AICPA

Agenda Item 1B

EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS *AMENDMENTS TO THE DESCRIPTION OF THE CONCEPT OF MATERIALITY*

(Amendments to

- ***Statement on Auditing Standards (SAS) No. 122,*** **Statements on Auditing Standards: Clarification and Recodification*****, as amended,***
    - ***section 200,*** **Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards [AICPA, Professional Standards, *AU-C sec. 200];***
    - ***section 320,*** **Materiality in Planning and Performing the Audit~~;~~ [AICPA, Professional Standards, *AU-C sec. 320];* *and***
    - ***section 600,*** **Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors) *[AICPA,* Professional Standards, *AU-C sec. 600]***

- ***SAS No. 134*****, Auditor Reports and Amendments, Including Amendments Addressing Disclosures in the Audits of Financial Statements, *[AICPA,* Professional Standards*, AU-C sec. 700]***

- ***SAS No. 13X,* Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA *[AICPA,* Professional Standards, *AU-C sec. 703*[1]*]***

PROPOSED STATEMENT ON STANDARDS FOR ATTESTATION ENGAGEMENTS

AMENDMENTS TO THE DESCRIPTION OF THE CONCEPT OF MATERIALITY

(Amendments to

- ***Statement on Standards on Attestation Standards (SSAE) No. 18, Statements on Standards for Attestation Engagements: Clarification and Recodification,***
    - ***section 205,* Examination Engagements *[AICPA,* Professional Standards, *AT-C sec. 205];***
    - ***section 210,* Review Engagements *[AICPA,* Professional Standards, *AT-C sec. 210].)***

June__, 2019

Comments are requested by August__,2019

Prepared by the AICPA Auditing Standards Board for comment from persons interested in auditing and reporting issues.

Comments should be addressed to Sherry Hazel at shazel@aicpa.org.

[1] SAS No. 13X, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, which is expected to become effective no earlier than for audits of financial statements for periods ending on or after December 15, 2020, is expected to be issued in third quarter of 2019 and codified as AU-C section 703 in AICPA *Professional Standards*. As of the issuance date of this exposure draft, SAS No. 13X has not been integrated into AICPA *Professional Standards*.

CONTENTS

Explanatory Memorandum

Introduction

This memorandum provides background to the proposed Statement on Auditing Standards (SAS) *Amendments to the Description of the Concept of Materiality* and to the proposed Statement on Standards for Attestation Engagements (SSAE) *Amendments to the Description of the Concept of Materiality.*

If adopted as final, the proposed SAS will amend the following SASs:

- SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as amended,
    - — section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards* (AICPA, Professional Standards, *AU-C sec. 200)*;
    - — section 320, *Materiality in Planning and Performing the Audit*~~;~~ (AICPA, Professional Standards, *AU-C sec. 320)*; and
    - — section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (AICPA, Professional Standards, *AU-C sec. 600)*
- SAS No. 134, *Auditor Reporting and* ~~*Related*~~ *Amendments*, *Including Amendments Addressing Disclosures in the Audit of Financial Statements,* (*AICPA*, Professional Standards, *AU-C sec. 700*)
- SAS No. 13X, *Forming an Opinion and Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* (*AICPA*, Professional Standards, *AU-C sec. 703*[2])

If adopted as final, the proposed SSAE will amend SSAE No. 18, *Statements on Standards for Attestation Engagements: Clarification and Recodification*,

- — section 205, *Examination Engagements*~~;~~ *(AICPA*, Professional Standards, *At-C sec. 205)*; *and*
- — section 210, *Review Engagements*~~.~~ *(AICPA*, Professional Standards, *AT-C sec. 210).*

[2] SAS No. 13X, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, which is expected to become effective no earlier than for audits of financial statements for periods ending on or after December 15, 2020, is expected to be issued in third quarter of 2019 and codified as AU-C section 703 in AICPA *Professional Standards*. As of the issuance date of this exposure draft, SAS No. 13X has not been integrated into AICPA *Professional Standards*.

