SINGAPORE STANDARD ON AUDITING **SSA 320**

Audit Materiality

The Singapore Standard on Auditing SSA 25 "Audit Materiality" was approved by the Council of the Institute of Certified Public Accountants of Singapore in September 1996.

Auditors are required to comply with the auditing standards contained in this SSA in respect of audits of financial statements for periods beginning on or after 1 January 1997.

SSA 320 supersedes SSA 25 of the same title in June 2004. No substantive changes have been made to the original approved text and all cross references have been updated, as appropriate.

This revised SSA 320 supersedes the SSA of the same title in June 2005.

The Audit Risk Standards, comprising SSA 315 "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement", SSA 330 "The Auditor's Procedures in Response to Assessed Risks" and SSA 500 (Revised) "Audit Evidence" gave rise to conforming amendments in this SSA. These amendments are effective for audits of financial statements for periods beginning on or after 15 December 2004.

This revised SSA 320 supersedes the SSA of the same title in December 2005.

Singapore Standards on Auditing (SSAs) are to be applied in the audit of financial statements. SSAs are also to be applied, adapted as necessary, to the audit of other information and to related services.

SSAs contain the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material. The basic principles and essential procedures are to be interpreted in the context of the explanatory and other material that provide guidance for their application.

To understand and apply the basic principles and essential procedures together with the related guidance, it is necessary to consider the whole text of the SSA including explanatory and other material contained in the SSA not just that text which is black lettered.

In exceptional circumstances, an auditor may judge it necessary to depart from an SSA in order to more effectively achieve the objective of an audit. When such a situation arises, the auditor should be prepared to justify the departure.

SSAs need only be applied to material matters.

The Public Sector Perspective (PSP) issued is set out at the end of an SSA. Where no PSP is added, the SSA is applicable in all material respects to the public sector.

Contents

SINGAPORE STANDARD ON AUDITING

SSA 320

Audit Materiality

Foreword

i This Standard is based on International Standard on Auditing 320, with such amendments as were considered appropriate for local adoption.

ii The amendments are as follows:

Paragraph 4

'... an identified financial reporting frame work' is replaced by 'Financial Reporting Standards.'

Introduction

1. The purpose of this Singapore Standard on Auditing (SSA) is to establish standards and provide guidance on the concept of materiality and its relationship with audit risk.

2. **The auditor should consider materiality and its relationship with audit risk when conducting an audit.**

3. "Materiality" is defined in the Council on Corporate Governance and Disclosure's "Framework for the Preparation and Presentation of Financial Statements" in the following terms:

   "Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful."

Materiality

4. **The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable Financial Reporting Standards.** The assessment of what is material is a matter of professional judgment.

5. In designing the audit plan, the auditor establishes an acceptable materiality level so as to detect quantitatively material misstatements. However, both the amount (quantity) and nature (quality) of misstatements need to be considered. Examples of qualitative misstatements would be the inadequate or improper description of an accounting policy when it is likely that a user of the financial statements would be misled by the description, and failure to disclose the breach of regulatory requirements when it is likely that the consequent imposition of regulatory restrictions will significantly impair operating capability.

6. The auditor needs to consider the possibility of misstatements of relatively small amounts that, cumulatively, could have a material effect on the financial statements. For example, an error in a month end procedure could be an indication of a potential material misstatement if that error is repeated each month.

7. The auditor considers materiality at both the overall financial statement level and in relation to classes of transactions, account balances, and disclosures. Materiality may be influenced by considerations such as legal and regulatory requirements and considerations relating to classes of transactions, account balances, and disclosures and their relationships. This process may result in different materiality levels depending on the aspect of the financial statements being considered.

8. **Materiality should be considered by the auditor when:**

   (a) Determining the nature, timing and extent of audit procedures; and

   (b) Evaluating the effect of misstatements.

