



**CASE STUDY**

# **MATERIALITY AS A PROCESS**

**Three Forces That  
Reshaped Lease Reporting  
at Newport Beach**





## ABOUT THE AUTHORS

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- GFOA would like to acknowledge the **California Society of Municipal Finance Officers** for creating the conditions for this case study to succeed

## ABOUT GFOA

The Government Finance Officers Association (GFOA) represents over 33,000 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 benefits 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.

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# THE THREE FORCES BEHIND RETHINKING MATERIALITY



Viewed as a process in financial reporting, materiality is the use of disciplined judgement about what information is most valuable to users of the report.



## #1 THE VALUE OF INFORMATION

Information has value only if it reduces uncertainty about decisions that matter. More information can reduce uncertainty, but with diminishing returns. The “goldilocks zone” is where information provides the best value.



## #2 THE PARETO PRINCIPLE

In many financial datasets, a small number of items drive most of the impact. The Pareto Principle underlies the familiar 80/20 rule, where 20% of items produce 80% of the effect. Focusing on high-impact items can preserve integrity while reducing workload.



## #3 DISCIPLINED JUDGMENT

Materiality is a judgment — not a formula. It must consider legal requirements, public expectations, auditor collaboration and more.



## THREE FORCES AT WORK

Complying with lease standards\* is a lot of work when there is a high volume of agreements. The City of Newport Beach manages:

- 141 leases
- \$268 million in total lease value
- Approximately 50 lease amendments per year



Without a materiality threshold, even low-dollar leases were capitalized. The question was whether all 141 leases required the same level of attention.

## ANALYZING THE DISTRIBUTION

When the leases were stratified by value, the City found that:

- 46 leases over \$1 million accounted for more than 90% of total lease value.
- 62 leases under \$300,000 accounted for just 2.4% of total lease value.

## “GOLDILOCKS ZONE”

Because most lease value was concentrated in a small number of agreements, the City could raise the capitalization threshold and get in the “Goldilocks zone” — the just right effort for the just right information.



### TESTING DIFFERENT THRESHOLDS:

- Not too high (\$300K)
- Not too low (all leases)
- But just right (\$200K)



## OUTCOME HIGHLIGHTS

- 40–50 staff hours saved, year-end close
- No impact on financial statement integrity
- Transparent disclosure maintained
- Audit collaboration preserved

\* By “leases” we are referring to GASB Codification of Governmental Accounting and Financial Reporting (Cod) Section L20-Leases reflecting GASB Statement No. 87, as amended.



## CASE STUDY

## Streamlining Compliance Without Compromise

Materiality can be defined 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 financial statements often face a large number of transactions and complex standards. A pragmatic and methodical approach to materiality helps them focus time and effort where it matters most.

This report provides a case study of the City of Newport Beach, California. It shows how a thoughtful approach to materiality can reduce workload, improve efficiency, and maintain transparency while successfully addressing materiality decisions with auditors. Before we get to Newport Beach’s case, we’ll review three forces that shaped Newport Beach’s conclusion.



### More Depth on Rethinking Materiality

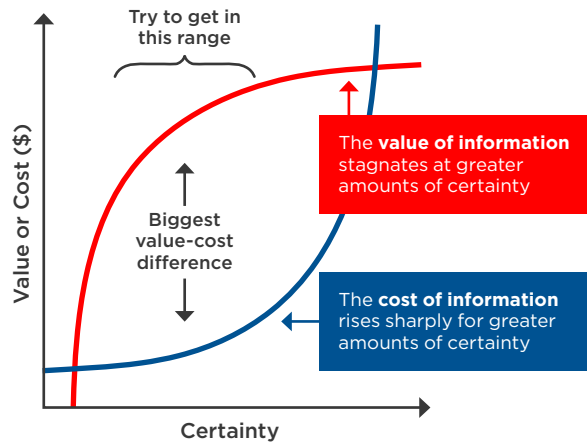
For more information, see two other GFOA reports. [“Finding the Balance: Rethinking Materiality in Government Accounting”](#) describes the rationale for a new approach to materiality. [“Materiality as a Process: What Really Counts”](#) describes the steps to applying a new approach to materiality.

## Force #1: Value of Information<sup>1</sup>

Information has value if it reduces uncertainty about a consequential decision or affects the behavior of those making it.<sup>2</sup> 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. Gathering more information can reduce uncertainty. However, the added benefit decreases as more information is collected, while the cost increases. At some point, additional information may not reduce uncertainty enough to influence decisions. At that point, capturing every detail is unnecessary. Preparers must find the balance where information is neither too much nor too little.