Background

The mission of the Auditing Standards Board (ASB) is to serve the public interest by developing, updating, and communicating comprehensive standards and practice guidance that enable practitioners to provide high-quality, objective audit and attestation services to nonissuers in an effective and efficient manner. The ASB accomplishes this mission in part by developing auditing, attestation, and quality control standards that inspire public trust in the profession. In developing and updating auditing standards, the ASB considers the standards of other standard-setters, such as the International Auditing and Assurance Standards Board (IAASB), the PCAOB, and the General Accounting Office (GAO).

Why Is the ASB Issuing These Amendments?

The ASB's current definition[3] of materiality is consistent with the definition of materiality used by the International Accounting Standards Board (IASB) and the International Audit and Assurance Board (IAASB). The ASB is proposing amendments to align the materiality concepts discussed in AICPA *Professional Standards* with the definition of materiality used by the United States (U.S.) judicial system, the auditing standards of the Public Company Accounting Oversight Board (PCAOB), the ~~Government Accounting Standards Board, the~~ U.S. Securities and Exchange Commission (SEC), and the Financial Accounting Standards Board (FASB~~), which~~) (hereinafter referred to as "U.S. judicial system and other U.S. standard setters and regulators"). The FASB amended its definition of materiality in August 2018 ~~for much~~to be consistent with the ~~same reason~~U.S. judicial system and other regulators and standard-setters in the U.S. The ASB believes it is in the public interest to eliminate inconsistencies between the AICPA *Professional Standards* and the definition of materiality used by the U.S. judicial system and other U.S. standard setters and regulators.

Definitions

The primary difference between the definitions held by the U.S. judicial system and other U.S. standard setters and regulators and the definitions currently held by the ASB, IASB and IAASB relate to whether a misstatement "*would* influence the judgment of a reasonable investor" or "*could reasonably be expected* to influence the judgment of a reasonable person". In essence, the ~~United States Supreme Court, the SEC,~~U.S. judicial system and ~~the PCAOB~~other U.S. standard setters and regulators define an omission or misstatement as material if there is a *substantial likelihood* that a reasonable person *would* consider it important. The IASB, IAASB and ASB definition state that misstatements, including omissions, are considered to be material if they, individually or in the aggregate, *could reasonably be expected* to influence the economic decision of users taken on the basis of the financial statements. (emphasis added)

History

[3] The term *definition* in this explanatory memorandum means the words used to explain the concept of materiality and is not intended to mean a statement of the exact meaning of the term *materiality*.

1976: The U.S. Supreme Court Defines Materiality

In *TSC Industries, Inc v. Northway, Inc. (426 U.S. 438, June, 14, 1976), ("TSC v. Northway"),* the U.S. Supreme Court defined materiality as the term was (and is) used in SEC Proxy Rule 14a-9. Rule 14a-9 requires that no proxy solicitation be made "which . . . is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading . . . ." The U.S. Supreme Court opined:

> [A]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder ***would*** consider it important in deciding how to vote. The standard is fully consistent with Mills' general description of materiality as a requirement that 'the defect have a significant propensity to affect the voting process'. It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of the substantial likelihood that, under all circumstances, the omitted fact ***would*** have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted face ***would*** have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available. (426 U.S. 438, 449) (emphasis added)

With this opinion, the U.S. Supreme Court reversed the ~~United States~~U.S. Seventh Circuit Court of Appeals which had held that material facts included "all facts which a reasonable shareholder ***might consider important***." (512 F2d 324 at 330) (emphasis added) The U.S. Supreme Court stated that the U.S. Seventh ~~Circuit's~~Circuit Court of Appeal's formulation of the test for materiality set "too low a threshold for the imposition of liability under Rule 14a-9."

1980: FASB Defines Materiality

In May 1980, the FASB issued Statement of Financial Accounting Concepts (FASCON) No. 2, *Qualitative Characteristics of Accounting Information*" ~~("CON~~(FASCON 2~~", May 1980~~), the glossary of which defined financial statement materiality as:

> the magnitude of an omission or misstatement of accounting information that, in 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. (FASCON 2, Page 6) (emphasis added)

However, as discussed below, FASB's definition of materiality changed in September 2010 when FASB issued FASCON 8~~.~~ (see below).

