s definition of materiality demonstrates an orientation to the users of financial statement: 'The magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.' (Statement of financial accounting concepts, No. 2, FASB, 1980)

Similar to FASB, Generally Accepted Government Auditing Standards (GAGAS) define government audit materiality in the respect of the effects on financial statements: "the concept of materiality recognizes that some matters, either individually or in the aggregate, are important for fair presentation of financial statements in conformity with generally accepted accounting principles, while other matters are not important. In performing the audit, matters that, either individually or in the aggregate, could be material to the financial statements are a primary consideration."

The materiality concept was introduced into Chinese government audit in 2003, and defined as 'magnitude of an omission or misstatement of information in auditees' financial statement. And this magnitude possibly influences the judgment and decision of financial statement users.' (Chinese Audit Principles and Standards, Chinese National Audit Office 2003)

The above definitions indicate the similarity between government audit and corporate audit standards in defining the concept of materiality. This similarity reflects on Christensen (2003, p.26)'s argument that 'they (professional accountants) were certainly supportive of convergence of public and private accounting standards." In practice of both audit contexts, materiality plays a critical role in determining the information available to be analyzed, and the form of communicating information. Auditors set materiality levels for detecting errors and irregularities, with a conventional thought that only material items need adjustments to the financial statement.

2.2 Qualitative Considerations and Guidance

An inherent aspect of audit materiality tends to be quantification. Researchers suggest that auditors traditionally use quantitative rules of thumb (such as 5 percent of net income) in their materiality assessment (e.g., Chewning, Wheeler and Chan, 1998; Messier, Martinov-Bennie &Eilifsen, 2005).

However, the SEC (1999) has highlighted the danger of simple reliance on quantitative measures and the requirement for serious considerations of qualitative factors that can make even very small misstatements material (DeZoort, Harrison and Taylor, 2006). SEC suggests that considerations should be given when concluding not to adjust statements for known errors because of the myriad of qualitative factors influencing the decision (Chewning& Higgs 2002). Consistent with this view, Ng & Tan (2007) assert that overreliance on quantitative materiality thresholds may cause auditors to waive quantitatively immaterial but qualitatively material audit differences, thus the audit quality may be undermined. Ng & Tan (2007) furthermore conduct an experiment to measure auditors' judgments about materiality thresholds related to the qualitative factors. In views of Ng & Tan (2007), existing mechanisms that draw attention to qualitative materiality factors may not necessarily achieve consistent and intended effects because of differential materiality thresholds that auditors use to assess qualitative materiality. This conclusion highlights the importance of more explicit guidance on the determination of qualitative materiality, although SAB provides qualitative factors but they are vague (Ng & Tan 2007).

2.3 Materiality Judgment in different audit situations

DeZoort, Harrison and Taylor (2006) discover the relationship between accountability pressure and audit materiality judgment. From an experiment where they manipulate accountability at four levels (i.e., anonymity, review, justification and feedback) and evaluate how accountability pressure affects auditors' materiality judgment, Dezoort, et al (2006) found that under higher levels of accountability pressure, auditors emphasized more qualitative materiality factors than auditors under lower levels of pressure.

Public sector is accountable for a broader stakeholders, that is, public accountability is inherent for the public sector; as Christensen and Skabek (2007) indicate that public entities report to a broader audience and accountability reports image as truth providers for citizens' democratic consumption. As an organ of the public sector, government audit is assumed to be in higher accountability pressure than corporate auditors. We may apply Dezoort, et al (2006)'s argument in the government audit context, and claim that government auditors, under that public accountability, may focus more on qualitative materiality thresholds than corporate aduitors. This claim is supported by the findings of Relmond & VanDaniker (1994). Based on a survey on a number of government auditors in USA, Relmond & VanDaniker (1994) suggest that auditors are likely to respond to a higher level of perceived exposure risk (such as political sensitivity, media and litigation) by increasing the extent of audit testing and a tighter materiality estimate. From this point of view, government audit materiality judgment should be significantly influenced by qualitative factors.

Iselin & Iskandar (2000) also relate materiality thresholds to situational differences – the materiality thresholds varied with industry market risk – the higher risk the industry suffers, the lower materiality threshold auditors tend to set. They provide anexplanation: lower thresholds result in the disclosure of more information, thus more information in higher risk industry is available for decision-making purposes and help offset the greater risk (Iselin & Iskandar 2000).