This range, where the benefit exceeds the cost by the greatest amount, is the Goldilocks zone. It represents the level where information provides meaningful value without costing too much, as illustrated in Exhibit 1.<sup>3</sup> The Goldilocks zone will vary from government to government and from topic to topic.

EXHIBIT 1 | Information Value vs. Cost



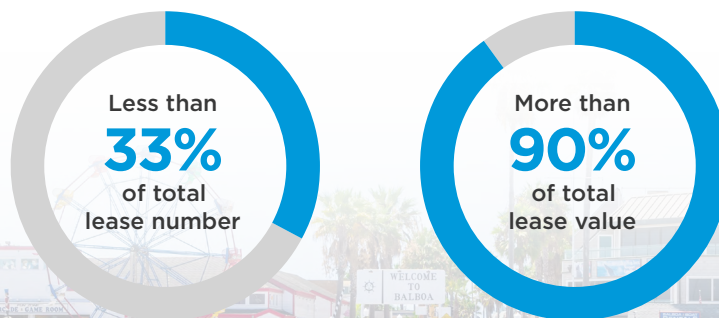
## Force #2: The Pareto Principle

The Pareto Principle comes from the field of statistics. It describes situations in which a small number of items drive most of the impact. This principle underlies the familiar 80/20 rule, in which 20% of items produce 80% of the effect.

For financial reporting, this means that a small number of items often make up most of the dollars reported. Preparers can therefore focus on larger items and give less attention to smaller ones.

The Pareto Principle applies to many financial reporting data sets, though not all. In Newport Beach, leases over \$1 million account for more than 90% of total lease value but represent only 33% of the leases. Leases under \$1 million account for less than 10% of total dollar value, yet they represent more than 20% of the leases.

### NEWPORT BEACH LEASES OVER \$1 MILLION:





### Force #3: Disciplined Judgment

Economic reasoning and statistical concentration can suggest where reporting effort should be focused. However, these forces alone cannot determine the appropriate reporting threshold. Materiality requires disciplined professional judgment.

Disciplined judgment recognizes that materiality is not purely mathematical. Quantitative thresholds must be considered along with qualitative factors, including legal requirements and public expectations. The structure of financial statements matters too. An item that seems immaterial overall may still be significant within a specific fund or reporting unit.

Materiality decisions take place within an institutional environment. Thresholds and policies should be developed by governments, in consultation with auditors, so they are defensible, follow professional standards, and align with the structure of the financial statements. Collaboration ensures that efficiency gains do not weaken credibility and that reporting policies stay aligned with the purpose of the audit.

Disciplined judgment also balances accuracy with precision. Giving users what they need to make good decisions (high accuracy) does not always require the greatest level of detail for every transaction (high precision). For some items, reasonable estimates may provide decision-useful information at far lower cost.\* By matching effort to impact, judgment preserves both accuracy and practicality.

**Disciplined judgment turns economic logic and statistical concentration into a defensible reporting policy. It prevents materiality from becoming either mechanical or arbitrary and ensures that efficiency gains do not come at the expense of financial statement integrity.**

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Let's illustrate these forces in action. We'll show how Newport Beach applied materiality to its lease portfolio. This case study demonstrates how analyzing distributions, setting thresholds, and collaborating with auditors can reduce workload, improve efficiency, and maintain financial statement integrity. It also highlights the interplay of fund-level and government-wide materiality.

\*For more on this topic, see: ["Close Counts: Expanding the Use of Estimates for Better, Faster Financial Reporting."](#)

## The Three Forces at Work: Newport Beach and GASB Lease Reporting

Agencies that manage many leases often find GASB Codification Section L20 challenging to follow. The standard requires calculating present values, maintaining amortization schedules, and tracking lease data. This work can be burdensome. Excluding leases with immaterial financial impact can reduce this burden.

The City of Newport Beach provides a clear example. The City had 141 leases as a lessor, totaling \$268 million. Without a materiality threshold, the City capitalized many low-dollar leases and amended them annually. For example, in 2025, approximately 50 leases required updates due to changes in terms. Each amendment requires detailed review and recalculation of lease values and amortization schedules, adding to staff workload during year-end close.

To address this, the City examined the distribution of lease values to see if a lease recognition threshold could reduce workload while maintaining GASB compliance.