The Relationship between Materiality and Audit Risk

9. When planning the audit, the auditor considers what would make the financial statements materially misstated. The auditor’s understanding of the entity and its environment establishes a frame of reference within which the auditor plans the audit and exercises professional judgment about assessing the risks of material misstatement of the financial statements and responding to those risks throughout the audit. It also assists the auditor to establish materiality and in evaluating whether the judgment about materiality remains appropriate as the audit progresses. The auditor's assessment of materiality, related to classes of transactions, account balances, and disclosures helps the auditor decide such questions as what items to examine and whether to use sampling and substantive analytical procedures. This enables the auditor to select audit procedures that, in combination, can be expected to reduce audit risk to an acceptably low level.

10. There is an inverse relationship between materiality and the level of audit risk, that is the higher the materiality level, the lower the audit risk and vice versa. The auditor takes the inverse relationship between materiality and audit risk into account when determining the nature, timing and extent of audit procedures. For example, if, after planning for specific audit procedures, the auditor determines that the acceptable materiality level is lower, audit risk is increased. The auditor would compensate for this by either:

    (a) Reducing the assessed risk of material misstatement, where this is possible, and supporting the reduced level by carrying out extended or additional tests of control; or

    (b) Reducing detection risk by modifying the nature, timing and extent of planned substantive procedures.

Materiality and Audit Risk in Evaluating Audit Evidence

11. The auditor's assessment of materiality and audit risk may be different at the time of initially planning the engagement from at the time of evaluating the results of audit procedures. This could be because of a change in circumstances or because of a change in the auditor's knowledge as a result of performing audit procedures. For example, if audit procedures are performed prior to period end, the auditor will anticipate the results of operations and the financial position. If actual results of operations and financial position are substantially different, the assessment of materiality and audit risk may also change. Additionally, the auditor may, in planning the audit work, intentionally set the acceptable materiality level at a lower level than is intended to be used to evaluate the results of the audit. This may be done to reduce the likelihood of undiscovered misstatements and to provide the auditor with a margin of safety when evaluating the effect of misstatements discovered during the audit.

Evaluating the Effect of Misstatements

12. **In evaluating whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework, the auditor should assess whether the aggregate of uncorrected misstatements that have been identified during the audit is material.**

13. The aggregate of uncorrected misstatements comprises:

    (a) Specific misstatements identified by the auditor including the net effect of uncorrected misstatements identified during the audit of previous periods; and

    (b) The auditor's best estimate of other misstatements which cannot be specifically identified (i.e. projected errors).

14. The auditor needs to consider whether the aggregate of uncorrected misstatements is material. If the auditor concludes that the misstatements may be material, the auditor needs to consider reducing audit risk by extending audit procedures or requesting management to adjust the financial statements. In any event, management may want to adjust the financial statements for the misstatements identified.

15. **If management refuses to adjust the financial statements and the results of extended audit procedures do not enable the auditor to conclude that the aggregate of uncorrected misstatements is not material, the auditor should consider the appropriate modification to the auditor's report in accordance with SSA 700 "The Auditor's Report on Financial Statements".**

16. If the aggregate of the uncorrected misstatements that the auditor has identified approaches the materiality level, the auditor would consider whether it is likely that undetected misstatements, when taken with aggregate uncorrected misstatements could exceed materiality level. Thus, as aggregate uncorrected misstatements approach the materiality level the auditor would consider reducing audit risk by performing additional audit procedures or by requesting management to adjust the financial statements for identified misstatements.

Communication of Errors

17. If the auditor has identified a material misstatement resulting from error, the auditor should communicate the misstatement to the appropriate level of management on a timely basis, and consider the need to report it to those charged with governance in accordance with SSA 260 "Communication of Audit Matters to Those Charged with Governance."

Public Sector Perspective

1. *In assessing materiality, the public sector auditor must, in addition to exercising professional judgment, consider any legislation or regulation which may impact that assessment. In the public sector, materiality is also based on the "context and nature" of an item and includes, for example, sensitivity as well as value. Sensitivity covers a variety of matters such as compliance with authorities, legislative concern or public interest.*