2.4 Literature Highlights and Research Questions

(1) Materiality judgment varies across differential audit situations.

(2) Materiality in government audit may differ from corporate audit. One difference has been identified is: government auditors tend to adopt tighter materiality thresholds than corporate auditors.

(3) Auditors in higher accountability pressure tend to emphasize more qualitative materiality thresholds than corporate auditors. This argument potentially reveals another difference: government auditors might focus on qualitative consideration, for they tend to work in the public accountability.

Based on the literature review, the research questions are proposed:

(1) What are the differences between corporate and government audit materiality? (Although tight threshold as one difference has been recognized in prior research, any other differences exist?)

(2) Why these differences happen? (prior research does not explain and reason on the occurring of the materiality difference)

3. Research Design

3.1 A Case-study Method

To answer the research question, the researcher is to observe and interpret the behaviors of government auditors in applying materiality in real practice, rather than to test and evaluate their performance in controlled situations. Thus the case-study approach is selected and adopted in this research; for "case study methods are useful when 'how' or 'why' questions are being posed, when the researcher has little control over events, and when the focus is on a contemporary phenomenon within some real-life context" (Yin 2003).

This research targets on a group of government auditors, to see how they judge material information, and how and why government audit materiality differs from corporate audit.

3.2 Data Collection Methods

"A case study is considered an ideal unit of analysis when multiple sources of evidence are required to provide the organization context of the phenomenon examined" (Smith et al 1998). This research collects data from primary sourcefocusing on in-depth interviews with government auditors / public sector accountants.

(1) In-depth, face-to-face interviews with 12 government auditors /public sector accountants, who are working in the government audit office, or once worked for government audit projects.

(2) Among the 12 interviewees, 8 of them have both government and corporate audit experience. These include 5 corporate auditors with government audit experience, and 3 government auditors with corporate audit experience.

(3) These interviewees are selected based on a random sample approach. The interview questions are semi-structured and guided by the research questions.

Insert Questionnaire Here

3.3 Case Organization

The case organization is an audit office located in Huazhou city where there are 1.2 million residents. This audit office was subject to two tiers: one is the city people representatives' conference (PRC), the other is the national audit office. The head auditor is elected by the city PRC every 4 years. The government auditors are offered rights to inspect those corporations and persons who are involved in public funds, whether they are in public sector or private sector. But public entities (e.g., hospitals, schools, departments of the government) are the focus of government audit.

The structure of the audit office is flexible. The head auditor appoints a team of 2 to 6 auditors to conduct a government audit. He can decide the team members and the team leader. Sometimes two different audit teams are appointed to the same audit task but in different time. The head auditor then can compare results of the two reports, so as to guarantee the audit quality and objectivity.

4. Findings: Materiality Application Differences

(1) In views of informants, differences between the two audit contexts seem significant. All interviewees can sense differences. And 9 of them sense 'significant differences' including 7 of 8 interviewees with experience on both government and corporate audit. That is, 100% interviewees sense the differences, including 75% feeling differences significant. And for those with direct experience of both audit contexts, 87% demonstrate the significant differences.

Insert Figure 1 Here

Insert Figure 2 Here

(2) The results collaborate Relmond & Van Daniker (1994)'s survey finding that government audit materiality judgment is much tighter than in corporate context. All intervieweesclaim to adopt tighter materiality threshold than in corporate audit. Most of them choose 'much stricter materiality levels'; only one says he tends to use the similar but slightly stricter materiality judgment.

Furthermore, among all 12 interviewees, 5 interviewees claimed they frequently adopt the 'zero error tolerance', that is, they would never tolerate any misstatement on some aspects of the financial statement. And 5 interviewees said they may not too often adopt 'zero' materiality threshold, but sometimes do that; other 2 said although they did not use zero materiality threshold, but would adopt a very low materiality level.

Insert Figure 3 Here

(3) A finding is that government auditors tend to focus on qualitative materiality considerations. All interviewees say that they do 'not often' employ a preset quantitative amount or percentage for particular accounts in government audit. And 67% auditors said they 'very seldom' use quantitative materiality thresholds, other 33% choose 'sometimes'.

