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Ms. Sherry Hazel  
American Institute of Certified Public Accountants  
1345 Avenue of the Americas, 27th Floor  
New York, NY 10105  
USA

**Re: Proposed Statement on Auditing Standards, Amendments to the Description of the Concept of Materiality, and Proposed Statement on Standards for Attestation Engagements, Amendments to the Description of the Concept of Materiality**

Dear Ms. Hazel:

Deloitte & Touche LLP (“D&T”, “our,” or “we”) is pleased to respond to the request for public comment from the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) on its proposed Statement on Auditing Standards (SAS), *Amendments to the Description of the Concept of Materiality*, and its proposed Statement on Standards for Attestation Engagements (SSAE), *Amendments to the Description of the Concept of Materiality* (the “exposure draft”). We support the efforts of the ASB to align the materiality concepts in the relevant SASs<sup>1</sup> with the definition<sup>2</sup> of materiality used by the U.S. judicial system, the auditing standards of the Public Company Accounting Oversight Board (PCAOB), the U.S. Securities and Exchange Commission (SEC), and the Financial Accounting Standards Board (FASB) (collectively the “U.S. judicial system and other U.S. standard setters and regulators”). We also agree with the ASB’s proposed amendments to the guidance in the SSAE<sup>3</sup> such that the materiality concepts in the suite of AICPA Professional Standards are consistently applied.

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<sup>1</sup> Statement on Auditing Standards (SAS) No. 122, *Statements on Auditing Standards: Clarification and Recodification, as amended*, specifically section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*; section 320, *Materiality in Planning and Performing an Audit*; and section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

SAS No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*; and

SAS No. 136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*.

<sup>2</sup> The use of the word “definition” is used to describe the underlying concepts of materiality, and not necessarily a defined term typically included in a glossary.

<sup>3</sup> Statement on Standards for Attestation Engagements (SSAE) No. 18, *Attestation Standards: Clarification and Recodification*, specifically section 205, *Examination Engagements*; and section 210, *Review Engagements*.

D&T does not anticipate that these amendments will have any significant practice implications in the determination of materiality in an audit or attestation engagement (refer to our response to **Issue 2**), and we believe that it is in the public interest to align the manner in which materiality is conceptualized in connection with performing audits and attestation engagements within our U.S. jurisdiction so as to avoid any unintended consequences and unnecessary confusion.

One concept that may warrant further clarification relates to use of the phrase “materiality level or levels” as stated in paragraph 10 of AU-C section 320, *Materiality in Planning and Performing an Audit*. Confusion exists as to whether this phrase refers to the testing that is intended to be performed, or whether the materiality level(s) are intended to address the evaluation of misstatements for those particular classes of transactions, account balances, or disclosures. We believe the intention of this sentence relates to the evaluation of misstatements, and request the ASB amend the last sentence of paragraph 10 of AU-C section 320 to address this practice issue as follows; “... materiality level or levels to be applied to those particular classes of transactions, account balances, or disclosures **when evaluating whether the financial statements are materially misstated.**”

Our responses to the specific matters posed in the Explanatory Memorandum and other items that we would like to draw to the attention of the ASB are discussed in further detail in Appendix A — Issues for Consideration and Editorial Recommendations.

\* \* \*

D&T would be pleased to discuss our letter with you at your convenience. If you have any further questions, please contact Dora Burzenski at +1 206 716 7881.

Sincerely,

A handwritten signature in cursive script that reads "Deloitte & Touche LLP".

Deloitte & Touche LLP

## **Appendix A – Issues for Consideration and Editorial Recommendations**

The recommended changes in the text are highlighted as follows: Additions are noted in **bold underline** and deletions are noted in ~~strike-through text~~. The markup of the paragraphs follows the same sequential ordering of sections as structured in the exposure draft. All proposed changes noted below assume the amendments in the exposure draft are accepted by the ASB as final.

### **Issue 1. Revised Definition of Materiality**

D&T believes that the wording of the amendments in the exposure draft are broadly consistent with the definition of materiality used by the U.S. judicial system and other U.S. standard setters and regulators. We also believe that the ASB's approach as outlined in the exposure draft is appropriate and consistent with the ASB's goals of considering the standards of other standard-setters and striving to mitigate any unnecessary differences between the auditing standards applicable to issuers<sup>4</sup> and nonissuers. Similarly, it is reasonable for the ASB to adopt an analogous approach to ensure conformity as it pertains to the underlying materiality concepts between the SASs and the SSAEs.

