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MATERIALITY IN AUDITING DEFINITIONS AND BENCHMARKS

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ABSTRACT

This paper fills the gap of establishing how audit materiality is being defined and benchmarked based on the analyses of comments submitted by seven international firms of accountants on the proposed revision of the International Standard of Auditing 320 on "Materiality in the Identification and Evaluation of Misstatements". The findings show that the respondents recommended the definition should be focused on the auditing perspective and include qualitative elements, and the benchmarks be expressed in a range rather than a specific percentage. The results have wide implications to the stakeholders in particular the audit profession, policy makers and regulators. The paper offers new impetus on ways forward for the audit profession on defining, defending and measuring materiality.

INTRODUCTION

In December 2004, the Auditing and Assurance Standards Board (AASB) issued an exposure draft (ED) that revised the content of Statement of the International Standard on Auditing (ISA 320) on "Materiality in the Identification and Evaluation of Misstatements". By late April 2005, the AASB has received comments from seven firms of accountants. The ED has defined materiality in the accounting, rather than auditing perspective and included a benchmark on measuring materiality. The accounting materiality focuses on how significant items should be separately disclosed in the financial statements while the audit materiality emphasizes the extent of items for verifications and disclosure. Though the emphasis of both the accounting and auditing approaches may seem dissimilar, both are intended for ensuring that significant items are properly and separately disclosed and verified enabling users to make rationale decisions.

This paper reviews commentaries received from the practitioners to gain insight on how does materiality is being defined and measured in the real world. This is due to both the management and auditors are not statutorily required to disclose how materiality is being determined and defined. In view of these comments were sent by head office of the respective firms, this reflects the concerns these firms have on this concept, importance of the issue and how materiality is being dealt with in the international perspective.

In the ED, it defines materiality as "omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken 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" (Para 7). This definition is an exact extraction from paragraph 6 of IAS 1 (Presentation of Financial Statements). Materiality is a concept that helps determine the level of significance of an item for audit verifications and separate disclosure in the financial statements. Failure to define and determine materiality means the auditors are exposed to audit risks and negligence, and eventually responsible for the financial demise. However, the auditors are not obliged to disclose how materiality is being determined or defined in their audit reports, thus making materiality a myth. There is no known literature that reports a systematic analysis of these comments and this paper fills the void.

Materiality is a subjective concept consisting of three elements. These are the quantitative benchmarks, qualitative variables and professional judgments. In determining the quantitative benchmark, an auditor may opt for a lower benchmark which equates to more samples are being selected for verifications, and may help reduce the audit risks for negligence; and more items are being disclosed separately in the financial statements enabling the stakeholders to make rationale decisions. A higher benchmark means a contra flow in the direction and possible audit implications. Too low a benchmark means that the auditor may need more time for verifications and add audit costs to the clients; too high a benchmark may reduce the sample size but an increase in the risk level. A balance needs to be struck between the extremes. Apart from quantitative benchmarks, the auditor needs to consider the qualitative variables. These include factors that may arise within or outside the organization that may impact upon the current and future performance of a client's operations and strategies. Extent of impact on materiality depends on characteristics of the client's business, its accounting policies and systems, and political and economic conditions that may affect its performance and activities. Before finalizing the decisions on materiality, the auditors may apply professional judgments to ensure that all material items are properly

verified and being disclosed separately in the financial statements. The auditors are constantly facing the challenge of defining materiality and determining specific benchmarks that fit to the audit situations.

An analysis of these comments enhances the users' understanding and appreciating of the challenges faced by the auditors in defining materiality and determining the benchmarks. Out of these seven comments, four were from each of the Big Four and the remaining three were from the second-tier firms. The findings show that the respondents want the ED to be redrafted to incorporate the auditing perspective of definition and consider the needs and expectations of the stakeholders. For the benchmarks, the respondents suggest that materiality should be based on a range, rather than a specific percentage of a particular variable. The ED should include examples of qualitative variables that may have audit implications. These comments have implications to the regulators, stakeholders and auditing profession worldwide.

