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MATERIALITY

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Abstract: Professional (audit) risk consists of accepting and expressing in the auditor's report an incorrect opinion about the reliability of the statements of the audited enterprise. Something to pay attention to here, that the auditor confirms the reliability not of every figure in the reporting, but the reliability of the reporting "in all significant aspects." Otherwise, in our opinion, the reporting could not be confirmed at all. Thus, audit risk is inextricably linked with the concept of materiality.

Keywords: audit risk, auditing, materiality, audit planning, indicators, reporting.

Introduction

The concept of materiality in auditing is perhaps more important than the concept of risk. It is not without reason that it is mentioned in the international auditing standard - in the Procedure for Drawing up an Auditor's Report, in which special attention of auditors is drawn to the use of the principle of materiality when drawing up an audit report.

Moreover, ISA 200 standard directly states that the auditor's report cannot and should not be interpreted by economic entities and interested users as a complete, absolute guarantee of the auditor about that. that all reporting indicators are completely reliable and there are not and cannot be any other circumstances that have or can have an impact on the financial statements of an economic entity.

In accordance with the standard, the level of materiality is understood as the maximum value of an error in the financial statements, starting from which a qualified user of these statements with a high degree of probability will no longer be able to draw correct conclusions based on them and make correct economic decisions [1].

Material and method

In accordance with the Standard, audit organizations are required to calculate the level of materiality by taking a certain proportion of any basic indicators: numerical values of accounting accounts, balance sheet items or financial reporting indicators. In this case, both basic indicators of the current year and average indicators of the current and previous years, as well as any calculation procedures that can be formalized, can be used. The commentary also states that the order specified in the standard is given for a sample and is of a recommendatory nature.

In addition, the standard notes that audit firms must, taking into account the mandatory requirements of this Rule (Standard), develop their own procedure for determining the level of materiality.

For example, in contrast to the proposed order, they can:

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- change the values of the coefficients;

- enter, remove, change financial indicators;

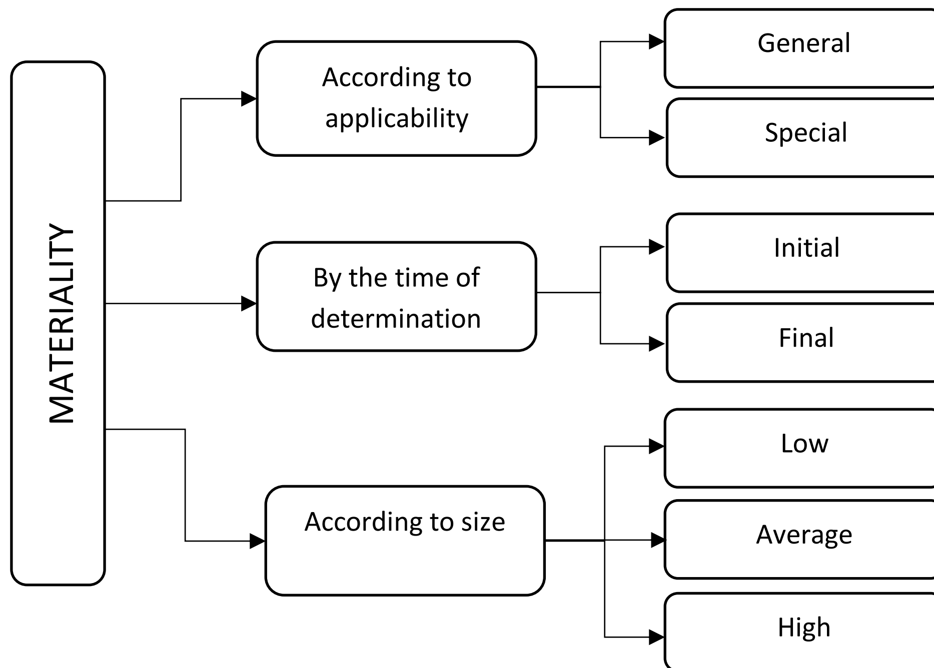
- change the order of averaging when finding the indicator;

- take into account the values of financial indicators for previous years and take into account the dynamics of their changes;

- provide more than one indicator of the level of materiality, about several - for various balance sheet items;

- independently develop a table and introduce a scheme for calculating the level of materiality.

According to the "materiality and audit risk" ISA 320 standard, the auditor must determine the level of materiality (either overall or by line item). Already at this stage, the question arises: to apply a general level of materiality or to determine the level of materiality for each item (groups of similar items) of the financial statements. We consider it necessary to provide a more complete classification of materiality in an audit:



Picture 1. Classification of materiality [2]

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General materiality is used to assess the reliability of accounting and reporting as a whole. Special materiality is used to assess the reliability of individual accounting segments and reporting items. The initial level of materiality is determined at the audit planning stage. The final level of materiality can only be determined as a result of a general assessment of all materials (evidence) collected by the auditor during the audit. However, to determine the final overall materiality, the auditor must take into account various aspects of materiality, including:

- compliance with formal legal requirements for documentation and accounting of significant business transactions and balance sheet items;

- compliance with legal requirements on the merits;

- absence of significant errors and inaccuracies in the reports submitted for confirmation;

- the presence or absence of significant information about the audited entity, which its administration did not disclose in the financial statements;

- the economic entity has significant uncertainties in the audited period, or after the reporting date, but before the date of the audit report [3].

