AG ISA (NZ) 320
THE AUDITOR-GENERAL'S STATEMENT ON
MATERIALITY IN PLANNING AND PERFORMING AN ANNUAL AUDIT

Contents

Introduction

Scope of this Statement

1. This Auditor-General's Auditing Statement:
   (a) establishes the Auditor-General's requirements in relation to ISA (NZ) 320: *Materiality in Planning and Performing an Audit* (ISA (NZ) 320);[1] and
   (b) provides additional guidance to reflect the public sector perspective.

Application

2. Compliance with this Statement is mandatory for Appointed Auditors who carry out annual audits on behalf of the Auditor-General. This Statement requires compliance with all of the requirements of ISA (NZ) 320 and the additional requirements included in this Statement.

3. This Statement applies to audits of financial statements and/or performance information that have been prepared for reporting periods beginning on or after 1 April 2020, although earlier application is encouraged.

Objective

4. The objective of the Appointed Auditor is to apply the concept of materiality appropriately and to reflect the public sector perspective in planning and performing the annual audit.

Definitions

5. For the purpose of this Auditor-General's Auditing Statement, the defined terms have the meanings attributed:
   (a) in the Glossary of Terms issued by the New Zealand Auditing and Assurance Standards Board (the NZAuASB glossary) of the External Reporting Board (although, where a term with a specific meaning in the New Zealand public sector differs from the NZAuASB glossary, the New Zealand public sector definition shall prevail);
   (b) in the Auditor-General's Glossary of Terms; and
   (c) in the following term.

[1] The ISA (NZ) Auditing Standards are scoped so that they apply to audits of "historical financial information". However, for the purposes of the Auditor-General's Auditing Standards and Statements, all references to "historical financial information" should be read as the audit of "historical financial and historical performance information".

Material	means, for the purposes of forming an opinion on a public entity's financial and performance information, a statement, omission, fact, or item of such a nature or amount that its disclosure, or the method of treating it, given full consideration of the circumstances applying at the time the financial and performance information is completed, could reasonably be expected to influence readers' overall understanding of the financial statements and performance information in making decisions or assessments about the stewardship and allocation of resources and the performance of the public entity.

Requirements

Materiality to be applied to the annual audit of financial and performance information

6. The Appointed Auditor shall consider whether a statement, omission, fact, or item is material when planning and performing the annual audit of the financial and performance information prepared by an entity. The consideration of materiality by the Appointed Auditor shall be taken from several perspectives as follows:
   (a) The Appointed Auditor shall apply the general definition of "material", in paragraph 5 of this Statement, as the overall test of whether a statement, omission, fact, or item is material when planning and performing the annual audit of an entity's financial and performance information.
   (b) If an entity prepares performance reports for audit, the Appointed Auditor shall apply the materiality requirements of AG-4: *The audit of performance reports*.
   (c) In considering the laws and regulations that apply to an entity, the Appointed Auditor shall also apply the materiality requirements of ISA (NZ) 250 (Revised): *Consideration of Laws and Regulations* and take into account the considerations in paragraph 8 of the accompanying Auditor-General's Statement AG ISA (NZ) 250 (Revised).
   (d) If a public entity receives a Parliamentary appropriation on behalf of a Minister, the Appointed Auditor shall apply the materiality requirements of AG-2: *The appropriation audit and the controller function* (ref: para A1-A3).

Additional requirement to consider issues of effectiveness and efficiency, waste, and a lack of probity or financial prudence

7. Regardless of the requirements in paragraph 6 of this Statement, the Appointed Auditor shall maintain an alertness for, and awareness of, issues of effectiveness and efficiency, waste, and a lack of probity or financial prudence when planning and performing the annual audit. Such alertness and awareness shall be maintained for the purpose of reporting such issues to the OAG.

8. The Appointed Auditor shall specifically maintain an alertness for, and awareness of, such issues and, should an issue come to their attention, form an initial view as to whether to report the issue to the OAG. Issues that are clearly trivial or inconsequential are not required to be reported to the OAG.

9. The Appointed Auditor shall refer to AG-3: *The approach to issues arising from section 16(1) of the Public Audit Act 2001* for further requirements and guidance.

Appointed Auditors to comply with other OAG instructions on materiality

10. The Appointed Auditor shall, as a minimum, comply with any materiality considerations specified in instructions by the OAG. Irrespective of any materiality considerations specified by the OAG, the Appointed Auditor shall apply a lower materiality limit if this is necessary to achieve the objective of this Statement.

Determining an appropriate materiality base for the financial information as a whole

11. The Appointed Auditor shall, when setting materiality for the financial information, take into account the activities of the public entity. For example:
    (a) For public entities whose purpose is primarily to provide public benefits, the focus is likely to be on the quality of its expenditure. In this instance, gross expenditure might be an appropriate base for determining the level of financial materiality.
    (b) For public entities whose primary purpose is the pursuit of commercial objectives, a financial materiality that is consistent with that entity's commercial objectives would be more appropriate.

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Application and other explanatory material

Materiality to be applied to the annual audit of financial and performance information (ref: para. 6)

Limitations in the definition of materiality in the New Zealand financial reporting framework

A1. The financial reporting framework in New Zealand defines materiality as:

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. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

PBE IPSAS 1 includes the following additional guidance in respect of public benefit entities:

Material. In addition to the definition of "Material" given in paragraph 7, omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements.

Public benefit entities are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.

A2. For the purposes of annual audits, the definition of materiality in the financial reporting framework is too narrow for the following reasons:

(a) Limiting the definition to "omissions or misstatements" effectively excludes concerns identified by the auditor about financial management behaviour that would not directly impact on the fair presentation (or truth and fairness) of the financial and performance information. An example of financial management behaviour that would be material to users but that would not necessarily result in an omission or misstatement of the financial and performance information would be when entity management had invested unlawfully or without authority. In this instance, the financial and performance information may fairly present the investment, although the investment is unlawful or unauthorised.

(b) Limiting the definition to “economic decisions of users” also fails to recognise that users may choose to make decisions other than economic decisions, such as changing the governing body where they have the power to do so. In the public sector, many users do not have the power to make economic decisions and must therefore resort to other action, such as voting for a change in their elected representatives.

Auditing in the public sector places greater emphasis on the qualitative aspects (the nature) of materiality

A3. Paragraph A3 of ISA (NZ) 320 describes matters to consider when determining materiality levels in the public sector. When determining whether a particular class of transactions, account balance, disclosure, or other assertion that is part of the financial and performance information is material by virtue of its nature, the Appointed Auditor should take into account qualitative aspects such as:

(a) the context in which the matter appears – for example, if the matter is also subject to compliance with authorities, legislation, or regulations, or if law or regulation prohibits overspending of public funds, regardless of the amounts involved;

(b) the needs of the various stakeholders and how they use the financial and performance information;

(c) the nature of the transactions that are considered sensitive to users of the financial and performance information;

(d) public expectations and public interest, including emphasis placed on the particular matter by Parliament or other elected representatives, including the necessity of certain disclosures;

(e) the need for legislative oversight and regulation in a particular area; and

(f) the need for openness and transparency.