Insert Figure 4 Here

(4) A finding is that government auditors focus materiality judgment on only two subjects, 'income' and 'expenditure'.

Table 1 shows two differences between government and corporate audit in materiality judgment. One is that government auditors focus materiality judgment on only two subjects: revenue and expenditure, whilst corporate auditors on a range of subjects or indicators. Some subjects are focuses of materiality judgment in corporate audit however not for government auditors.

This table also shows the tighter materiality thresholds in governmental context: auditors tend to adopt zero level or very litter materiality estimates. The so-called 'zero level tolerance' means auditors do not allow even a smallest error on this subject.

Insert Table 1 Here

5. Reasoning: Why Materiality Differences Happen?

These findings indicate: three materiality aspects in government audit different from corporate audit

- Tight materiality thresholds;
- Focus on qualitative materiality consideration;
- Involving only two general subjects.

The following is to answer why these differences happen.

5.1 Why Government Auditors Set Tighter Materiality Thresholds?

The study identifies three factors, whichlead to the tight materiality threshold in government audit.

<u>Factor One: Accountability</u>

Corporate audit: investor accountability;

Government audit: public accountability

Corporate audit is accountable for financial providers, which include investors, banks, and debtors. Economic decisions that financial providers make are based on financial statements but under uncertain situations and thus they risk the loss resulting from making inappropriate economic decisions. Corporate auditors are to provide assurance on financial statements, so as to reduce the risk in auditee's decision making.

Governmental audit serves for the nation and the people. Auditees include corporations and individuals that are involved in public interests. Certainly, auditees are public entities (e.g. public hospitals, public schools, and public companies), governmental departments, and officials. The government audit offices represent the public to monitor behavior of the auditees.

Corporate audit concerns only financial providers; but government audit concerns the public. An evident example is that the government audit reports often appear in remarkable place of newspapers, and lead to extensive public discussion: how the government copes with the issues, whether all material issues have been disclosed. They struggle to meet the expectation of the public, and their work is under strict examination by the public. Thus, lower materiality thresholds are required and necessary to suffice public accountability in government audit.

<u>Factor Two: auditor status in auditee-auditor relationship</u>

Corporate auditors work as servers to auditee as customers

Government auditors work as supervisors to auditee as supervisees.

Certainly, corporate audit is conducted by CPA firms, which are economic entities seeking survival and growth in the economic market. For auditors, auditees are the customers, a source of financial income. Thus in the market environment, audit firm and auditee are able to select each other, and the selection is influenced economic considerations. Auditors tend to prefer the projects of more audit fees, less audit time, and less audit risk. And auditee may consider audit fees, fame of the audit firm, and audit quality. In short, they are in a market relationship. The financial or economic considerations offer auditee an advantage on the audit relationship. And it may damage the independence of auditors who are required to issue fair and objective report on financial statements. To keep a good relationship with auditees, auditors sometimes adopt relatively high materiality level, or even negotiate materiality thresholds with auditees to meet their expectations.

In government audit, there is no flexible room for auditee to choose auditors. In support of laws and policies, the audit office works as supervisors and monitors to the auditee. To a large extent, governmental audit avoids the economic influence from the auditee. The audit office is an authority, not an audit firm depending on the financial income from auditee. Therefore, auditees are unable to select audit offices and government auditors, nor to exert significant financial influenceon them. Auditors can conduct compulsory audit without auditee permissions. Unlike corporate audit firms in a competitive market with strong financial impacts from auditees, government auditors are located in a relatively independent position, which enables them to lower the materiality thresholds.

<u>Factor Three: Resource and Power in audit evidence collection</u>

Corporate auditors' power is limited in collecting audit evidence;

Government auditors are powerful in this respect.

In corporate audit, the principal source of audit evidence is financial statements that the auditees provide, sometimes including information from third parties such as the debtors, banks and suppliers. However in normal cases, to collect audit evidence, auditors must obtain the permission or agreement from the auditee and third parties. If they refuse to provide further information, what corporate auditors can do may be an issue of qualified opinions or zero claim.