BACKGROUND

Theoretical framework

Financial statements provide information that enables the stakeholders to make relevant decisions. It is essential that an organization provides appropriate, timely, accurate and quality information to the stakeholders. The stakeholder theory defines the constituency of an organization as `a person or group that can affect or is affected by the achievement of the organization's objectives' (Freeman, 1984, p46). While the theory intends to `broaden management's vision of its roles and responsibilities beyond the profit maximization functions to include interests and claims of non-stockholding groups' (Mitchell et al 1997, p855), it is essential that the organization and auditors provide relevant information, assurance and transparency in their activities to sustain the needed trust and confidence in exchange for long-term survival and success. For an organization, materiality benchmarks are intended for ensuring that the level of disclosing items in the financial statements is appropriate; while for the auditors, the benchmarks are useful for determining the extent of items be selected for verifications and disclosure. Failure to define what material is and set an appropriate benchmark could mean that items that are deemed significant are being omitted in the audit processes. This may lead to audit negligence and going concern of the auditees. Any financial demise will widen the existing gulf of trusts, relationships and confidence between the auditors, auditees and stakeholders. However, the definition and benchmarks for materiality remain vague and confusing to the users. This could be due to the intrigue nature of the concept and complexities of the different audit scenarios. To determine the materiality benchmarks, the auditors are expected to consider the quantitative benchmarks, qualitative variables and professional judgments. However, within the remit of professional judgments, there is a line of constraints where both the auditors and auditees need to observe the legitimacy limit.

Legitimacy is a `generalized perception or assumption that the actions of an entity are desirable, proper; or appropriate within some socially constructed system of norms, values beliefs, and definitions' (Suchman, 1995, p.574). This is the rights and obligations exercised by the legitimate individuals and entities based on the norms, beliefs, values, rules and regulations that have been practiced, recognized and accepted by the stakeholders. All the parties will achieve the needed legitimacy level or exercise their rights without undue hindrance or fear on conditions of the practices have a legitimate standing in a society (that is the stakeholders) or a legitimate rights of claims on an organization (that is the auditee) and its agents (that is the auditors). This closely-knitted triangular relationship between the auditors, auditees and stakeholders will continue until one of the parties, normally the

stakeholders, secure evidence of failure on the part of the others. The relationships break when the suffering party exercises the legitimate rights to press charges on the other parties for liabilities. This means that the auditors and auditees are under constant pressure ensuring that an appropriate and accurate level of material items are being verified and disclosed in the financial statements, and the statements show a true and fair view. Materiality becomes the norm for the auditors to determine items are properly sampled, verified and disclosed in the financial statements. There is a wide range of literature on materiality reflecting a concern expressed by the audit profession and inconsistencies in the definitions and benchmarks for materiality.

Literature review

This section intends to review the extant literature on materiality. The review is divided in two sections. First it looks at definitions of materiality and then how the benchmarks are being determined. Despite extensive search, there is a lack of supporting evidence on how materiality is being defined and benchmarked by the auditors that helps the users understand and appreciate challenges faced by the audit profession.

Definitions of materiality

Materiality has been described as the cornerstone of accountancy (Frishkoff, 1970) and the Achilles' heel of the accounting profession (O'Glove & Olstein, 1977). It is a psychological (Moonitz, 1961, p. 47), important (Study Group on Audit Technique, 1965), an unknown (Reiniaga, 1968), a mystery (Rose, Becker & Sorter, 1970), elusive (Pattillo, 1975; Lee, 1970), and an illusive (Barnes, 1976) concept. It is a subjective determination with no consensus (Siegel & Lebensbaum, 1975; Pattillo, 1976).This wide range of expressions reflects the concerns, a lack of general consensus, myths, confusions and ambiguity on the definition (Chong, 1992).

Early definitions on materiality are based on the accounting perspective. For example, Chetkovick (1955) considers materiality as `an accounting concept useful for separating those important from unimportant items', while Ghatalia (1984) refers it as `... what is important and what matters'. A much detailed definition is offered by Gordon (1933) who expresses materiality as `... a fact, the untrue statement or omission of which would be likely to affect the conduct of a reasonable man with reference to the acquisition, holding or disposal of the security in question.' This may be due to, at that time, the emphasis is for disclosing items in the financial statements rather than verification purposes. The standards setters remain silent until the Institute of Chartered Accountants in England and Wales (ICAEW) published its Statement No. V10 entitled `The interpretation of `material' in relation to accounts' in 1968. In it, materiality is defined as `an accounting threshold of an item that is considered non disclosure, misstatement or omission would be likely to distort the view given by the accounts or other statement under consideration' (paragraph 6). The emphasis remains on the accounting perspective. The ICAEW's definition has become the cornerstone for many other professional bodies including the Australian Accounting Research Foundation [1974], the Accounting Standard Board in New Zealand [1985] and Fijian Accounting Board [1985]. This definition does not differ from the earlier definitions by Gordon (1933) whereby materiality is important concept for determining disclosure of an item for rationale decision making processes (Chong [1992]). In fact, an accounting approach to materiality focuses on the extent of disclosing items in the financial statements while the auditing approach emphasizes on the extent of verifications and disclosures. Failure to establish an auditing materiality benchmark could lead to audit risks and negligence. The accounting and auditing definitions seem interchangeable. For example, in the