Determining final specific materiality may involve several steps. The first step, of course, is to determine planned materiality. Some authors allow the use of not only a strictly quantitative assessment of materiality, but also the use of verbal definitions. In our opinion, the determination of materiality should always be made in quantitative terms. In this case, it is advisable to apply a preliminary judgment about materiality not only in general, but also to audit segments. The second stage is traditionally to clarify materiality based on an analysis of the results of the tests performed. At this stage there are several steps:

- assessment of errors in the segment and determination of the total error in the segment;

- comparison of a certain error in a segment with the planned level of materiality for the segment;

- making a decision on the level of materiality for a segment (leave it as planned or accept a new value).

Analysis and results

The auditor may also determine that additional evidence needs to be collected, which may result in these steps being repeated several times. This raises the question: what is all this for? Why evaluate and "re-evaluate" materiality?

On the one hand, audit risk is the risk of expressing an unreliable opinion on the financial statements in all material aspects. In other words, the risk of auditor error lies precisely in missing a material error. Thus, from the point of view of assessing audit risk, according to the author, the auditor faces the following tasks:

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- determine the size of the error in the financial statements, starting from which such an error becomes significant;

- divide the identified errors into single and repeating ones and conduct additional research for repeating errors below the established level of materiality in order to determine the cumulative impact of all errors of the same type on the financial statements;

- assess the relationship between materiality and audit risk. The solution to the last problem seems to be the most interesting and revealing.

As we have already noted, an increase in the level of materiality automatically leads to a decrease in audit risk, and vice versa, a decrease in the level of materiality leads to an increase in audit risk. This connection directly follows from the definition of audit risk, but does not fully reflect its essence.

As a result, an incorrectly determined level of materiality leads to an incorrect determination of audit risk. Moreover, this relationship is completely inapplicable when determining the business risk of an audit organization.

Discussion

Let's explain this more detail. Most of authors quite reasonably argue that audit risk is the basis of the business risk of an audit organization. Indeed, if the audit organization has conscientiously and efficiently checked the client's documents and reports and has indicated in written information all existing violations of the law, errors and inconsistencies, then the likelihood of the Client's claims against the audit organization being presented and subsequently satisfied is practically zero. In other words, if the audit risk is zero, then the business risk of the audit organization (in terms of professional activities) is zero[4].

However, upon closer examination, it turns out that the above audit risk for the accepted level of materiality may be practically equal to zero, and for another level of materiality it may turn out to be very large. As a result, the model of the relationship between the business risk of an audit organization and audit risk turns out to be inapplicable directly, without additional reservations about the level of materiality, the inclusion of which in this model is inappropriate due to the extreme complexity of the model.

Thus, in the author's opinion, we can only talk about the existing influence of audit risk on the business risk of the audit organization and the direction of such influence, but not about a specific quantitative influence. Thus, assessing materiality should not be an end in itself when conducting an audit - only general formalization and professional judgment are sufficient.

Basic indicators (criteria) for determining the level of materiality, as a rule, are:

- balance sheet currency;

- sales revenue;

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- cost;

- equity and other indicators.

Auditing organizations can establish their own specifics for determining the level of materiality. Moreover, these features may concern not only the development of one's own algorithm for calculating the level of materiality, but also the differentiation of this algorithm depending on the characteristics of economic entities. An important requirement of the Standard is the need to consolidate the methodology for determining materiality in the internal standards of the audit organization. Thus, it is quite logical to establish in internal auditing standards various methods for determining the level of materiality for various economic entities. This will allow, on the one hand, to increase the objectivity of the assessment of materiality, and, on the other hand, to reduce the risk of unfounded accusations against the audit organization from clients.

We would like to draw attention to the fact that the purpose of the materiality criterion is to help the auditor make a correct assessment of the acceptable level of materiality for a given client, and as a result, correctly express an opinion on the reliability of the audited statements. Therefore, even with the official internal establishment of the procedure for determining the level of materiality, it should be taken into account that such guidelines are approximate. They should not be considered the "ultimate truth" and the auditor should not neglect to consider errors that formally turned out to be below the established level of materiality.

Conclusion

Conversely, in some cases, the auditor may issue a positive opinion even if certain reporting indicators deviate from those considered correct by an amount greater than the planned level of special materiality. They should not be considered the "ultimate truth" and the auditor should not neglect to consider errors that formally turned out to be below the established level of materiality. Conversely, in some cases, the auditor may issue a positive opinion even if certain reporting indicators deviate from those considered correct by an amount greater than the planned level of special materiality.

1) Assessment of materiality based on reporting indicators, for example, (2% of revenue + 2% of cost + 5% of balance sheet currency) / 3.

2) Adopting a specific level of materiality based on the auditor's professional judgment and data on the economic entity for each item in the financial statements (which, in principle, corresponds to account balances and a number of account turnovers), as well as for individual account turnovers.

The use of this approach allows, on the one hand, to strictly comply with the requirements of the Standard (subject to appropriate documentation), and, on the other hand, does not require complex calculations. In this case, the value of special materiality, calculated either as a single indicator or by audit segments (which is more desirable), is a numerical value, and therefore can be used in modeling audit risk.

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