Government auditors are far more able to collect audit evidence than corporate auditors. According to audit laws, auditees and the third parties (such as banks, tax authorities and supplier companies) are compulsorily required to be in cooperation with auditors. Another aspect is that audit offices can exert the regulatory power to collect evidence. For example, if auditors suspect that the auditee may be involved in illegal affairs, the audit office can require direct assistance of law officers and policemen, so as to enhance ability to evidence collection.

In corporate audit, to gather more audit evidence often leads to an increase in financial cost, time, effort and inconvenience. So that higher materiality thresholds are likely to be accepted for corporate auditors to avoid financial cost and to meet the report deadline. Comparatively, government auditors are more powerful in conducting further investigation, and also enjoy less restrains in collecting evidence. Such ability assists them to set tighter materiality thresholds.

5.2 Why government auditors tend to emphasize on qualitative materiality considerations?

This section concludes that government auditors' emphasis on qualitative considerations may result from pressure of public accountability.

A research on relationship between accountability pressure and auditors' judgment is conducted by Dezoort et al (2006), who review and synthesize 13 experimental accounting studies that have manipulated different levels of accountability pressure. The results indicate that accountability pressure decreases judgment variability and increases judgment conservatism and effort.

Dezoort et al (2006) figure out a theoretical perspective on explaining why accountability pressure affects materiality judgment. This theoretical perspective refers to Schlenker and Leary (1982)'s argument: when accountability pressure exists, the social anxiety is created. The so-called "accountability-based anxiety" that Schlenker and Leary (1982) conceptualize is based on Carver (1979)'s model of 'self-attention', a notion on the increasing concern about meeting perceived standards for behavior. In this context, an individual's motivation to make a positive impression on the evaluative audience increases, as performance importance increases. Similarly, Tetlock (1992) proposes a social contingency model; in which accountability pressure can stimulate a politically motivated need inmaintaining important evaluative constituents (Dezoort et al 2006).

Consistent with this theoretical perspective, researchers claim that, when audience views are known, professional auditors have tended to tailor their message to their specific audience (Buchman, Tetlock, & Reed, 1996; Cuccia, Hackenbrack, & Nelson, 1995; Hackenbrack& Nelson, 1996). Otherwise, when audience views are unknown, accountable auditors have provided more thorough justifications for their decisions than auditors who were not accountable (Koonce, Anderson, &Marchant, 1995).

This theoretical perspective provides a basis to explain why government auditors tend to adopt tighter materiality estimates and to focus on qualitative materiality judgment. With audit work being critically examined and scrutinized by the public, government auditors suffer more accountability pressure than corporate auditors responsible for only a relatively small group of financial providers. This public accountability locates government auditors in the state of what Tetlock (1992) calls 'politically motivation', or what Schlenker& Leary (1982) define as "social anxiety". It thus increases conservatism and effort in materiality judgment. In the requirement of "complex and careful analysis of available information induced by high accountability pressure' (Dezoort et al 2006), government auditors are likely to provide more justifications to their judgment, and more emphasize on qualitative factors.

5.3 Why government auditors focus materiality subjects on only 'income' and 'expenditure'?

An interesting finding from interviews is that: compared to corporate materiality judgment concerning a range of subjects, government auditors in this case focus materiality judgment on only two subjects, 'revenue' and 'expenditure'.

This materiality difference is unrecognized in prior research. I once asked interviewees why they focused on only two subjects. Their explanations share such a view: income and expenditure reflects directly whether the auditee behaviors in compliance to the policy and law; and other subjects seem less relevant in this regard.

I conclude the underlying reason as 'stakeholder value': the stakeholders that government audit and corporate audit are responsible are different; and that leads to the different focus on material accounting information.

Corporate audit is responsible for investors whose investment value reflects on a range of subjects including income, expenditure, profits after tax, and assets. For example, ROC (return on capital) as the key indicator for investor decision involves 3 subjects, PBIT (profit before interest and tax), Asset and Liability:

$$\text{ROC} = \text{PBIT} / (\text{total Asset} - \text{total Liability}).$$

That means the three relevant subjects should be significant and high relevant to investorsin decision making, and accordingly befocuses of materiality judgment. There are alsoother indicators reflecting investment value, such as liquidity and solvency; they also involve a range of financial subjects.

