The Percentage That Never Changes

Materiality is taught as a calculation. It is actually the most consequential judgement in the entire audit — and it has quietly atrophied into a template.

The Number That Gets Set Once and Never Questioned Again

Ask a room full of audit professionals how materiality is determined, and most will describe a calculation. A percentage — 5% of Profit Before Tax, 1% of revenue, 2% of net assets, depending on the benchmark selected — applied to arrive at a number. That number becomes the threshold against which everything else in the engagement is measured.

The calculation itself is not the problem. SA 320 requires a benchmark and a percentage, and using one is entirely appropriate. The problem is what happens before and after the calculation — the judgement that is supposed to surround the number, and that in practice has quietly disappeared from a significant proportion of audit files.

Before the calculation: which benchmark actually reflects what matters to this entity's users, and why? After the calculation: does this number, once applied, still make sense given everything the auditor has learned about the entity since planning began?

In many files, neither question is genuinely asked. The benchmark is selected because it was used last year. The percentage is applied because it falls within the range the firm's methodology permits. The number is calculated once, at planning, and then largely forgotten — a fixed threshold sitting quietly in the background while the actual audit work proceeds around it.

> Consistency in materiality percentages across a firm's entire client portfolio is not evidence of a robust methodology. It is evidence that judgement has been replaced by a default.

Why the Same Percentage Across Every Entity Is Itself a Red Flag

Materiality is, at its core, a judgement about what would change a user's economic decisions. That means it should look different for different entities, because different entities have different users with different concerns.

The Leveraged Entity

Users are lenders whose decisions are acutely sensitive to movements in the specific line items the debt covenant is calculated against. A standard percentage of Profit Before Tax may miss the covenant sensitivity entirely.

The Newly Listed Company

Users are new retail investors with limited sophistication in interpreting financial statements — correspondingly less tolerance for misstatements that would alter their basic understanding of the company's trajectory.

The Pre-Revenue Technology Company

Users are focused overwhelmingly on cash runway and burn rate. A materiality benchmark based on Profit Before Tax may be almost entirely irrelevant, since the entity has no meaningful profit to benchmark against.

When the same percentage, applied to the same benchmark, appears across an auditor's entire portfolio of clients regardless of these differences, that consistency is not evidence of a robust methodology. It is evidence that the judgement SA 320 requires has been replaced by a default that travels from file to file, undisturbed by what actually makes each entity distinct.

What SA 320 Actually Asks For & Performance Materiality

What SA 320 Actually Asks For

SA 320 requires materiality to be determined with reference to the financial reporting needs of users as a group, based on the auditor's understanding of the entity and its environment. That understanding is meant to inform both the benchmark selected and the percentage applied to it.

Where Profit Before Tax is volatile or not representative of the entity's underlying performance — as is common for entities with significant one-off items, or those recently through a restructuring — a different benchmark, such as revenue or total assets, may better reflect what users actually rely on. Where the entity has multiple classes of users with materially different interests, the auditor's determination should reflect the users whose decisions the financial statements are primarily prepared to serve, understanding that different classes of users might reasonably reach different judgements about what is material.

None of this can be answered by consulting a firm-wide default. It requires the auditor to have genuinely engaged with who relies on this entity's financial statements, and why.

Performance Materiality — The Discipline Within the Discipline

SA 320 also requires the auditor to determine Performance Materiality — an amount set below overall materiality specifically to reduce, to an appropriately low level, the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.

This second calculation is frequently even more mechanical than the first. Many firms apply a standard percentage of overall materiality — commonly somewhere between 50% and 75% — without genuine consideration of the entity-specific factors SA 320 identifies as relevant: the nature and extent of misstatements identified in prior audits, the auditor's understanding of the entity gained during planning, and the effectiveness of the entity's control environment.

