# EXPOSURE DRAFT

# PROPOSED 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]; 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, *[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*

***(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]*)**

## June 5, 2019

## Comments are requested by August 5, 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 sherry.hazel@aicpa-cima.com.**

[1] Statement on Auditing Standards (SAS) No. 13X, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA,* which will be effective for audits of financial statements for periods ending on or after December 15, 2020, is expected to be issued in the 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

Page

## 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 issued 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 an 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 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 Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* (AICPA, *Professional Standards*, AU-C sec. 703[2])

If issued as final, the proposed SSAE will amend the following sections of 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)

[2] Statement on Auditing Standards (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 the 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 Public Company Accounting Oversight Board (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 IAASB. The ASB is proposing amendments to align the materiality concepts discussed in AICPA *Professional Standards* with the definition of materiality used by the U.S. judicial system, the auditing standards of the PCAOB, the U.S. Securities and Exchange Commission (SEC), and the Financial Accounting Standards Board (FASB) (hereinafter referred to as "U.S. judicial system and other U.S. standard setters and regulators"). FASB amended its definition of materiality in August 2018 to be consistent with the U.S. judicial system and other U.S. standard setters and regulators. The ASB believes it is in the public interest to eliminate inconsistencies between the definition of materiality in 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" versus "*could reasonably be expected* to influence the judgment of a reasonable person." In essence, the U.S. judicial system and 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 ASB, IASB, and IAASB definitions 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 decisions of users taken on the basis of the financial statements.[4]

### *History*

#### 1976: The U.S. Supreme Court Defines Materiality

[3] The term *definition* in this explanatory memorandum refers to the words used to explain the concept of materiality and is not intended to refer to a statement of the exact meaning of the term *materiality*.
[4] Italics in quoted or paraphrased language throughout this explanatory memorandum have been added for emphasis.

In *TSC Industries, Inc. v. Northway, Inc.*,[5] 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

> an 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 fact *would* have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.[6]

With this opinion, the U.S. Supreme Court reversed the decision of the U.S. Seventh Circuit Court of Appeals, which had held that material facts included "all facts which a reasonable shareholder *might consider important*."[7] The U.S. Supreme Court stated that the U.S. Seventh 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, FASB issued Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*, 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."

However, as discussed later, FASB's definition of materiality changed in September 2010 when FASB issued Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*.

**1999: The SEC Provides Guidance When Evaluating Materiality**

On August 12, 1999, the staff of the SEC 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 FASB Concepts Statement No. 2 glossary definition of materiality (issued in May 1980) and *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."

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[5] TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (June 14, 1976).
[6] *TSC Industries v. Northway*, 426 U.S. 438, 449.
[7] Northway, Inc. v. TSC Industries, Inc., 512 F.2d 324 (7th Cir. 1975).

**1983 and 2006: ASB Issues SASs on Materiality**

In December 1983, the ASB issued SAS No. 47, *Audit Risk and Materiality in Conducting an Audit*. SAS No. 47 did not define materiality but quoted the FASB Concepts Statement No. 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. As did SAS No. 47, SAS No. 107 quotes the FASB Concepts Statement No. 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."[8] However, SAS No. 107 also stated that the determination of materiality takes into account how users *could* reasonably be expected to be influenced in making economic decisions.[9]

**2009: IAASB Defines Materiality**

International Standard on Auditing (ISA) 320, *Materiality in Planning and Performing 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 follows: "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."[10]

**2010: IASB Defines Materiality**

In 2010, the *Conceptual Framework for Financial Reporting* issued by the IASB defined materiality as follows: "Information is material if omitting or misstating *could* influence decisions that users make on the basis of financial information about a specific reporting entity."[11]

The definition of materiality in the IASB framework is substantially the same as the definition of materiality in paragraph 5 of International Accounting Standard (IAS) 8, *Accounting Policies and Accounting Estimates*, which states, "Omissions or misstatements of items are material if they *could*, individually or collectively, influence the economic decisions that users make on the basis of the financial statements."

**2010: FASB Issues Concepts Statement No. 8**

In September 2010, FASB issued Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, which superseded Concepts Statement Nos. 1 and 2. As stated in Concepts Statement No. 8, "the Board has undertaken a project with the IASB to improve and converge

[8] Paragraph 4 of SAS No. 107, *Audit Risk and Materiality in Conducting an Audit.*
[9] Paragraph 6 of SAS No. 107.
[10] Paragraph 2 of International Standard on Auditing (ISA) 320, *Materiality in Planning and Performing an Audit*.
[11] Paragraph 2.11 of the *Conceptual Framework for Financial Reporting*.

their frameworks." The Concepts Statement No. 8 definition of materiality aligns with the definitions adopted by the IASB.