On the other hand, government audit is responsible for the public interests, rather than a small group of investors who corporate auditors are concerned. Thus government auditors concern whether the auditee performs in compliance with the law and relevant policies in which public interests are reflected. Normally, the audited entities (e.g., public schools, hospital, government departments) are unlikely to be open to the capital market. Except for specific cases (e.g. the privatization of these public entities), government auditors need not care for investment value reflecting on those subjects such as the asset and liability. And hence consider little onthose financial indicators, which interest investors and involve a wider range of accounts.

5.4 How-and-why Matrix to interpret materiality differences

A Matrix is generated to abstract the above discussions on why these materiality differences happen.

Insert the Matrix Here

6. Conclusion

Materiality is contextual. That is the main argument of this paper. This argument is supported by the three materiality differences discovered in a case study on a local audit office. This paper further reasons these materiality differences by relating them to corresponding contextual differences between government and corporate audit.

(1) Government auditors tend to set much stricter materiality thresholds than corporate auditors. This difference is attributed to the situations that: government auditors are responsible for the public (public accountability), while corporate auditors responsible for only investors; government auditors are in a higher status in auditor-auditee relationship (supervisors – supervisees) rather than in corporate audit (servers – customers); and as an organ of the government, government auditors are far more powerful that corporate auditors in collecting audit evidence.

(2) Government auditors tend to focus more on qualitative materiality thresholds than corporate auditors traditionally on quantitative materiality models (such as '5% rule'). This difference may be resulted from the situation that government auditors suffer more pressure from public accountability than corporate auditors from only investor accountability.

(3) In assessing materiality, government auditors tend to concern only a few accounting subjects (in this case, only income and expenditure) than corporate auditors on a range of subjects. This materiality difference is likely relevant to the 'stakeholder value': government audit is responsible for the public interests, rather than a small group of investors who corporate auditors are concerned (i.e., investor interest). In government audit, income and expenditure can reflect directly whether the auditee performs in compliance with the law or policy; while in corporate audit, investment value reflects on a wide range of accounting subjects.

The matrix on the three materiality differences and corresponding contextual differences implies that, due to contextual differences, it is uneasy, unreasonable and unnecessary to copy directly from corporate audit materiality models and guidelines to governmental audit. Instead, the formulation of governmental materiality guidance or models should be based on serious consideration on governmental context itself.

This research enriches our understanding and knowledge on how the accounting concept of materiality is contextually applied, and how the context shapes the application of this accounting concept. The research should interest government audit standards setters and accounting standards theorists, especially those who deliberate on the content of accounting and auditing guidance. The research results should interest researchers exploring nature, characteristics and application of materiality and other accounting concepts or standards in different accounting and auditing contexts, and also interest theorists on contextualizing accounting and auditing standards and concepts.

References

ACCA. (2007). *Audit and Assurance*, BPP, London

Acito, A, Burks, J, & Jonhson, W. (2009). Materiality decision & the correction of accounting errors. *The Accounting Review*, vol.84, iss.3, pp. 659 – 688. http://dx.doi.org/10.2308/accr.2009.84.3.659

Buchman, T, Tetlock, P., & Reed, R. (1996). Accountability and auditors' judgment about contigent events. *Journal of Business Finance and Accounting*, vol.23, iss.3, 378 – 398.

Carpenter, B, Dirsmith, M., & Gupta, P. (1994). Materiality judgments and audit firm culture: social-behavioural and political perspectives. *Accounting, Organization and Society*, vol.19, iss.4, pp.355-380.

Carver, C. (1979). A cybernetic model of self-attention processes. *Journal of Personality and Social Psychology*, vol.37, iss.8, pp.1251 – 1281.

Chewning, E., & Higgs, J (2002), What does materiality really mean?. *The Journal of Corporate Accounting & Finance*, vol.13, iss.4, pp.61 – 71.

Chewning, G, Wheeler, S., & Chan, K. (1998). Evidence on auditor and investor materiality thresholds resulting from equity-for-debt swaps. *Auditing: a Journal of Practice & Theory,* vol.17, iss.1, pp. 39 – 53.