1999: The SEC ~~and SAB 99~~ Provides Guidance When Evaluating Materiality

On August 12, 1999, the Staff of the Securities and Exchange Commission ("Staff") issued Staff Accounting Bulletin (SAB) No. 99, *"Materiality,* to provide guidance to preparers and independent auditors when evaluating materiality. SAB No. 99 quotes both the FASCON 2 Glossary definition of materiality (issued in May 1980) and from *TSC v. Northway* and states that "This formulation in the accounting literature is in substance identical to the formulation used by the courts in interpreting the federal securities laws."

1983 and 2006: ~~Auditing Standards Board Standards~~ ASB Issues SASs on Materiality

In December 1983, the ASB issued Statement on Auditing Standards (SAS) No. 47, *Audit Risk and Materiality in Conducting an Audit*. SAS No. 47 did not define materiality but quoted the FASCON 2 Glossary definition of materiality as guidance to independent auditors when considering financial statement materiality in the context of an audit of financial statements.

In March 2006, the ASB issued SAS No. 107, *Audit Risk and Materiality in Conducting an Audit,* which superseded SAS No. 47. Like SAS No. 47, SAS No. 107 quotes the FASCON 2 definition of materiality: "the magnitude of an omission or misstatement of accounting information that, in 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".[4] However, SAS No. 107 also states that the determination of materiality takes into account how users *could* reasonably be expected to be influenced in making economic decisions.[5] (emphasis added)

2009: IAASB Defines Materiality

International ~~**Standards**~~Standard on ~~**Auditing – IAASB**~~

~~International Standards of~~ Auditing (ISA) 320, *Materiality in the Context of an Audit,* issued by the IAASB and effective for audits of financial statements for periods beginning on or after December 15, 2009, defines financial statement materiality as:

> Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, *could* reasonably be expected to influence the economic decision of users taken on the basis of the financial statements. (ISA 320, paragraph 2) (emphasis added)

2010: ~~International Standards on Accounting – IASB~~IASB Defines Materiality

In 2010 the "Conceptual Framework for Financial Reporting" issued by the IASB defined materiality as:

> Information is material if omitting or misstating *could* influence decisions that users make as the basis of financial information about a specific reporting entity. (Par. QC 11) (emphasis added).

This definition of materiality in the IASB Framework is substantially the same as the definition of *material* in ~~the IAS 8~~International Accounting Standard (IAS) 8, *Accounting Policies and Accounting Estimates*, at paragraph 5, which states:

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[4] Paragraph ,04 of AU section 312, *Audit Risk and Materiality in Conducting an Audit.*

[5] Paragraph .06 of AU section 312.

> Omissions or misstatements of items are material if they ***could***, individually or collectively, influence the economic decisions that users make on this basis of the financial statements. (emphasis added)

2010: FASB Issues FASCON 8

In September 2010, the FASB issued FASCON No. 8, *Conceptual Framework for Financial Reporting*~~,~~ (FASCON 8), which superseded FASCON 1 and FASCON 2. As stated in FASCON 8, "the Board has undertaken a project ~~which~~with the IASB to improve and converge their frameworks." The FASCON 8 definition of materiality aligns with the definitions adopted by the IASB~~ and the IASB.~~.

The FASCON 8 definition of materiality states:

> Information is material if omitting it or misstating it *could* influence decisions that users make on the basis of the financial information of a specific reporting entity." (~~Par QC11~~FASCON 8, Chapter 3~~ of FASCON8~~, Par QC11). (emphasis added)

~~2011~~2010: PCAOB Issues ~~Auditing Standards No. 11~~Standard on Materiality

In ~~December~~August 2010, the PCAOB issued Auditing Standard (AS) No. 11, *Consideration of Materiality in Planning and Performing an Audit*, (~~AS 2105~~renumbered AS 2105 as part of the PCAOB reorganization project) which set forth the PCAOB's position for evaluating "materiality in the context of an audit" as it applies to auditors of the financial statements of SEC registrants. AS ~~No. 11~~2105, issued with the approval of the SEC, expressly relies on *TSC v. Northway* as the basis for its definition of materiality and makes no reference to the FASB Statements of Financial Accounting Concepts.

