



***Statement on
Auditing Standards***

*December 2019
138*

Issued by the Auditing Standards Board

**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]***

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(2019–2020)

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Note: *Statements on Auditing Standards are issued by the Auditing Standards Board, the senior technical body of the AICPA designated to issue pronouncements on auditing matters. The “Compliance With Standards Rule”(ET sec. 1.310.001)¹ of the AICPA Code of Professional Conduct requires compliance with these standards in an audit of a nonissuer.*

¹ All ET sections can be found in AICPA *Professional Standards*.

Statement on Auditing Standards

Amendments to the Description of the Concept of Materiality

Boldface italics denotes 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 Audit¹

[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. 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.

[No amendment to paragraph .03.]

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

¹ All AU-C sections can be found in AICPA *Professional Standards*.

- 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 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–.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 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.^{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 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)

^{fn1} 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 .33–.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)

[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 the users taken~~ ***judgment made by a reasonable user based*** on the basis of these ~~the~~ 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~~ ***the*** 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~~ ***the*** 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.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.