Chinese National Audit Office. (2003). *Chinese Audit Principles and Standards 2003*.available at <www.audit.gov.cn>.

Christensen, M. (2003). Without 'reinventing the wheel': business accounting applied to the public sector. *Australian Accounting Review*, vol. 13, iss.31, p.22 – 27. http://dx.doi.org/10.111/j.1835-2561.2003.tb00396.x

Christensen, M., & Skabak, P. (2007). Framing and overflowing of public sector accountability innovations: a comparative study of reporting practices. *Accounting, Auditing and Accountability Journal,* vol.20, iss 1, pp. 101 – 132.

Cuccia, A., Hackenbrack, D., & Nelson, M. (1995). The ability of professional standards to mitigate aggressive reporting. *The Accounting Review*, vol.70, pp.227 – 248.

DeZoort, T, Harrison, P., & Taylor, M. (2006). Accountability &aduitors' materiality judgements: the effects of differential pressure strength on conservatism, variability, and effect. *Accounting, Organisation and Society,* vol.31, iss.1, pp. 373 – 390. http://dx.doi.org/10.1016/j.aos.2005.09.001

Financial Accounting Standards Board. (1980). Qualitative characteristics of accounting. *Statement of Financial Accounting Concepts*, no.2, FASB.

Government Accounting Standard Board. (1994). *Codification of Government Accounting and Financial Reporting Standard*, June, Norwalk, CT.

Hackenbrack, K., & Nelson, M. (1996). Auditors' incentives and their applications of financial accounting standards. *The Accounting Review*, vol.71, pp. 43 – 59.

Holmes, W. (1972). Materiality through the looking glass. *Journal of Accountancy,* vol.133, pp. 44 – 49.

Iselin, E., & Iskandar, T. (2000). Auditors' recognition and disclosure materiality thresholds: their magnitude and the effects of industry. *The British Accounting Review,* vol.32, iss.3, pp. 289 – 391.

Jordon, C., & Hendeson, J. (1991). Materiality guidelines for changes in accounting principles. *The Women CPA,* vol.53, iss.3, pp.18 – 20.

Juma'h. A. H. (2009). The implications of materiality concept on accounting practices and decision making. *Inter Metro Business Journal,*vol.5, iss.1, pp. 22 – 37.

Krogstad, JL, Ettenson, R. T., & Shanteau, J. (1984). Context and experience in auditors materiality judgments. *Auditing: a Journal of Practice & Theory*, vol.4,iss.1, pp. 54-73.

Koonce, L, Anderson, U., & Marchant, G. (1995). Justification of decisions in auditing. *Journal of Accounting Research*, vol. 33, pp. 369 – 384.

Messier, W. (1983). The effect of experience and firm type on materiality/disclosure judgments. *Journal of Accounting Research*, autumn, pp. 611-618.

Messier, W., Martinov-Bennie, N., & Eilifsen, A. (2005). A review and integration of empirical research on materiality: two decades later. *Auditing: a Journal of Practice and Theory,* vol. 24, no.2, pp. 153 – 187.

Ng, T., & Tan, H. (2007). Effects of qualitative factor salience: expressed client concerns and qualitative materiality thresholds on auditor's audit adjustment decisions. *Contemporary Accounting Research,*vol.24, iss4, pp. 1171 – 1192. http://dx.doi.org/10.1506/car24.4.5

Plumblee, M., & Lombardi, T. (2010). An analysis of the underlying causes attribute to restatement. *Accounting Horizons,* vol.24, iss.1, pp. 41 – 64. http://dx.doi.org/10.2308/acch.2010.24.1.41

Pratt, M. (2009). From the editors: for the lack of a boilerplate: tips on writing up (and reviewing) qualitative research. *Academy of Management Journal,* 52(5), pp. 856 – 862.

Relmond, K., & VanDaniker, R. (1994). Materiality in government auditing. *Journal of Accountancy,* Feb, pp. 71 – 76.

Schlenker, B., & Leary, M. (1982). Social anxiety and self-presentation: a conceptualization and model. *Psychological Bulletin*, vol.92, iss.3, pp.641 – 669.

Smith, C., Whipp, R., & Willmott, H. (1988). Case study research in accounting: methodological breakthrough or ideological weapon? *dvance in Public Interest Accounting,* vol.2, iss.1, pp. 95 – 120.

