Audit Materiality



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Introduction:

- As identified in AUS 202 "Objective & General Principles Governing an Audit of a Financial report" –The objective of an audit of a financial report is to enable the auditor to express an opinion whether the financial report is prepared, in all "material" respects, in accordance with an identified financial reporting framework.
- The auditor shall design and perform risk assessment procedures to obtain audit evidence that provides an appropriate basis for:

- Identification & assessment of risks of material misstatement, whether due to fraud or error, at the financial report & assertion levels; and
- To design further audit procedures in accordance with ASA 330

Audit Materiality - AASB

- Audit materiality, as defined by the Australian Accounting Standards Board (AASB) and in alignment with the Australian Auditing Standards (notably ASA 320 "Materiality in Planning and Performing an Audit").
- Refers to the level of significance at which an omission or misstatement in financial statements, in the auditor's professional judgment, would be expected to influence the economic decisions of users.
- This concept plays a key role in shaping the scope and extent of the audit procedures.
- It helps auditors determine the areas of focus and ensures that the audit effectively addresses potential risks to financial statement accuracy.
- Materiality also guides decisions regarding the nature, timing, and extent of audit tests.

Key Aspects of Audit Materiality under AASB:

1. <u>Materiality Judgement:</u>

- Materiality is not determined by a fixed percentage but rather through the auditor's professional judgment, considering their understanding of the financial statements and the needs of the users. The appropriate level of materiality is influenced by both qualitative and quantitative factors, including the nature of the item in question and its relative significance.

2. <u>Quantitative Basis:</u>

- Materiality is often expressed as a percentage of a base figure in the financial statements, such as:
- **Revenue**: Typically used for larger entities with significant revenue.
- **Profit before tax**: Frequently applied to companies where profitability is the key focus.
- **Total assets or equity**: Relevant for entities with substantial asset bases.

Generally, materiality thresholds range from 1% to 5% of profit or revenue, depending on the specific characteristics of the company.

Key Aspects of Audit Materiality under AASB:

3. <u>Performance Materiality:</u>

- Performance materiality refers to a reduced threshold of materiality used during the audit to assess the risk that the total misstatements in the financial statements might exceed the overall materiality level. The auditor applies performance materiality to mitigate the risk of failing to detect material misstatements.

4. <u>Qualitative Considerations:</u>

- In some instances, even minor misstatements can be considered material if they involve issues such as:
- Non-compliance with laws or regulations.
- Fraud or asset misappropriation.
- Misstatements that undermine the integrity of the financial reporting.

Key Aspects of Audit Materiality under AASB:

5. <u>Aggregate Misstatements:</u>

- The auditor assesses the cumulative misstatements, whether individually or in total, against the materiality threshold to evaluate their impact on the financial statements. If the misstatements are deemed material, the auditor may request adjustments to ensure the financial statements present a true and fair view.

6. <u>Revised Materiality:</u>

- Materiality may be adjusted during the audit if there are changes in the entity's circumstances or if significant new information emerges, requiring a reassessment of the materiality level.

Process of Applying Materiality:

- **Planning Phase:**
  Materiality is established during the planning phase to guide the development of the audit strategy and to define the scope and extent of audit procedures.

- **Execution Phase:**
  During the audit, the auditor evaluates specific areas of the financial statements, determining whether individual misstatements exceed the established materiality threshold.

- **Evaluation Phase:**
  At the audit's conclusion, the auditor reviews the overall financial statements, considering the cumulative effect of any misstatements identified.

Audit materiality under AASB is a crucial concept that enables auditors to focus on areas of the financial statements that are most significant and likely to influence the decisions of users. Its application combines both quantitative measures and qualitative factors, aiming to provide reasonable assurance that the financial statements are free from material misstatements.

Explanation of Quantitative and Qualitative Considerations (as per AASB)

1.Quantitative Considerations: These are numeric measures used to determine materiality, based on financial factors like size or performance of an entity. Key benchmarks include:

- Profitability and Revenue: Typically, 5% of pre-tax profit or 1% of revenue is used as a standard threshold.
- Assets and Net Assets: For industries with significant assets, materiality is often set at 1-2% of total assets.
- Revenue Variability: In sectors with fluctuating incomes, materiality may be based on net assets or equity instead of revenue.

2.Qualitative Considerations: These involve non-numeric factors that affect the materiality threshold, such as:

- Stakeholder Impact: In sectors like not-for-profits or schools, even small errors can have large reputational or regulatory consequences.
- Regulatory and Legal Compliance: Heavily regulated industries (e.g., solicitors, government) require a lower materiality threshold due to the potential for legal or compliance issues.
- Market Conditions: In volatile industries, like real estate, material misstatements can have a large financial impact, prompting a more cautious approach to materiality.