US, the concept has been defined by the FASB in Statement of Financial Accounting Concepts no 2 (FASB [1980]) and Auditing standards (SAS 47, 1984) as:

> `The omission or misstatement of an item is material in a financial report, if, in light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of an item.' (paragraph 132)

The SEC's approach to the definition is very much similar to the standards setters except it replaces the phrase `a reasonable person' by `an average prudent investor who ought to reasonably be informed about before purchasing the security registered.' The 2004 ED, however, relies on the International Accounting Standard 1 (Presentation of Financial Statements) which defines materiality as:

> `Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken 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.' (paragraph 6).

All these definitions merely focus on the accounting perspective of materiality. The IAS 1 has focused on considering the qualitative aspect of materiality, that is size and nature, but without offering much illustration. FASB (1975) offers a list of these variables that the auditors may need to be considered in the course of determining the benchmarks in Table 1 below. These variables should be incorporated in the ED as references to the auditors, auditees and stakeholders.

Appendix B of the Financial Accounting Standard Board's Discussion Memorandum [1975] on 'Criteria for determining materiality' listed the following quantitative and qualitative factors that help determine the benchmarks for materiality:

<u>DETERMINANT FACTORS</u>

- Dollar amount of the judgement item;
- Judgement item as a percentage of sales;
- Judgement item as a percentage of gross margin;
- Judgement item as a percentage of net income;
- Judgement item as a percentage of assets;
- Judgement item as a percentage of liabilities;
- Judgement item as a percentage of stockholder equity;
- Judgement item as a percentage of its account total (e.g. machinery);
- Judgement item as a percentage of its category total (e.g. plants);
- Judgement item as a percentage of its classification total (e.g. fixed assets).

<u>MODIFYING FACTORS</u>

<u>a. Characteristics of the environment</u>

- Political -- national and world;
- Economic -- national and world;
- Industry -- national and world;
- Firm's position in its industry;
- Business practices and customs;
- Regulatory requirements;
- Income tax considerations;

- Needs and expectations of users of financial statements; etc.

b. Characteristics of the firm
- Age and maturity of the firm;
- Capitalization structure;
- Seasonal nature of its operations;
- Competitive situation;
- Geographical dispersion of operations;
- Integrated nature of the operations;
- Diversity of suppliers and customers;
- Ownership interests and diversity;
- Costs of gathering and presenting data against relative benefits;
- Public image of the firm;
- Management's capabilities and public credibility;
- Liquidity -- short and long run;
- Solvency -- short and long run;
- Profitability -- trend of earnings;
- Profitability -- prospects for the future;
- Organisational structure; etc.

c. Characteristics of the event or judgement item
- Timing -- current effect or future effect;
- Timing -- one-time effect or continual effect;
- Result of discretionary or non-discretionary action of management;
- Result of temporary or permanent condition;
- Related party or arm's length transaction;
- Potential for violation of certain agreements;
- Potential for violation of certain laws;
- Result of mathematical error or actual event;
- Nature of the event or judgement item;
- Potential for management of earnings;
- Relationship to normal operations;
- Certainty with respect to ultimate realisation of assets or liquidation of liabilities;
- Effect of the existence of other similar judgement items;
- Effect of the existence of other dissimilar judgement items; etc.

d. Characteristics of the accounting system or policies in use
- Selection of 'liberal' or 'conservative accounting policies;
- Extent of variation from generally accepted accounting principles;
- Extent of variation from accepted industry practice;
- Consistency of application of policies;
- Comparability of resulting information;
- Effects of subsequent events;
- Extent and specificity of disclosure of accounting policies in use; etc.