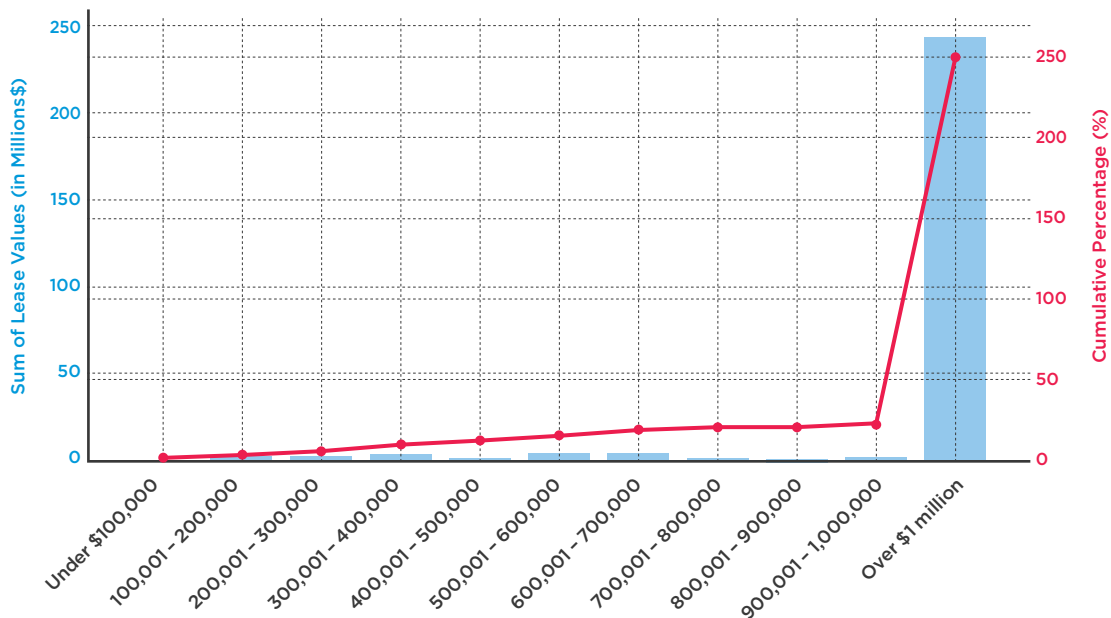
The table in Exhibit 2 groups the 141 leases by individual lease value. The City’s data follows a Pareto distribution.

The Pareto chart in Exhibit 3 shows the distribution of leases by value.

**EXHIBIT 2 | Leases by Individual Lease Value**

Individual Lease Value Range	Sum of Values	# 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
<b>Total</b>	<b>\$268,028,061.08</b>	<b>141</b>

**EXHIBIT 3 | Pareto Distribution of Lease Values**





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 its auditors about whether a \$300,000 capitalization threshold would create audit issues. One concern was whether it could impact 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 receivable 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 most of the total lease value. Under this threshold, the total value of excluded leases in the Special Revenue Fund remained well within the fund's materiality threshold, so the threshold was acceptable from an audit perspective.

However, the excluded leases exceeded the clearly trivial threshold (CTT). The CTT is a lower threshold set by auditors during audit planning. It identifies the level below which misstatements are too small to accumulate or need further evaluation. Some immaterial misstatements are not clearly trivial, but anything that is clearly trivial is also immaterial. The key difference is that materiality focuses on what is significant enough to influence financial statement users. The CTT is a practical tool for excluding very small misstatements from further review.

**The City then considered a \$200,000 threshold, which would eliminate the need to monitor 51 leases while still capturing most of the total lease value.**

Since the excluded leases exceed the CTT, the City of Newport Beach’s auditors included the following language in their required communications with the Newport Beach City Council:

“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. This allows staff to focus on implementing new accounting standards and finalizing the financial statements on time. The disclosure ensures transparency without affecting financial statement integrity because the excluded leases are not material.

**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.**

## 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 applying the value of information, the Pareto Principle, and disciplined judgment, governments can identify thresholds that reduce workload without sacrificing integrity. Materiality decisions should be developed with auditors and should balance quantitative thresholds with qualitative factors.

When approached strategically, materiality helps governments focus on what matters most: providing decision-useful information, streamlining reporting, and improving financial management. In this way, materiality becomes more than a technical accounting concept. It becomes a force for better governance.

## Endnotes

<sup>1</sup> Government Finance Officers Association (2024). *Why GFOA is rethinking financial reporting*.

<sup>2</sup> This idea has existed since the 1950s as part of a field of mathematics called “decision theory.” See: Hubbard, D. (2014). *How to measure anything: Finding the value of “intangibles” in business* (3rd ed.). Wiley.

<sup>3</sup> Illustration courtesy of Doug Hubbard.



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