Issued 06/2024

AG ISA (NZ) 320

The Auditor-General's Statement on Materiality in Planning and Performing an Annual Audit

Controller and Auditor-General
Tumuaki o te Mana Arotake

Issued 06/2024

AG ISA (NZ) 320

The Auditor-General's Statement on Materiality in Planning and Performing an Annual Audit

Contents

Introduction

At a glance

The standard expands on the underlying standard ISA (NZ) 320 (XRB website) in that:

- you need to apply the Auditor-General's definition of "material" (see paragraph 5);
- you need to refer to the materiality considerations in other Auditor-General's Auditing Standards, where applicable;
- you need to use an appropriate materiality base depending on whether the public entity is a "public benefit entity" or a "for profit entity"; and
- you need to report all issues related to effectiveness and efficiency, compliance with laws and regulations, waste, and lack of probity or financial prudence to the Sector Manager (unless trivial or inconsequential).

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 the requirements of ISA (NZ) 320, in the context of the varying nature of public entities, 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 July 2024.

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.

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".

Definitions

5. For the purpose of this Auditor-General's Auditing Statement, the defined terms listed below have the following meanings:

Appointed Auditor

means the person or persons appointed by the Auditor-General to carry out the annual audit or other engagement on behalf of the Auditor-General, and who are supported by other members of the audit team. Where an Auditor-General's Statement or Standard expressly intends that a requirement be fulfilled by the Appointed Auditor personally, the requirement will indicate that the Appointed Auditor shall personally satisfy the requirement.

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* or NZ AS 1 (Revised): *The Audit of Service Performance Information* when this standard applies to the entity subject to audit from its commencement date.

(c) In considering the laws and regulations that apply to an entity, the Appointed Auditor shall take into account:

- The objectives of paragraph 8 of AG ISA (NZ) 250 (Revised);
- Planning advice and instructions from the OAG; and
- Advice received from the OAG about suspected instances of non-compliance.

(d) For expenditure authorised by an appropriation or other authority, the Appointed Auditor shall consider the application and other explanatory material in AG-2: *The Appropriation Audit and the Controller Function*.

Additional requirement to consider issues of effectiveness and efficiency, compliance with statutory obligations, 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, compliance with statutory obligations, waste, and a lack of probity or financial prudence when planning and performing the annual audit. The threshold for reporting to the Sector Manager at the OAG is that all issues shall be reported unless they are clearly trivial or inconsequential.

Appointed Auditors to comply with other OAG instructions on materiality

8. 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

9. 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. Where the entity is not an asset intensive entity, gross expenditure might be an appropriate base for determining the level of overall 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. (Ref: Paras A1 to A3)

Application and other explanatory material

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

A1. In the public sector there are some public benefit entities that own, and are responsible for maintaining the service potential of, significant assets that do not generate separate revenue streams but are essential for the provision of services provided by the public entity. These assets may include roads, water and sewerage infrastructure, or specialised buildings (such as hospitals). These assets are normally measured at their fair value, in accordance with the applicable financial reporting standard. The reported value of assets of this nature is often very large when compared to the other assets of the entity and to the entity's revenue and expenditure. Such public entities are often referred to as asset intensive entities.

A2. Users of the financial statements of asset intensive entities are, in most instances, interested in the delivery of services that are reflected in an entity's expenditure and associated service performance information. The approach normally used by auditors when determining the materiality of asset intensive entities is to establish one overall materiality for the financial statements as a whole, based on the value of the assets of the entity measured at fair value, and to establish lesser amounts than the overall materiality for the aspects of the entity's financial statements that could reasonably be expected to influence the decisions and assessments of users, in accordance with the definition of "material" in paragraph 5 of this Statement.

A3. This approach is consistent with the requirement of paragraph 10 of ISA (NZ) 320 and is appropriate when asset intensive entities measure their assets at fair value. Using materiality for the financial statements as a whole based on asset value means that the correct benchmark is used to determine if the carrying amount of the assets is likely to differ materially from the carrying amount reported at the previous reporting date. The likelihood of a material difference in the carrying amount of the assets would normally place an obligation on the entity to revalue its assets.