An entity with a history of accumulating small misstatements across multiple accounts — none individually material, but collectively significant when aggregated — warrants a Performance Materiality set more conservatively than an entity with a strong control environment and a clean history. Applying the same standard percentage regardless of this history treats Performance Materiality as a mechanical output of overall materiality, rather than as the separate, entity-specific judgement the standard actually requires.

Where the Mechanical Threshold Does Its Real Damage: Misstatement Evaluation

The consequence of a materiality threshold that was never genuinely reasoned about becomes visible not at planning, but at the conclusion of the audit — in how identified misstatements are evaluated.

SA 450 requires the auditor to accumulate misstatements identified during the audit, other than those that are clearly trivial, and to evaluate whether uncorrected misstatements are material, individually or in aggregate. That second word — aggregate — is where the mechanical threshold does its quiet damage.

A materiality threshold that was set as a default, without genuine consideration of what matters to this entity's users, provides no real anchor for judging whether an accumulation of individually small misstatements has crossed into territory that would actually change a user's decision. The auditor logs each misstatement, notes that it falls below the numerical threshold, and carries it forward — repeating this process across a schedule of adjustments that, examined individually, never trips the threshold, but that, examined together, may tell a materially different story about the entity's financial position than the one the financial statements present.

> ***This is precisely the 'individually immaterial but collectively material' pattern that SA 450 exists to catch — and precisely the pattern that a mechanically applied materiality threshold is least equipped to identify.***

The Qualitative Dimension That the Calculation Cannot Capture

SA 450 also requires the auditor to consider not only the size of a misstatement but its nature. A misstatement that is quantitatively small may nonetheless be qualitatively material — because it affects compliance with a debt covenant, because it relates to a matter that would attract particular regulatory scrutiny, because it masks a change in a trend that users would otherwise find significant, or because it results from fraud rather than error, regardless of the amount involved.

A file that documents each misstatement against the numerical threshold, without a parallel documented consideration of its qualitative significance, has completed the arithmetic exercise SA 450 requires without engaging the judgement it actually demands. Inspection findings across jurisdictions consistently identify this gap: quantitative aggregation performed diligently, qualitative assessment addressed briefly or not at all.

What a Genuinely Reasoned Materiality Determination Looks Like

Three Characteristics of a Genuine Determination

A materiality determination that reflects the judgement SA 320 requires, rather than a default applied mechanically, is visible in three specific characteristics.

Contextual Benchmark Selection

The benchmark is clearly documented around this entity's specific users and circumstances — not simply stated as the firm's standard approach. Where an unusual benchmark is more appropriate than the conventional one, the file explains why.

Risk-Adjusted Percentages

The percentage applied within the benchmark is explicitly calibrated to entity-specific risk factors — control environment quality, misstatement history, and benchmark stability — rather than a fixed point in the firm's permitted range applied by default.

Continuous Revision

SA 320 requires materiality to be revised if the auditor becomes aware of information that would have led to a different determination had it been known at the outset. Active evidence exists that the threshold was revisited as new audit findings emerged.

The Diagnostic Question

For any engagement, one question tests whether materiality has been genuinely determined or simply calculated:

> ***If I described this entity — its users, its specific risks, its history, what actually matters to the people relying on these financial statements — to someone who had never seen the materiality workpaper, would they reasonably expect the number I have arrived at, or would they expect something meaningfully different?***

If the honest answer is that the number could belong to almost any entity of similar size, the calculation has been performed. The judgement has not.

Materiality is not a percentage. It is a considered view of what would actually matter to the people this audit exists to serve. When that view has been replaced by a default, everything built on top of it — including the evaluation of every misstatement identified for the rest of the engagement — inherits the same absence of genuine judgement.

The percentage that never changes is rarely a sign of a well-calibrated methodology.

It is usually a sign that no one asked the question the standard actually requires.

CA Pranav Jain, FCA | Co-Founder, Anveshana Consulting Private Limited | anveshana@anveshanaconsulting.com — This article is part of Anveshana's Audit Quality Insights series.