PCAOB AS ~~No. 11~~2105 paragraph 2 states:

> In interpreting the federal securities laws, the Supreme Court of the United States has held that a fact is material if there is 'a substantial likelihood that the . . . fact *would* have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available'. As the Supreme Court has noted, determinations of materiality require ~~'~~"delicate ~~assessments'~~assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him . . ~~.~~." (PCAOB, AS 2105, paragraph 2, December 23, 2010). (emphasis added)

Further, PCAOB AS 2105 paragraph 7 ~~of AS 2105~~ states~~ that~~:

> The auditor should evaluate whether, in light of the surrounding circumstances, there are particular 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*. If so, the

auditor should establish separate materiality levels for those accounts or disclosures. (PCAOB AS 2105, paragraph 7). (emphasis added)

2011: ASB Issues SAS No. 122

In 2011, the ASB issued SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*. In SAS No. 122, the ASB adopted almost verbatim the IAASB definition of materiality, which is consistent with the IASB definition of materiality and with the 2010 FASCON 8 definition of materiality. Paragraphs 2 and 3 of AU-C section 320, *Materiality in Planning and Performing the Audit,* of SAS No. 122 state:

.02 Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and fair presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that

- misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users made on the basis of 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 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.

.03 Such a discussion about materiality provides a frame of reference to the auditor in determining materiality for the audit. If the applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred to in paragraph .02 provide the auditor with such a frame of reference.

2018: FASB amends FASCON 8

In August 2018, the FASB issued Amendments to Chapter 3, *Qualitative Characteristics of Useful Financial Information*, of ~~Concepts Statement~~FASCON 8~~.~~ (Amendments to FASCON 8). The main amendment to Chapter 3 of ~~Concepts Statement~~FASCON 8 reinstates the definition of materiality that was in ~~FASB Concepts Statement No.~~FASCON 2, ~~*Qualitative Characteristics of Accounting Information*,~~ which was superseded in 2010 by ~~Concepts Statement~~FASCON 8.

The amended definition of materiality states:

The omission or misstatement of an item in a financial report is material if, in light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report ***would*** have been changed or influenced by the inclusion or correction of the item. (emphasis added)

This definition of financial statement materiality is aligned with definitions held by the ~~Supreme Court, SEC and PCAOB and~~U.S. judicial system and other U.S. standard setters and regulators but does not align with the definition of financial statement materiality held by the AICPA ASB, IASB and IAASB.

~~Further, in its August 2018 revision to its definition of materiality, the FASB incorrectly stated that its revised definition of materiality is in substance identical to the definition held by the AICPA.~~

2018: IASB Amends Definition of Material

In October 2018 the International Accounting Standards Board issued *Definition of Material* (Amendments to IAS 1 and IAS 8). The amendments clarify and align the definition of 'material' and provide guidance to help improve consistency in the application of that concept whenever it is used in ~~IFRS~~International Financial Reporting Standards.

The amended definition states:

> *Information is material if omitting, misstating or* ***obscuring*** *it* ***could reasonably be expected*** *to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements which provide financial information about a specific reporting entity. (emphasis added)*

2019: ASB Proposes to Amend the Definition of Materiality

As described in the *Why Is the ASB Issuing These Amendments?* section above, the ASB is proposing to align its definition of materiality with that of the U.S. judicial system and other U.S. standard setters and regulators.

Effective Date

If issued as final, the proposed SAS ~~will~~would be effective for audits of financial statements for periods ending on or December 15, 2020. This date is provisional but will not be earlier than December 15, 2020.

If issued as final, the proposed SSAE ~~will~~would be effective for practitioners' reports dated on or after December 15, 2020. This date is provisional but will not be earlier than December 15, 2020.

Explanation of Proposed Changes

Materiality is described in existing AU-C section 320 as follows:

> misstatements, including omissions, are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence economic decisions of users that are taken based on the financial statements

The proposed amendments would change that description to the following:

> misstatements, including omissions, are considered to be material if there is substantial likelihood that, individually or in the aggregate, they would influence the judgment of a reasonable user made based on ~~the basis of~~ the financial statements.

