

(April 2006)

Explanatory Statement

ASA 320 Materiality and Audit Adjustments

Issued by the **Auditing and Assurance Standards Board**



Australian Government

Auditing and Assurance Standards Board

Explanatory Statement

Reasons for Issuing ASA 320 *Materiality and Audit Adjustments*

The Auditing and Assurance Standards Board (AUASB) issues Auditing Standard ASA 320 *Materiality and Audit Adjustments*, due to the requirements of the legislative provisions explained below.

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* established the AUASB as an independent statutory body under section 227A of the *Australian Securities and Investments Commission Act 2001*, as from 1 July 2004. Under section 336 of the *Corporations Act 2001*, the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

Process of making Auditing Standards

Section 1455 of the *Corporations Act 2001* and *Corporations Regulation 10.5.01* gave interim legal endorsement from 1 July 2004 to the majority of Auditing Standards made by the former Auditing & Assurance Standards Board of the Australian Accounting Research Foundation. The AUASB has reviewed the Auditing Standards and has proceeded to make them as legally enforceable Auditing Standards under the *Corporations Act 2001*.

The Auditing Standards have been made also in accordance with the Financial Reporting Council's Strategic Direction to the AUASB dated 6 April 2005, pursuant to section 225 of the *ASIC Act*.

The Strategic Direction, *inter alia*, provides that the AUASB develops Auditing Standards that:

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- have a clear public interest focus and are of the highest quality;
- use the International Standards on Auditing (ISAs) of the International Auditing and Assurance Standards Board (IAASB) as a base;
- conform with the Australian regulatory environment; and
- are capable of enforcement.

In implementing the Strategic Direction, the AUASB has undertaken a process of thorough review and revision that has:

- addressed the enforceability of mandatory requirements;
- clarified auditors' obligations under the Auditing Standards;
- provided for sector neutrality in the Auditing Standards; and
- included other amendments as necessary.

Purpose of Auditing Standard ASA 320 *Materiality and Audit Adjustments*

The purpose of Auditing Standard ASA 320 is to establish mandatory requirements and to provide explanatory guidance on materiality and its relationship with audit risk.

Auditing Standard ASA 320 is to be read in conjunction with the *Preamble to AUASB Standards*, which sets out the intentions of the AUASB on how the Auditing Standards are to be understood, interpreted and applied.

Operative Date

The Auditing Standard is operative for financial reporting periods commencing on or after 1 July 2006.

Main changes from Auditing Standard AUS 306 (June 2001) *Materiality and Audit Adjustments*

The main differences between ASA 320 and AUS 306 are that in ASA 320:

1. The word ‘shall’, in the **bold-type** paragraphs, is the terminology used to describe an auditor’s mandatory requirements, whereas an auditor’s degree of responsibility is described in AUS 306 by the word ‘should’.
2. The explanatory guidance paragraphs provide guidance and illustrative examples to assist the auditor in fulfilling the mandatory requirements, whereas in AUS 306 some obligations are implied within certain explanatory paragraphs. Accordingly, such paragraphs have been re-drafted to clarify that they form part of the explanatory guidance.
3. The following implied obligations, in AUS 306, have been elevated and re-stated as specific mandatory requirements:
 - (a) an auditor shall make a preliminary assessment of materiality to establish an appropriate quantitative materiality level to plan risk assessment procedures, further audit procedures at the assertion level, selection strategies and other audit procedures (paragraph 12);
 - (b) the auditor shall consider qualitative factors, which impact on the materiality of individual misstatements, to assess:
 - (i) the significance of the misstatement to the particular entity;
 - (ii) the pervasiveness of the misstatement; and
 - (iii) the effect of misstatement on the financial report as a whole (paragraph 21);

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- (c) the auditor shall bring to the attention of management, misstatements identified during the audit, other than those that are clearly trivial, for correction prior to evaluating the effect of the remaining uncorrected misstatements (paragraph 24); and
 - (d) when the auditor concludes that uncorrected misstatements are immaterial individually and in aggregate to the financial report, the auditor shall endeavour to obtain representations from management to acknowledge:
 - (i) uncorrected misstatements have been brought to their attention by the auditor; and
 - (ii) they have considered the effect of any uncorrected misstatements, aggregated during and pertaining to the latest period, on the financial report and consider the misstatements are immaterial individually and in aggregate to the financial report taken as a whole (paragraph 35).
4. Additional explanatory guidance is provided in relation to misstatements, identified during the audit, that an auditor shall bring to the attention of management (paragraphs 25 and 26).
5. The objective of an audit of a financial report is included within explanatory guidance and refers to Auditing Standard ASA 200 *Objective and General Principles Governing an Audit of a Financial Report* (paragraph 8). AUS 306, however, requires that 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 applicable financial reporting framework.

Consultation prior to issuing this Auditing Standard

The AUASB has consulted publicly as part of its due process in developing this Auditing Standard. Exposure Draft ED 33/05 *Proposed Auditing Standard: Materiality and Audit Adjustments (Re-issuance of AUS 306)* was issued on 16 December 2005 with a 45 day comment period. Submissions were received by the AUASB and it has considered these submissions as part of the development and finalisation of this Auditing Standard.