Table 1: Qualitative factors of materiality

In a review on legal decisions by UK judges on 28 cases (the remaining 287 cases do not contain financial details on how the decisions were made) that were recorded in the British Companies Cases (BCC) for the period 1990-1992, Chong and Vinten (1994) conclude that judges determined the definitions on materiality based on `their whim and fancy' due to the existing audit definitions are vague, confusing and ambiguous (p255). They suggest that there is an urgent need for the audit standards setters to lead, review and formulate a definition that is deemed appropriate for the audit profession rather than letting the definition be determined by the courts and legal profession. Turley and Cooper (1991) survey the audit manuals of 20 UK accounting firms (including all the then Big Eight) on how materiality is being defined. They conclude that 15 of these include `truth and fairness' while 17 emphasize on `meeting the needs of the users and decision makers' in their definitions. This disarray of definitions reflects a lack of a standardized definition acceptable by the firms. Without a proper and reliable roadmap on the definition, firms define the concept based on their own audit approaches and cultures (Carpenter, Dirsmith & Gupta, 1994). The confusions and myth of how materiality is being defined and determined will continue until it is being defined properly by a standards setter. Thus, the following hypothesis is formulated:

Hypothesis$_1$: there is a need for a separate accounting and auditing definition on materiality.

Materiality benchmarks

There is no known benchmark that fits for all the audit situations. Extensive prior research on how materiality should be defined has been carried out. Holstrum and Messier (1982) classify these researches based on approaches adopted by the researchers. These are the archival and empirical approaches. For an archival approach, the researchers use published data to determine responsiveness of the financial statements' users arising from disclosing or non-disclosing of items in the financial statements. For the empirical approach, interviews and questionnaires containing hypothetical cases were sent to the respondents. The results reveal that respondents use a wide range of benchmarks but 10-15 percent of net profit before tax seems to be the favorite determinant (e.g. Bernstein [1969, 1970]; Copeland and Fredericks [1968]; Neumann [1968]; Frishkoff [1970]; Messere [1976]; Thomas [1978]; Robinson and Fertuck [1985]). This means that an item (i) is considered immaterial if it is less than 10% of net profits; (ii) is subject to judgmental decisions if it lies between 10 and 15% of net profits; and (iii) is considered material if it is 15% or more of the net profits. Turley and Cooper's (1991) survey on audit manuals of twenty UK audit firms conclude that firms use a wide range of benchmarks including turnover, net profits and net assets; and reveals that firms judge materiality if an item has exceed one of the criteria of 2% of turnover, 25% of net profit before tax and 3.3% of net assets (p.80). This shows a discrepancy between the literature and practice. This confusion remains including the US standard setters. Nelson, Smith and Palmrose (2005) conclude that the standards setters have not promulgated quantitative materiality guides, methods, or criteria that preparers and auditors could look to for authoritative support (p.898). Although benchmarks such as five to ten percent of net income have long been used in practice (Pattillo 1976), the U.S. Supreme Court ruled in TSC v. Northway (426 U.S. 438, 449) that materiality should be determined with respect to the total mix of available information, and a guidance from the SEC (SAB No. 99) and ASB (AU Sec. 312) emphasize the importance of both qualitative and quantitative materiality dimensions. As indicated in SAB No. 99 by `quantifying, in percentage terms, the magnitude of a misstatement is only the beginning of an analysis of materiality; it cannot appropriately be used as a substitute for a full analysis of all relevant considerations' (SEC 1999, p2). There is no known idea of how materiality is being benchmarked in practice. Nonetheless, the Australian and New Zealand Accounting

bodies issued detailed materiality benchmarks as `an item is (a) considered material if it is >10% of the appropriate base; (b) considered immaterial if it is <5% of the appropriate base amount; and (c) subject to judgmental decisions if it lies between 5-10% of the appropriate base amount. Appropriate base means (a) for errors in profit and loss accounts, compare them with (i) the operating profit for the current year or (ii) average operating profits for the last 5 years, whichever is relevant, (b) for errors in balance sheet, use the lower of (i) total share capital plus reserves and (ii) appropriate balance sheet class total. This is a valuable guideline for the profession to streamline the judgmental decisions on materiality. In Scotland, the Research and Publications Committee of the Institute of Chartered Accountants of Scotland (I.C.A.S.) suggests that (a) for a profit and loss item, it is considered material if it exceeds 10% standard net profits, (b) for a statutorily-required disclosure profit-and-loss item, it is considered material if it exceeds (i) 5% of total expenses for an expense item or (ii) 5% of total income for an income item, and (c) for a balance sheet item, it is considered material if it exceeds (i) 5% of total assets or (ii) 10% of the balance sheet caption. A standard profit is defined as the average profits before tax for the preceding five years, but in a loss-making year or if the client has an abnormally low profit for a number of years, then the standard profits should be based on the profit trend of the industry as a whole. Again, the definition on standard profit for the industry is subject to abuse and interpretations due to different firms may use different accounting policies in calculating profits. The predominating benchmarks remain at 5-10% of net profit before tax. Therefore, the following hypothesis is formulated:
Hypothesis$_2$: Materiality thresholds are 5-10% of the standardized net profit