Audit Materiality Determination for Industry-Specific Audits

Industry	Calculation Procedures (as per AASB)	Materiality Concepts (Overall, Performance, and Trivial)
Companies	**Pre-tax Profit:** Materiality is typically set at 5% of pre-tax profit, though it can range from 3% to 10% depending on the auditor's judgment.	**Overall Materiality:** Typically, 5% of pre-tax profit.
	Revenue: Materiality can be set at 0.5% to 1% of revenue for entities with stable, predictable revenue streams.	**Performance Materiality:** 50% to 75% of overall materiality.
	Total Assets: Materiality may be calculated at 1% to 2% of total assets.	**Trivial Threshold:** Typically, 1% to 2% of overall materiality.
Schools	**Revenue:** Materiality is generally based on 1% to 2% of total revenue.	**Overall Materiality:** Based on 1% to 2% of total revenue.
	Assets: Alternatively, 1% of total assets may be used for schools with large asset bases.	**Performance Materiality**: Typically, 50% to 75% of overall materiality.
		Trivial Threshold: Typically, 0.5% to 1% of overall materiality.

Audit Materiality Determination for Industry-Specific Audits

Industry	Calculation Procedures (as per AASB)	Materiality Concepts (Overall, Performance, and Trivial)
Clubs	**Revenue:** Materiality is typically based on 1% to 5% of total revenue, depending on the size and financial nature of the club.	**Overall Materiality:** Based on 1% to 5% of total revenue or 2% to 3% of net assets.
	Net Assets: Alternatively, 2% to 3% of net assets could be applied.	**Performance Materiality:** Typically, 50% to 75% of overall materiality.
		Trivial Threshold: Typically, 0.5% to 1% of overall materiality.
Retirement Villages	**Revenue:** Materiality is typically calculated at 1% to 3% of total revenue.	**Overall Materiality:** Based on 1% to 3% of total revenue or 1% to 2% of total assets.
	Assets: Alternatively, 1% to 2% of total assets may be used, particularly for property-based entities.	**Performance Materiality:** Typically, 50% to 75% of overall materiality.
		Trivial Threshold: Typically, 0.5% to 1% of overall materiality.

Audit Materiality Determination for Industry-Specific Audits

Industry	Calculation Procedures (as per AASB)	Materiality Concepts (Overall, Performance, and Trivial)
Real Estate	**Revenue:** Materiality is usually set at 1% to 2% of revenue.	**Overall Materiality:** Typically, to 2% of revenue or 1% to 2% of total assets.
	Assets: For property-heavy organizations, 1% to 2% of total assets may be used.	**Performance Materiality:** Typically, 50% to 75% of overall materiality.
		Trivial Threshold: Typically, to 1% of overall materiality.
Solicitors	**Revenue:** Materiality is typically 1% to 2% of total revenue.	**Overall Materiality:** Typically, 1% to 2% of total revenue.
	Gross Assets: Alternatively, 0.5% to 1% of gross assets may be applied, especially when managing client trust funds.	**Performance Materiality:** Typically, 50% to 75% of overall materiality.
		Trivial Threshold: Typically, 0.5% to 1% of overall materiality.

Audit Materiality Determination for Industry-Specific Audits

Industry	Calculation Procedures (as per AASB)	Materiality Concepts (Overall, Performance, and Trivial)
Not-for-Profit Organizations	**Revenue:** Materiality is often calculated at 0.5% to 2% of total revenue.	**Overall Materiality:** Typically, 0.5% to 2% of total revenue or 0.5% to 1% of net assets.
	Net Assets: Alternatively, 0.5% to 1% of net assets may be used.	**Performance Materiality:** Typically, 50% to 75% of overall materiality.
		Trivial Threshold: Typically, 0.5% to 1% of overall materiality.
Others (e.g., Government entities, small businesses)	**Revenue:** Materiality may be based on 1% to 3% of revenue or expenditure, depending on the organization's size.	**Overall Materiality:** Typically, 1% to 3% of revenue or assets.
	Assets or Liabilities: Materiality may be based on 1% of assets or liabilities, particularly for small businesses or government entities.	**Performance Materiality:** Typically, 50% to 75% of overall materiality.
		Trivial Threshold: Typically, 0.5% to 1% of overall materiality.

Audit Materiality

Conclusion:

- **Audit materiality** is essential in determining the **scope and depth** of an audit engagement.

- As per **Australian Accounting Standards (AASB)**, materiality refers to the threshold above which **misstatements or omissions** in financial statements can influence the decisions of users such as **investors**, **creditors**, or **regulators**.

- The concept of materiality ensures auditors focus on the most **significant issues** that could impact the **true and fair view** of the financial statements.

- AASB guidelines help auditors apply **professional judgment** in tailoring materiality calculations based on the **specific characteristics** of the industry and the entity being audited.

- This approach ensures that financial statements provide a **true and fair view**, aiding informed decision-making by users.

Thankyou