Amendments are proposed to conform that description throughout AICPA *Professional Standards*, including the wording of the auditor's report as revised by SAS No. 134, *Auditor Reporting and Related Amendments*~~.~~, and in application material in AT-C section 205, *Examination Engagements*, and AT-C section 210, *Review Engagements*.

Issue for Consideration

In addition to overall views on the proposed amendments, the ASB would like to know whether you believe there would be any unintended negative consequences if the proposed amendments were finalized as exposed.

Guide for Respondents

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. If you agree with proposals in the exposure draft, it will be helpful if you make the ASB aware of this view, as well.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available on the AICPA's website after August ___, 2019, until a final standard is issued. Please send responses to Sherry Hazel at Sherry.Hazel@aicpa-cima.com by August ___, 2019.

Comment Period

The comment period for this exposure draft ends on August ____, 2019

Auditing Standards Board

(2018–2019)

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Proposed Statement on Auditing Standards, *Amendments to the Description of the Concept of Materiality*

Boldface italic denotes new language. Deleted text is in ~~strikethrough~~.

Proposed Amendment to SAS No. 122, Section 320, *Materiality in Planning and Performing an Audit.*

[No amendment to paragraph .01]

Materiality in the Context of an Audit

.02 Financial reporting frameworks often discuss the concept of materiality 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 in different terms, they generally explain that

- misstatements, including omissions, are considered to be material if ~~they~~ ***there is substantial likelihood that***, individually or in the aggregate, ~~could reasonably be expected to~~ ***they would*** influence the ~~economic decisions of~~ ***judgment of a reasonable user*** made ~~users taken~~***based*** on ~~the basis of~~ ~~these~~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 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.

.03 ~~Such a discussion about materiality provides a frame of reference to the auditor in determining materiality for the audit.~~ If the applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred to in paragraph .02 provide the auditor with such a frame of reference.

[No amendments to paragraphs .04-.09]

Determining Materiality and Performance Materiality When Planning the Audit

.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 ~~could reasonably be expected to~~ ***would*** influence the ~~economic decisions of users, then, taken~~ ***judgment of a reasonable user made based*** on ~~the basis of~~ 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)

[No amendments to paragraphs .11-.A11]

Materiality Level or Levels for Particular Classes of Transactions, Account Balances, or Disclosures (Ref: par. .10)

.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 ~~could reasonably be expected to~~ ***would*** influence the ~~economic decisions of users taken on the basis of~~ ***judgment of a reasonable user made based*** on ~~the basis of~~ 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)

[No further amendments to AU-C section 320]

This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.*

AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*

[No amendments to paragraphs .01-.06]

.07 The concept of materiality is applied by the auditor when both planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and

* This effective date is provisional but will not be earlier than December 15, 2020.

uncorrected misstatements, if any, on the financial statements. [fn1] In general, misstatements, including omissions, are considered to be material if ***there is a substantial likelihood that***, individually or in the aggregate, they ~~could reasonably be expected to~~ ***would*** influence the ~~economic decisions of users that are taken~~ ***judgment of a reasonable user made*** based on the financial statements. Judgments about materiality are made in light of surrounding circumstances, and involve both qualitative and quantitative considerations. These judgments are affected by the auditor's perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or both. The auditor's opinion addresses the financial statements as a whole. Therefore, the auditor has no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by fraud or error, that are not material to the financial statements as a whole, are detected. (Ref: par. .A14)

[fn 1] See section 320, *Materiality in Planning and Performing an Audit*, and section 450, *Evaluation of Misstatements Identified During the Audit*.

[No further amendments to AU-C section 200.]

