



Agenda Item 2A

STATEMENT ON AUDITING STANDARDS

AMENDMENTS TO THE DESCRIPTION OF THE CONCEPT OF MATERIALITY

(Amends

- ***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 an Audit [AICPA, Professional Standards, AU-C sec. 320];***
 - ***Section 450, Evaluation of Misstatements Identified During the Audit, [AICPA, Professional Standards, AU-C sec. 450]; 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 Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements, as amended,***
 - ***Section 700, Forming an Opinion and Reporting on Financial Statements [AICPA, Professional Standards, AU-C sec. 700]***

- ***SAS No. 136, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA [AICPA, Professional Standards, AU-C sec. 703]***

STATEMENT ON STANDARDS FOR ATTESTATION ENGAGEMENTS

AMENDMENTS TO THE DESCRIPTION OF THE CONCEPT OF MATERIALITY

(Amends the following sections of Statement on Standards on Attestation Engagements [SSAE] No. 18, Attestation Standards: 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])*

Materiality Definition
ASB Meeting, October 28-31, 2019

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CONTENTS

	Page
Statement on Auditing Standards <i>Amendments to the Description of the Concept of Materiality</i>	XX
Statement on Standards for Attestation Engagements <i>Amendments to the Description of the Concept of Materiality</i>	XX

Statement on Auditing Standards

Amendments to the Description of the Concept of Materiality

Boldface italics denote new language. Deleted text is in ~~strikethrough~~.

SAS No. 122, Statements on Auditing Standards: Clarification and Recodification, as Amended

AU-C 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 a substantial likelihood that*, individually or in the aggregate, they ~~could reasonably be expected to~~ *would* influence the ~~economic decisions of users~~ *judgment made by a reasonable user based* 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 materiality 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.

.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.

.04 The auditor's determination of materiality is a matter of professional judgment and is affected by the auditor's perception of the financial information needs of *reasonable* users

of the financial statements. ***For purposes of determining materiality,*** ~~In this context, it is reasonable for the auditor to~~ ***may*** assume that ***reasonable users,*** ~~*at a minimum,*~~

- 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.

[No amendment to paragraphs .05–.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 made by a reasonable user 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 amendment to paragraphs .11–~~.A2.~~]

~~**Determining Materiality and Performance Materiality When Planning the Audit**~~

~~***Considerations Specific to Governmental Agencies (Ref: par. 10)***~~

- ~~**.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.~~

~~[No amendments to paragraphs .A4–.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~~ *judgment of made by 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 amendment to AU-C section 320.]

1. 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 amendment 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 uncorrected misstatements, if any, on the financial statements. ^{fm1} 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 made by a reasonable user* 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 amendment to AU-C section 200.]

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

AU-C Section 450, *Evaluation of Misstatements Identified During the Audit*

[No amendments to paragraphs .01–.A22.]

.A23 The circumstances related to some misstatements may cause the auditor to evaluate them as material, individually or when considered together with other misstatements accumulated during the audit, even if they are lower than materiality for the financial statements as a whole. Circumstances that may affect the evaluation include the extent to which the misstatement

...

- affects other information that will be communicated in documents containing the audited financial statements (for example, information to be included in a "Management Discussion and Analysis" or an "Operating and Financial Review") ~~that may reasonably be expected to influence the economic decisions of the users of the financial statements~~ **when there is substantial likelihood that the other information would influence the judgment made by a reasonable user based on the financial statements**. Section 720A, *Other Information in Documents Containing Audited Financial Statements*, addresses the auditor's consideration of other information, on which the auditor has no obligation to report, in documents containing audited financial statements.

[No further amendments to AU-C section 450.]

3. 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 amendment 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 made by a reasonable user 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 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 amendment 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~~ ***would influence the judgment made by a reasonable user 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 amendment to AU-C section 600.]

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

SAS No. 134, Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in Audits of Financial Statements, as Amended

AU-C Section 700, Forming an Opinion and Reporting on Financial Statements

[No amendment 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 a substantial likelihood that***, individually or in the aggregate, they ~~could reasonably be expected to~~ ***would*** influence the ~~economic decisions of the users taken~~ ***judgment made by a reasonable user 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 amendment 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 a substantial likelihood that***, individually or in the aggregate, they ~~could reasonably be expected to~~ ***would*** influence the ~~economic decisions of the users taken~~ ***judgment made by a reasonable user 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 amendment to AU-C section 700.]

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

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

AU-C Section 703, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA

[No amendment to paragraphs .01–.73.]

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

[No amendment to items (a)–(c).]

- d. State that misstatements are considered 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~~ **judgment** made **by a reasonable user based** on ~~the basis of~~ these financial statements.¹⁰ (Ref: par. .A111)

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

[No amendment to paragraphs .75–.114.]

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

[No amendments to items (a)–(c).]

d. State that misstatements are considered 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~~ **judgment** made **by a reasonable user based** on ~~the basis of~~ these financial statements.¹⁶ (Ref: par. .A111)

¹⁶ Paragraph .02 of AU-C section 320, *Materiality in Planning and Performing an Audit*.

[No amendment 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 a substantial likelihood that, individually or in the aggregate**, they ~~could reasonably be expected to would~~ influence the ~~economic decisions of the users taken~~ **judgment made by a reasonable user based** on ~~the basis of~~ the financial statements as a whole.³⁵

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

[No further amendment to AU-C section 703.]

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

Statement on Standards for Attestation Engagements

Amendments to the Description of the Concept of Materiality

Boldface italics denote new language. Deleted text is in ~~strikethrough~~.

SSAE No. 18, Attestation Standards: Clarification and Recodification

AT-C Section 205, Examination Engagements

[No amendment to paragraphs .01–.A16.]

.A17 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 judgment relevant decisions of~~ *made by* 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. *For purposes of determining materiality*, ~~In this context, it is reasonable for the practitioner to~~ *may* assume that intended users, ~~at a minimum~~

- 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.

[No further amendment to AT-C section 205.]

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

AT-C Section 210, Review Engagements

[No amendment to paragraphs .01–.A15.]

.A16 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 judgment* ~~relevant decisions of~~ *made by* 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. *For purposes of determining materiality*, ~~In this context, it is reasonable for the practitioner~~ *may* ~~to~~ assume that intended users, ~~at a minimum~~

- 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~~ *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.

[No further amendment to AT-C section 215.]

2. This amendment is effective for practitioners’ review reports dated on or after December 15, 2020.