D&T has, however, some additional observations as it relates to the potential impacts of the amendments, as well as further recommended changes to clarify the paragraphs addressing the concept of materiality. These are as follows:

#### **Statement on Auditing Standards**

##### AU-C section 320

The amendments to AU-C section 320 in the exposure draft introduce the notion of a *reasonable* user. While D&T acknowledges the rationale is to align with the definition as used by the U.S. judicial system and other U.S. standard setters and regulators, including the concepts in PCAOB AS 2105, *Consideration of Materiality in Planning and Performing an Audit*, the qualifier *reasonable* has not been consistently used when referring to users in AU-C section 320. It is therefore unclear if there is an intended difference when considering the judgments of a reasonable user versus other actions by a user. D&T believes that the ASB should consider whether conforming edits need to be made to paragraphs .02, .04, .A4, .A5, and .A12 of AU-C section 320 in order to align the use of terminology, the unintended consequences of doing so, and the related impact throughout the SASs. This matter would also need to be considered as it pertains to intended users in the SSAEs.

##### Paragraph .02 of AU-C section 320

Financial reporting frameworks issued by standard setting bodies are only one example where the concept of materiality is discussed; other examples include opinions interpreting the federal securities law issued by the U.S. Supreme Court and guidance issued by the SEC. We believe the reference to financial reporting frameworks should be deleted in the introductory sentence as it too narrowly categorizes the source of the discussions relating to the concept of materiality.

Further, it is noted that the bullets referenced in paragraph .02 of AU-C section 320 are all relevant in the context of the financial statements, and we therefore recommend amending the second sentence accordingly. We also recommend an additional bullet to address the qualitative and quantitative

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<sup>4</sup> The term "issuer" means an issuer as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c), the securities of which are registered under section 12 of that Act (15 U.S.C. 781), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn. [Sarbanes-Oxley Act of 2002]

considerations outlined in paragraph .07 of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. These changes are indicated below.

~~.02~~ Financial reporting frameworks often discuss ~~the~~ the concept of materiality **is often discussed** in the context of the preparation and fair presentation of financial statements, which provides a frame of reference to the auditor in determining materiality for the audit. Although ~~financial reporting frameworks may discuss materiality~~ **as it relates to the financial statements may be discussed** in different terms, they generally **the discussion** explains that

- misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment of a reasonable user ~~made based on the financial statements~~.
- judgments about materiality are made in light of surrounding circumstances and are affected by the size or nature of a misstatement, or a combination of both.
- **judgments involve both qualitative and quantitative considerations.**
- judgments about matters that are material to users ~~of the financial statements~~ are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

Paragraph .04 of AU-C section 320

When aligning the materiality concepts with the definition of materiality used by the U.S. judicial system and other U.S. standard setters and regulators, the concept of “economic decisions of users” was necessarily deleted. Conforming amendments to paragraph .04 of AU-C section 320 are therefore recommended. This change and other edits are below.

**.04** The auditor’s determination of materiality is a matter of professional judgment and is affected by the auditor’s perception of the **common** financial information needs of users of the financial statements. In this context, it is reasonable for the auditor to assume that users

- a. have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
- b. understand that financial statements are prepared, presented, and audited to levels of materiality;
- c. recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events; and
- d. make ~~reasonable economic decisions on the basis of~~ **judgments based on** the information in the financial statements.

We also suggest a detailed search of the professional standards be undertaken in order to identify instances where the phrase *economic decisions* has been used in order to determine whether the wording should be amended to align with the proposed amendments in AU-C section 320; for example paragraph .A23 (11<sup>th</sup> bullet) of AU-C section 450, *Evaluation of Misstatements Identified During the Audit*, references misstatements “that may reasonably be expected to influence the economic decisions of the users of the financial statements.”

