COLLEGE OF ACCOUNTING

AUDITING/CORPORATE GOVERNANCE | BASIC/INTERMEDIATE

Video Transcription: Materiality

Hi there, my name is Wayne and this video will explain the concept, "materiality".

So, what is materiality and when is it used in an audit? Materiality is used during the course of an audit when an auditor identifies a misstatement. A misstatement is considered to be material if it will affect how the users of the annual financial statements, such as banks or shareholders, view the annual financial statements. In other words, if a misstatement makes the users of the annual financial statements, view the annual financial statements in a more positive or a more negative light, then the misstatement is likely to be material. You can remind yourself what a misstatement is, by watching the video "What is a Misstatement?" by Sumaya West.

So, how is materiality applied once a misstatement has been identified? Once a misstatement has been identified, the auditor needs to consider quantitative materiality and qualitative materiality. Qualitative materiality refers to the nature of a misstatement. Quantitative materiality refers to the amount or value of a misstatement.

Let's first look at qualitative materiality. Qualitative materiality looks at the nature of a misstatement. This means that an auditor will determine if the nature of the misstatement that has happened, will affect the users of the annual financial statements without looking at the amount or value of the misstatement. For example, if an auditor detects that management of the company has committed fraud by stealing money, this will be material regardless of the amount of money that management has stolen. This will affect the users of the annual financial statements as they will probably doubt anything that management have prepared, such as the annual financial statements, as being true. Can you see? That the effect this has on the users has nothing to do with how much money was stolen, but rather the fact that management stole.

So, what is quantitative materiality? Quantitative materiality looks only at the value, or amount, of the misstatement that has been identified during the audit. Let's go back to our example of management committing fraud by stealing money. Let's imagine that the company being audited has millions of rands worth of sales. If management stole R1 000, do you think that this small amount would make a difference to how the users of the financial statements would view these statements? The amount, or value, of the misstatement is most likely not going to be considered quantitatively material. What if management stole R1000 000? Would this amount make a difference to how the users of the financial statements would view these statements? The value of this misstatement is most likely going to be considered quantitatively material.

Once an auditor has identified a misstatement, the auditor will consider both the qualitative and quantitative factors and then, based on both these factors, determine whether the misstatement is material.

So, does a misstatement have to be both quantitatively material and qualitatively material in order for us, as auditors, to mention the misstatement in our audit report? Not necessarily. A misstatement can be qualitatively material without being quantitatively material and it will be mentioned in the audit report; for example, management stealing money from the company regardless of the amount. A misstatement can be quantitatively material without be qualitatively material and it will be mentioned in the audit report. For example, a large enough mistake made by an employee that changes the annual financial statements. Or a misstatement that is both qualitative and quantitative will be mentioned in the audit report. For example management stealing and the amount stolen is a very large amount.

Thank you, and I hope this video helped you understand the concept of materiality.