RESEARCH METHOD AND ANALSIS

Procedures

The AASB issued an ED on audit materiality in December 2004 and solicited for comments on its content. At the closing date on April 30 2005, the AASB received seven comments from firms of accountants. These comments were posted on the AASB's website and accessible by the public. The comments are from the Big Four, these are Deloitte and Touche (DT), Ernst and Young (EY), KPMG and PricewaterhouseCooper (PWC) and second-tier firms, and these are Grant Thornton (GT), Howarth International (HI) and PKF. In the analysis, no specific weighting is being placed on the length, style and fashion of the comments or whether the comment is from a Big Four or non-Big Four. The purpose is to gain understandings on how the audit firms define and benchmark materiality. All the comments come from either the head office or technical office of the respective firms. This lends supports on the weighting and standpoints of the firms' audit approaches to materiality.

Definitions of materiality

The ED stipulates that `materiality can be defined as omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken 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." (paragraph 6) Even though EY offers an alternate definition on materiality as `a misstatement or the aggregate of misstatements in financial statements is considered to be material if, in the light of surrounding circumstances, it is probable that the decision of a person who is relying on the financial statements, and who has a reasonable knowledge of business and economic activities (the user), would be changed or influenced by such misstatement or the aggregate of all misstatements.' This definition does not differ from the ED's despite EY's definition focuses on misstatements rather than omissions of items. However, PWC offers a wider

perspective on the definition of materiality that includes both misstatements and omissions in the sense that "a misstatement is a difference between an amount, classification, or presentation of a reported financial statement item and the amount, classification, or presentation that is required for the item to be in accordance with the applicable financial reporting framework. A misstatement can arise from error or fraud. Examples of misstatements include may consist of (a) an inaccuracy in gathering or processing data from which financial statements are prepared, (b) a difference between the amount, classification, or presentation of reported financial statement item and the amount, classification, or presentation that is required for the item to be in accordance with the applicable financial reporting framework, (c) an omission of an amount or disclosure that is required by the applicable financial reporting framework, or is otherwise needed for the fair presentation of the financial statements, (d) an incorrect accounting estimate arising, for example, from an oversight or misinterpretation of facts and (e) differences between management's and the auditor's judgments concerning accounting estimates, or the selection and application of accounting policies that the auditor considers inappropriate." These two commentators offer a clearer direction on misstatements and omissions that may lead to unfair presentations on the financial positions of the clients and much in line with Turley and Cooper's (1991) study of audit manuals that materiality is the tool for the audit firms to `meet the needs of the users and decision makers' and four firms (DT, EY, HI and PWC) suggest that the definition should include the benchmarks and qualitative aspects of materiality, rather than just the benchmark. This is true in situations where the amount of an item or the aggregate of which, may not be material but the implications could be serious to cause the auditee facing penalties or even going concern. For example, a small amount of legal fee paid for the penalty imposed on non-compliance to regulations could, due to its nature, cause risk to both the auditee and the auditors. The auditee may face penalties and worst insolvency, while the auditors face litigations and bad reputation. The impact is serious as this may have domino results on the profession as a whole. All the respondents suggest the ED to be redrafted and include the auditing perspective of defining materiality rather than based on the accounting approach on defining materiality. In view of this, **$H_{1:}$ is supported, that is the definition for materiality in the ED is ambiguous.** The ED should revamp its definition to incorporate both the qualitative and quantitative aspects of materiality and focus on auditing perspective.