Tetlock, P. (1992). The impact of accountability on judgment and choice: toward a social contingency model. *dvances in Experimental Social Psychology*, vol.25, pp. 331 – 376.

Tetlock, P., Coller, M., & Plumlee, D. (2002). he effect of misstatements on decisions of financial statement users: an experimental investigation of auditor materiality thresholds. *Auditing: A Journal of Practice and Theory,* vol. 21, iss.1, pp. 11 – 28.

Wagner, S. (1994). Accounting policy and materiality. *Australian Accountant*, 64(6), pp. 61 – 63.

Yin, R. K. (2003). *Case Study Research, Design and Methods* (3rd ed), Sage Publications, Newbury Park. Park.

Interview Questions

1. Are there differences between government audit and corporate audit?

a. Significantly different; b. different but not significant; c. very similar

2. Would you provide some examples from you experience to describe the differences?

3. From your experience, are tighter materiality thresholds in government audit than in corporate audit? (only interviewees with both govt and corporate audit experience are required to answer this question)

a. Much tighter; b. slightly tighter; c. the same or others

4. In which areas do you set tighter materiality thresholds?

5. Do you often adopt preset quantitative bases to judge material information?

a. Very seldom; b. sometimes; c. often

6. Do you often adopt zero materiality levels? what subjects (e.g., income, expenditure, total asset, and profits) would you like to focus you materiality judgment on?

7. From your experience, how do you judge or find out material information?

A Theoretical Matrix:

how and why materiality in GA differ from CA

GA: Government audit

CA: Corporate Audit

Materiality differences	**corresponding contextual reason(s)**
GA: lower materiality level (CA higher materiality level)	✓**GA: public accountability** (CA: investors-focused accountability) ✓**GA: high status, as supervisor to auditee** (CA: as servers toauditee as customers) ✓**GA: high evidence collection ability** (CA: limited ability in collecting evidence)
GA: qualitative emphasis (CA quantitative emphasis)	✓**GA: pressure from public accountability** (CA: investors-focused accountability)
GA:focuses on few subjects, income and expenditure (CA a wider range of accounts)	✓**GA: require auditee in compliance with laws and policies reflecting public interests** (CA: concerns investment value reflecting on a range of financial subjects and indicators)

Table 1. Materiality judgment differences between GA and CA (rules of thumb vs GA interviewees views). CA: corporate audit; GA: govt audit

Subjects	CA materiality estimate (rules of thumb)	GA materiality estimates (views from the 12 interviewees)
Revenue	0.5 – 1 %	Often Zero tolerance (5/12); Sometimes Zero tolerance (5/12) not zero but very little (2/12)
Expenditure	0.5 – 1%	
Profit before interest and tax (PBIT)	5%	not judged on a preset quantitative base; not the focus of materiality judgment
Total Asset	1 – 2 %	Not judged on a preset quantitative base; not the focus of materiality judgment

Note: (1) The data for corporate audit materiality estimates (rules of thumb) source from ACCA 2007: Audit and Assurance.

(2) 'Often zero tolerance (5/12)' means 5 interviewees of 12 say they often adopt 'zero' as materiality level. That is, they do not allow any misstatement or error in this account.

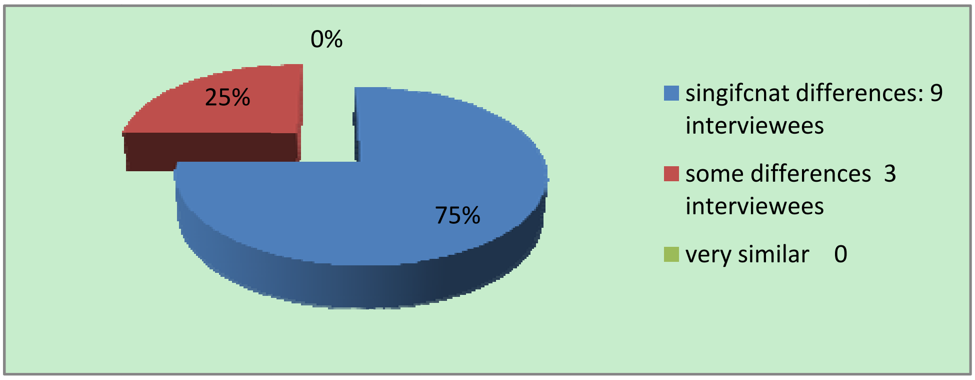

Figure 1. Significance of differences between CA and GA: views of all interviewees