This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.*

AU-C section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

[No amendments to paragraphs .01-.31]

.32 The group engagement team should determine the following: (Ref: par. .A63)

a. Materiality, including performance materiality, for the group financial statements as a whole when establishing the overall group audit strategy. [fn 10]

b. Whether, in the specific circumstances of the group, particular classes of transactions, account balances, or disclosures in the group financial statements exist for which ***there is a substantial likelihood that*** misstatements of lesser amounts than materiality for the financial statements as a whole ~~could reasonably be expected to~~ ***would*** influence the ~~economic decisions of users taken~~ ***judgment of a reasonable user made based*** on ~~the basis of~~ the group financial statements. In such circumstances, the group engagement team should determine materiality to be applied to those particular classes of transactions, account balances, or disclosures.

c. Component materiality for those components on which the group engagement team will perform, or for which the auditor of the group financial statements will assume responsibility for the work of a component auditor who performs, an audit or a review. Component materiality should be determined taking into account all components, regardless of whether reference is made in the auditor's report on the

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group financial statements to the audit of a component auditor. To reduce the risk that the aggregate of uncorrected and undetected misstatements in the group financial statements exceeds the materiality for the group financial statements as a whole, component materiality should be lower than the materiality for the group financial statements as a whole, and component performance materiality should be lower than performance materiality for the group financial statements as a whole. (Ref: par. .A64–.A66)

fn 10 See section 320, *Materiality in Planning and Performing an Audit.*

[No amendments to paragraphs .32-.A62]

.A63 The auditor is required [fn 24]

a. when establishing the overall audit strategy

i. to determine materiality for the financial statements as a whole.

ii. to consider whether, in the specific circumstances of the entity, 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 ~~could reasonably be expected to influence the economic decisions of users taken on the basis of~~ ***would influence the judgment of a reasonable user made*** ***based*** on ~~the basis of~~ the financial statements. In such circumstances, the auditor determines materiality to be applied to those particular classes of transactions, account balances, or disclosures.

b. to determine performance materiality for purposes of assessing the risks of material misstatement and designing further audit procedures to respond to assessed risks.

In the context of a group audit, materiality is established for both the group financial statements as a whole and the financial information of those components on which the group engagement team will perform, or request a component auditor to perform, an audit or review. Materiality for the group financial statements as a whole is used when establishing the overall group audit strategy.

fn 24 Paragraphs .10–.11 of section 320.

[No further amendments to AU-C section 600]

This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.*

* This effective date is provisional but will not be earlier than December 15, 2020.

SAS 134, *Auditor Reporting and Amendments Addressing Disclosures in Audit of Financial Statements,* AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*

[No amendments to paragraphs .01-.34]

***Auditor's** Responsibilities for the Audit of the Financial Statements*

35. This section of the auditor's report should do the following: (Ref. par. A43)

a. State that the objectives of the auditor are to

i. obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and (Ref: par. A44)

ii. issue an auditor's report that includes the auditor's opinion

b. State that reasonable assurance is a high level of assurance but is not absolute assurance and, therefore, is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists (Ref. par. A45)

c. State that the risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control

d. State that misstatements are considered material if ***there is substantial likelihood that,*** individually or in the aggregate, they ~~could reasonably be expected to~~ ***would*** influence the ~~economic decisions of the~~ ~~users taken~~ ***judgment of a reasonable user made based*** on ~~the basis of~~ these financial statements [fn 2] (Ref. par. A46)

[fn 2] Paragraph .02 of AU-C section 320, *Materiality in Planning and Performing an Audit.*

[No amendments to paragraphs .36-.A13]

A14. The auditor's evaluation about whether the financial statements achieve fair presentation, considering both presentation and disclosure, is a matter of professional judgment. This evaluation takes into account such matters as the facts and circumstances of the entity, including changes thereto, based on the auditor's understanding of the entity and the audit evidence obtained during the audit. The evaluation also may include consideration, for example, of the disclosures needed to achieve a fair presentation arising from matters that could be material, such as the effect of evolving financial reporting requirements or the changing economic environment. In general, misstatements are considered material if ***there is substantial likelihood that,*** individually or in the aggregate, they ~~could reasonably be expected to~~ ***would*** influence the ~~economic decisions of the~~ ~~users taken~~ ***judgment of a reasonable user made based*** on ~~the basis of~~ the financial statements ~~as a whole~~.[fn 2]

[fn 2] See AU-C section 320, *Materiality in Planning and Performing an Audit.*

[No further amendments to SAS No. 134.]

