



**IAASB May 11-13, 2003**

*Audit Materiality*

*Agenda Item 4-B*

## *Reasons for Revision*

- **Recommendations of US Materiality Task Force (1998)**
- **Some standard setters have updated national standards**
- **Link with aggressive earnings management**

## *Link with Aggressive Earnings Management*

- Inappropriate accounting policies
- Bias in accounting estimates
- Deliberate “immaterial” errors

## *General Approach*

- Existing ISA 320 conceptually sound and provides useful platform for additional guidance
- More judgmental/Less formulaic
- An holistic approach - nature and size
- Materiality levels for individual components reflecting perceived importance to users
- Better understanding of user needs

## *An Holistic Approach*

- Some existing national standards and guidance distinguish between quantitative and qualitative factors
- Task Force prefers “Materiality depends on the size and nature of the item judged in the particular circumstances”
- Appendix to proposed ISA gives examples of factors that impact evaluation (covers qualitative factors addressed by national standards and guidance)

## *Materiality Levels for Individual Components*

- Aim to avoid simplistic formulae and encourage auditors to think more about user needs
- Require “materiality levels [to] be determined taking account of the ... importance to users of different items disclosed in the financial statements ...”
- Does not require the allocation of materiality as currently undertaken by some firms
- Should we note that, for example, users expect cash items to be more precisely stated than estimates?

## *Better Understanding of User Needs*

- Proposed definition:

“The auditor should consider information to be material if it is probable that its misstatement ...would reasonably change or influence decisions, taken on the basis of the financial statements as a whole, by users who have a reasonable understanding of business and economic activities ...”

## *Linkage with Other ISAs*

- Accounting Estimates
- Group Audits
- Auditor's Report
- Fraud and Error
- Corporate Governance Disclosures



## *Timetable (as for Accounting Estimates)*

- First draft of exposure draft considered by IAASB
- July 2003
- Issue exposure draft
- End 2003
- Final ISA 320
- End 2004

[Blank page]