The Concepts Statement No. 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."[12]

**2010: PCAOB Issues Standard on Materiality**

In August 2010, the PCAOB issued Auditing Standard (AS) No. 11, *Consideration of Materiality in Planning and Performing an Audit* (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 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 Concepts Statements.

PCAOB AS 2105, paragraph .02 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 of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him . . ."

Further, PCAOB AS 2105, paragraph .07 states

> 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.

**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 the 2010 FASB Concepts Statement No. 8 definition of materiality. Paragraphs .02 and .03 of AU-C section 320, *Materiality in Planning and Performing an Audit*,[13] of SAS No. 122 state the following:

> **.02** Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and fair presentation of financial statements. Although

[12] Chapter 3, paragraph QC11 of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting.*
[13] All AU-C sections can be found in AICPA *Professional Standards*.

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 Concepts Statement No. 8**

In August 2018, FASB issued amendments to chapter 3, *Qualitative Characteristics of Useful Financial Information,* of Concepts Statement No. 8. The main amendment to chapter 3 reinstates the definition of materiality that was in Concepts Statement No. 2, which was superseded in 2010 by Concepts Statement No. 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."

This definition of financial statement materiality is aligned with definitions held by the 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 ASB, IASB, and IAASB.

**2018: IASB Amends Definition of Material**

In October 2018, the IASB 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 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."

**2019: ASB Proposes to Amend the Definition of Materiality**

As described in the "Why Is the ASB Issuing These Amendments?" section, 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.

Amendments are proposed to conform the definition of materiality throughout AICPA *Professional Standards*, including the wording of the auditor's report as revised by SAS No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements,* and in application material in AT-C section 205, *Examination Engagements*,[14] and AT-C section 210, *Review Engagements*.

## Effective Date

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

If issued as final, the proposed SSAE 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.

## Issues for Consideration

In drafting the proposed SAS, the ASB identified the following issues for which feedback is specifically requested:

***Revised Definition of Materiality***

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 a substantial likelihood that, individually or in the aggregate, they would influence the judgment of a reasonable user made based on the financial statements."

[14] All AT-C sections can be found in AICPA *Professional Standards*.

1. Please provide your views on whether the wording of the amendments is consistent with the definition of materiality used by the U.S. judicial system and other U.S. standard setters and regulators. If the wording is not consistent, please identity the areas of inconsistency and suggest alternate wording.

***Consistency with Current Practice***

The ASB believes that the proposed definition of materiality and related conforming amendments are substantially consistent with current firm practices with respect to determining and applying materiality in an audit or attest engagement. Accordingly, the ASB believes that the proposed amendments will better align with the U.S. jurisdiction, including the recent FASB changes to the conceptual framework, but would not result in significant impact on the extent of work performed in those engagements.

2. Please provide your views on whether the proposed amendments will change how auditors determine materiality in an audit or attestation engagement. If the amendments would result in a change, how would the change affect those engagements?

## 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 5, 2019, until a final standard is issued. Please send responses to Sherry Hazel at Sherry.Hazel@aicpa-cima.com by August 5, 2019.

## Comment Period

The comment period for this exposure draft ends on August 5, 2019.

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## Proposed 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*

#### AU-C Section 320, *Materiality in Planning and Performing an Audit*

[No amendments 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 of a reasonable user*** made ***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 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~~ ***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

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

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~~ ***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, Including Amendments Addressing Disclosures in Audits 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 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 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 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 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, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*[15]

[No amendments to paragraphs 1–73.]

**74.** 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 of a reasonable user*** made ***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 amendments 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 of a reasonable user*** made ***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 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

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

[15] SAS No. 13X, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, which will be effective for audits of financial statements for periods ending on or after December 15, 2020, is expected to be issued in the 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*.

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 of a reasonable user made 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 amendments to SAS No. 13X.]

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.

# Proposed 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~~.

**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 a 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 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.[**]

[**] This effective date is provisional but will not be earlier than 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 ***there is a substantial likelihood that***, individually or in the aggregate, they ~~could~~ ~~reasonably be expected~~ ~~to~~ ***would*** influence ~~relevant decisions of intended users that~~ ~~are~~ ***the judgment of a reasonable user*** 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.

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.