Benchmarks

The ED suggests that materiality should be measured as `(a) for a profit oriented entity, five percent of profit before tax from continuing operations, or one half of one percent of total revenues, (b) for a not-for-profit entity, one half of one percent of total expenses or total revenues, (c) for an entity in the mutual fund industry, one half of one percent of net asset value. The auditor may consider higher or lower percentages than those illustrated above to be appropriate.' (paragraph 14). While the ED emphasizes that these benchmarks are for illustrative purposes, all the seven firms welcomed these benchmarks and suggested that materiality should be expressed in a range, rather than on a specific percentage to cater for different audit scenarios. For example, DT suggests that (a) for a profit oriented entity, five to ten percent of profit before tax from continuing operations, or one half of one percent to three percent of total revenues; (b) for a not-for-profit entity, one half of one percent to three percent of total expenses or total revenues, while (c) an entity in the mutual fund industry, one half of one percent to two percent of net asset value. This shows that net profit remains the main determinant for materiality benchmarks and the range remains to be 5-10%. DT comments that although the benchmarks may be used by the auditor as a guide to determine materiality, the auditor uses professional judgments in the audit processes. All the seven

respondents in particular GT emphasizes that `these benchmarks are provided for the purpose of providing illustrative examples and are not required to be applied by the auditor.' KPMG commented that while the benchmarks are useful, `for an entity in the mutual fund industry, asset based entity, one half of the assets should be used'. All the respondents conclude that the benchmarks should not be applied in a formulaic manner without professional judgments due to nature and circumstances of the audits and clients' industries, and if these benchmarks are to be included in the ED, they should be inserted in the appendix to avoid confusions to users. In view of the sentiments, **H_2 is rejected** due to materiality benchmarks should not be based solely on a specific percentage of a particular variable, but a range of percentages using a number of variables. All the comments suggest that the benchmarks be included in the appendix instead of in the body of the ED. This could help avoid misunderstandings that the benchmarks are mandatory for conformation by all concerns.

CONCLUSIONS AND RECOMMENDATIONS

The ED on materiality is a useful guide to the audit firms, auditees and users. The continuing interactions between the three parties should continue and the practices on how materiality defined and benchmarked should be made clear to all the parties. All the seven comments from the firms of accountants give a useful insights on (a) the definition of materiality needs to include both the quantitative and qualitative aspects, (b) the current definition needs to focus on the auditing rather than accounting perspective and (c) the benchmarks, even though they are meant to be illustrative, should be expressed in a range of percentages rather than a specific cut off point. The ranges suggested by the commentators are 5-10% of net profit before tax, while the mutual funds should be based on 0.5% of net asset value.

The analyses help contribute to the literature and users on how materiality is being defined and determined by the auditors. Materiality is a myth due to the stakeholders due to complexities of the clients' business activities, audit scenarios and possible audit implications. While it is not statutorily required to publish materiality benchmarks in the accounting policies and audit reports, the comments have given the opportunity to the stakeholders to understand the challenges faced by the auditing profession. These comments are useful reference to ensure that the standards setters set a clear and well-defined definition and benchmark for the profession.

Similar to all other research, this research suffers from the shortcomings of basing the commentaries received by the AASB. There are many silent individuals who may have better suggestions on the way forward including disclosing the audit benchmarks in the audit reports and accounting policies to help stakeholders in the decision making process (Chong & Vinten, 1994). However, this may have limited usefulness unless the stakeholders fully understand the implications and reasons for the additional disclosure. The standard setters may consider requiring the auditors to communicate with the audit committees on the materiality approach applied and the implications of this application. Another suggestion is the standards setters to mandate use of only one materiality approach for all the audit situations. Deviations from the suggested set of benchmarks deserve a separate disclosure in the footnote and audit report. However, given that the comments and past research have yield so many conflicting results, this approach will be a challenge for the standards setters to convince all the players to agree upon a set of specific benchmarks. Additional disclosure in the footnote and audit report may jeopardize the focus of the shareholders when interpreting the financial performance of the auditees. It should be made clear that this paper does not intend to address whether the individual commentators have actually complied with what they have suggested in their comments. Firms may react differently in the real-life situations

as these would involve their reputations, quality of audit, nature of the clients' business activities and many other qualitative issues. Future research could include an evaluation of what and why certain comments were taken on board by the ED. To help unravel the mystical aspect of materiality, future research may include conducting questionnaires surveys and interviews with those commentators and the other stake-players within and outside the audit profession. Materiality remains a mystery concept and is worth further research.

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