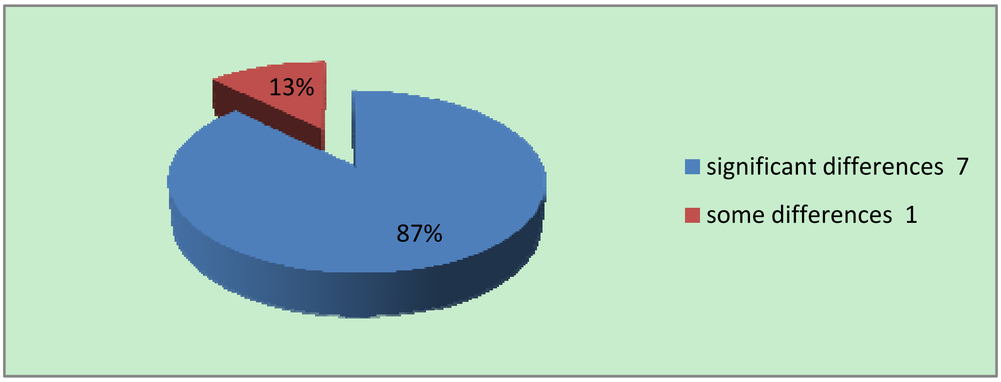

Figure 2. Significant Differences between GA and CA: views from 8 interviewees with both CA and GA experience

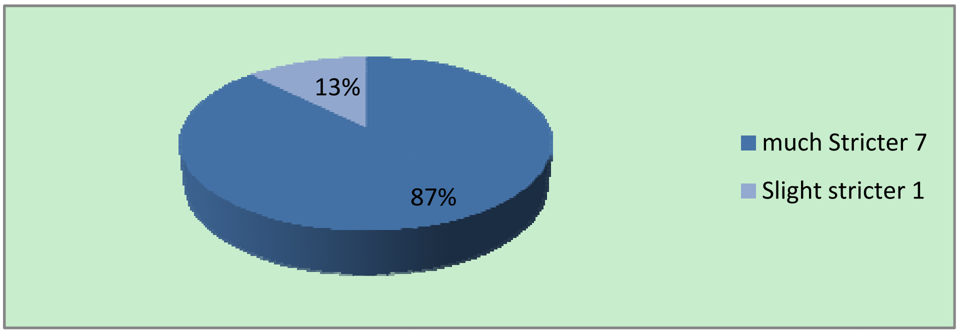

Figure 3. Tightness of GA materiality thresholds views of the 8 auditors with both govt and corp audit experience

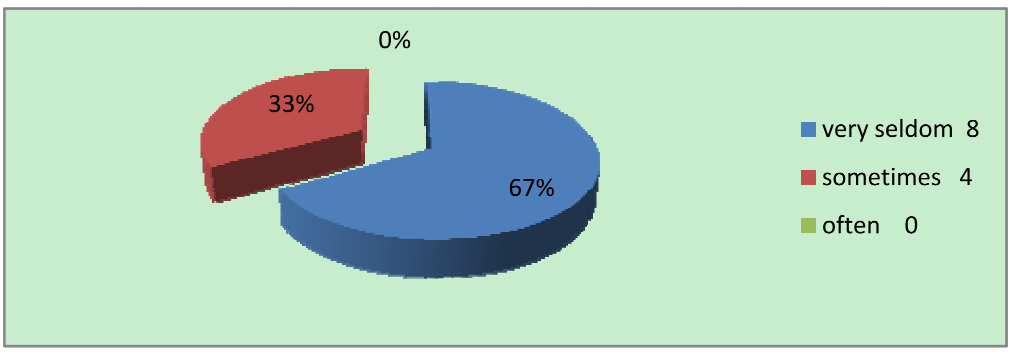

Figure 4. How often do government auditors focus on quantitative materiality thresholds?