Paragraphs .10, .A3, and .A12 of AU-C section 320 and paragraphs .32 and .A63 of AU-C section 600

We do not believe that it is necessary to reference that the judgment of a reasonable user be made in the context of the financial statements. D&T recommends that the wording in paragraph .10 of AU-C section 320 be more concise as the context has been clearly established and addressed in paragraph.02 of AU-C section 320. The proposed edits also align with the construct outlined in paragraph .07 of PCAOB AS 2105 which states that “. . . there are certain accounts or disclosures for which there is a substantial likelihood that misstatements of lesser amounts than the materiality level established for the financial statements as a whole would influence the judgment of a reasonable investor.” Similar edits are proposed to paragraphs .32 and .A63 of AU-C section 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*. Further, D&T recommends that the guidance in paragraphs .A3 and .A12 of AU-C section 320 be amended to reflect the proposed edits to the requirement in paragraph .10 of AU-C section 320. These changes are provided below.

**.10** When establishing the overall audit strategy, the auditor should determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, one or more particular classes of transactions, account balances, or disclosures exist for which there is a substantial likelihood that misstatements of lesser amounts than materiality for the financial statements as a whole would influence the judgment of a reasonable user ~~made based on the financial statements~~, the auditor also should determine the materiality level or levels to be applied to those particular classes of transactions, account balances, or disclosures. (Ref: par. .A3-.A13)

**.A3** In the case of a governmental entity, legislators and regulators are often the primary users of its financial statements. ~~Furthermore, the financial statements may be used to make decisions other than economic decisions.~~ The determination of materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances, or disclosures) in an audit of the financial statements of a governmental entity, therefore, may be influenced by law or regulation.

**.A12** Factors that may indicate the existence of one or more particular classes of transactions, account balances, or disclosures for which there is a substantial likelihood that misstatements of lesser amounts than materiality for the financial statements as a whole would influence the judgment of a reasonable user ~~made based on the financial statements~~ include the following:

- Whether law, regulation, or the applicable financial reporting framework affect users' expectations regarding the measurement or disclosure of certain items (for example, related party transactions and the remuneration of management and those charged with governance)
- The key disclosures with regard to the industry in which the entity operates (for example, research and development costs for a pharmaceutical company)
- Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements (for example, a newly acquired business)

Paragraph .07 of AU-C section 200; paragraphs .35 and .A14 of AU-C section 700; and paragraphs 74, 115, and A69 of AU-C section 703

D&T recommends that for paragraph .07 of AU-C section 200; paragraphs .35 and .A14 of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*; and paragraphs 74, 115, and A69 of AU-C section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, the sentence addressing the materiality concept as highlighted in the

amendments in the exposure draft be revised, as appropriate, to reflect the following proposed wording:

. . . considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment of a reasonable user.

### **Statement on Standards for Attestation Engagements**

#### Paragraph .A17 of AT-C section 205 and paragraph .A16 of AT-C section 210

D&T recommends that paragraph .A17 of AT-C section 205, *Examination Engagements*, be amended to more closely align with the proposed edits to paragraphs .02 and .04 of AU-C section 320. However, we do not believe that it is appropriate to introduce the concept of a reasonable user in the attestation standards since the materiality decisions are already made contemplating an intended user as described in paragraph .A17 of AT-C section 205. Similar edits are proposed for paragraph .A16 of AT-C section 210, *Review Engagements*. These changes are below.

**.A17** In general, misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment of an **an reasonable intended** user ~~made based on the subject matter~~. The practitioner's consideration of materiality is a matter of professional judgment and is affected by the practitioner's perception of the common information needs of intended users as a group. In this context, it is reasonable for the practitioner to assume that intended users

- a. have a reasonable knowledge of the subject matter and a willingness to study the subject matter with reasonable diligence.
- b. understand that the subject matter is measured or evaluated and examined to appropriate levels of materiality and have an understanding of any materiality concepts included in the criteria.
- c. understand any inherent uncertainties involved in measuring or evaluating the subject matter.
- d. make ~~reasonable decisions on the basis of~~ **judgments based on** the subject matter taken as a whole.

Unless the engagement has been designed to meet the particular information needs of specific users, the possible effect of misstatements on specific users, whose information needs may vary widely, is not ordinarily considered.

### **Issue 2. Consistency with Current Practice**

D&T does not believe that the proposed amendments will change how auditors determine materiality, nor result in a significant impact on the extent of work performed.