This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.*

SAS 13X~~, AU-C section 703~~, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*[6]

~~Amendments to the ERISA SAS will be consistent with the amendments with AU-C section 700. They will be included here once the ERISA SAS has been conformed to the new auditor's report, which will place the content to be amended in the ERISA SAS.~~

Amendments are shown in ***bold italics*** and **~~bold strikethrough~~.**

[No amendments to paragraphs .01-.73]

74. ~~65.~~This section of the auditor's report should do the following: (Ref: par. A108)

[No amendments to bullets *a-c*]

d. State that misstatements are considered material if, ***there is substantial likelihood that,*** individually or in the aggregate, they ~~could reasonably be expected to~~ ***would*** influence the ~~economic decisions of users~~ ***judgment of a reasonable user*** made ***based*** on ~~the basis of~~ these financial statements.[10] (Ref: par. A111)

fn 10 Paragraph .02 of AU-C section 320, *Materiality in Planning and Performing an Audit.*

[No amendments to paragraphs .75-.114]

115. This section of the auditor's report should do the following: (Ref: par. A108)

[No amendments to bullets *a-c*]

d. State that misstatements are considered material if, ***there is substantial likelihood that,*** individually or in the aggregate, they ~~could reasonably be expected to~~ ***would*** influence the ~~economic decisions of users~~ ***judgment of a reasonable user*** made ***based*** on ~~the basis of~~ these financial statements. [10] (Ref: par. A111)

fn 10 Paragraph .02 of AU-C section 320, *Materiality in Planning and Performing an Audit.*

* This effective date is provisional but will not be earlier than December 15, 2020.

[6] SAS No. 13X, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, which is expected to become effective no earlier than for audits of financial statements for periods ending on or after December 15, 2020, is expected to be issued in third quarter of 2019 and codified as AU-C section 703 in AICPA *Professional Standards*. As of the issuance date of this exposure draft, SAS No. 13X has not been integrated into AICPA *Professional Standards*.

[No amendments to paragraphs .116-.A68]

A69. The auditor's evaluation about whether the financial statements achieve fair presentation, considering both presentation and disclosure, is a matter of professional judgment. This evaluation takes into account such matters as the facts and circumstances of the plan, including changes thereto, based on the auditor's understanding of the plan and the audit evidence obtained during the audit. The evaluation also may include consideration, for example, of the disclosures needed to achieve a fair presentation arising from matters that could be material, such as the effect of evolving financial reporting requirements or the changing economic environment. In general, misstatements are considered material if ***there is substantial likelihood that, individually or in the aggregate,*** they ~~could reasonably be expected to~~ ***would*** influence the ~~economic decisions of the users taken~~ ***judgment of a reasonable user made based*** on ~~the basis of~~ the financial statements as a whole. [35]

fn 35 See section 320, *Materiality in Planning and Performing an Audit.*

[No further amendments to SAS No. 13X.]

This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.[*]

Proposed Statements on Standards for Attestation Engagements, *Amendments to the Description of the Concept of Materiality*

Boldface italic denotes new language. Deleted text is in ~~strikethrough~~.

AT-C section 205, *Examination Engagements*

[No amendments to paragraphs .01-.A16]

.A17 In general, misstatements, including omissions, are considered to be material if ***there is substantial likelihood that***, individually or in the aggregate, they ~~could reasonably be expected to~~ ***would*** influence ***the judgment of a reasonable user*** ~~relevant decisions of intended users that are~~ 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.

[*] This effective date is provisional but will not be earlier than December 15, 2020.

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 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.

[No further amendments to AT-C section 205]

This amendment is effective for practitioners' examination reports dated on or after December 15, 2020.*

AT-C section 210, *Review Engagements*

[No amendments to paragraphs .01-.A15]

.A16 In general, misstatements, including omissions, are considered to be material ~~if~~ if ***there is substantial likelihood that***, individually or in the aggregate, they ~~could reasonably be expected to~~ ***would*** influence ***the judgment of a reasonable user*** ~~relevant decisions of intended users that are~~ 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 reviewed 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 the subject matter taken as a whole.

* This effective date is provisional but will not be earlier than December 15, 2020.

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.

[No further amendments to AT-C section 215]

This amendment is effective for practitioners' review reports dated on or after December 15, 2020.[*]

[*] This effective date is provisional but will not be earlier than December 15, 2020.