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MATERIALITY GUIDE

Purpose of this guide

This guide has been developed to assist partners and staff apply the concept of materiality. When considering this guide personnel must have read and understood the relevant sections of the Audit & Assurance Services Policy (AASP), in particular Section 6 regarding ‘Engagement Performance’.

It is Firm policy that:

‘The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of misstatements identified during the audit and of uncorrected misstatements, if any, in the financial report and in forming the opinion in the auditor's report.’ (AASP 6.4)

‘For Financial Audits, the Engagement Partner and Engagement Team members acknowledge the mandatory requirement to: Apply the concept of materiality appropriately in planning and performing the audit.

It should also be noted the benchmarks and weightings for different entity types are a guide and may be amended based on the individual client circumstances. In all cases, the Engagement Partner should approve materiality calculations.

1. Overall Materialtiy	• Determine benchmarks • Apply benchmark % • Apply weighting factors
2. Overall Performance Materiality	• Apply performance materiality %
3. Specific Materiality	• Determine items requiring specific materiality • Apply specific materiality %

1. Overall Materiality (for the Financial Report as a whole)

The highest amount of information that if omitted, misstated or not disclosed, then that information has the potential to affect the economic decisions of users of the financial report or the discharge of accountability by management or those charged with governance.

The determination of overall materiality should be made with the following questions in mind:

- Who are the major users of the financial report?
- What information is important to their economic decision making and discharging of their responsibilities?
- In addition to quantitative amounts, what qualitative factors might impact upon the users financial reporting requirements as they relate to materiality?

Staff should use the firm's 'Materiality Template' when conducting an audit of a financial report. The template provides both a qualitative and quantitative section. The qualitative factors should be used to establish whether or not they will influence, either up or down, the quantitative measure determined in the bottom section of the template.

Whilst the standard CaseWare document '2-200 Materiality' will not be used for calculating materiality, the document should not be deleted and the following information manually input: Audit Assessment of Overall Materiality (from template), Performance Materiality % (from template) and Clearly Trivial Percentage (5%).

Quantitative Guidance on Overall Materiality

The following table should be used to help determine appropriate parameters when calculating the benchmark percentages and weighting factors.

Benchmark % - based upon the expectations of users

Section	**User's tolerance for misstatements**				
	Low	**Low to Medium**	**Medium**	**Medium to High**	**High**
Revenue	2%	1.75%	1.5%	1%	0.5%
Profit Before Tax	10%	8%	7%	6%	5%
Total Assets	2%	1.75%	1.5%	1%	0.5%
Net Assets/Equity	10%	8%	7%	6%	5%
Net Current Assets	10%	8%	7%	6%	5%

It is important to note that Overall Materiality is based upon users' needs and expectations not those of the auditor based on audit risk. We will use 'Performance Materiality' to accommodate for our audit risk in the next section.

Weighting Factor % - based upon the expectations of users

Section	Entity Type		
	For Profit	Not for Profit	Council
Revenue	50%	50%	50%
Profit Before Tax	50%	-	-
Total Assets	-	50%	-
Net Assets/Equity	-	-	-
Net Current Assets	-	-	50%

Basis of Materiality – use an average where possible.

The template allows the user to choose between various bases of materiality, such as average of the two or three prior years. Wherever possible an average should be used so as to avoid the potential for benchmarks to be influenced by unusual or one off results in revenue or profit. If a one off event occurred in a previous period and the current period approximates to normal then use the current period. Notwithstanding which basis is used the work paper should provide explanation.

In the case of council audits, preliminary materiality should be based on the average of the two previous years for the purposes of the interim audit and final materiality should be based on the current year results (adjusted for abnormal items).

2. Overall Performance Materiality

The amount set by us as auditor at less than the Overall Materiality, to reduce to an appropriately low level, the probability that the aggregate of undetected misstatements exceeds Overall Materiality.

Overall Performance Materiality must be set at a % of the Overall Materiality so as to allow us a margin or buffer for the possible undetected misstatements that may occur during the engagement. We use a sliding scale of % based upon an estimate of the engagement risk associated with the client.

Performance Materiality as a % of Overall Materiality

Engagement Risk				
Low	Low to Medium	Medium	Medium to High	High
90%	85%	80%	75%	70%

3. Specific Materiality (for particular classes of transactions, account balances or disclosures)

The misstatements or events that are used by the auditor to identify misstatements at lesser than the Overall Materiality.

Specific Materiality could relate to sensitive areas such as particular note disclosures (that is, management remuneration or industry-specific data), compliance with legislation or certain terms in a contract, or transactions upon which bonuses are based. It could also relate to the nature of a potential misstatement such as an illegal act, non-compliance with loan covenants and statutory/regulatory reporting requirements.

Other times we may wish to use Specific Materiality for particularly high risk items such as cash, revenue or related party transactions. On such occasions the history of material misstatements in relation to a particular balance or class of transaction is also relevant.

Specific Materiality – disclosure guidance

Disclosure of the following transactions, balances or events would normally be subject to a Specific Materiality level lower than Overall Materiality:

- Related party transactions and balances
- Disclosure of items such as those related to financial instrument risk
- Significant management estimates or valuations including sensitivity analysis
- Director's remuneration
- Director's expense accounts
- Auditor's remuneration, particularly non-audit services
- Significant accounting policies or changes in accounting policies
- Sensitive income and expense accounts such as management fees and commissions.