Agenda Item 1B

Proposed Amendments†

AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with GAAS*

Definitions

.14 For purposes of GAAS, the following terms have the meanings attributed as follows:

…

(f) Financial statements – A structured representation of historical financial information, including ~~related notes~~ ***disclosures***, intended to communicate an entity's economic resources or obligations at a point in time***,*** or the changes therein for a period of time***,*** in accordance with a financial reporting framework. ~~The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information.~~ The term "financial statements" ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement. ***Disclosures comprise explanatory or descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement, or in the notes.***

† This proposed Amendments uses certain International Federation of Accountants (IFAC) copyright material, used with the permission of IFAC.

AU-C Section 210, *Terms of Engagements*

Requirements

[NO CHANGE TO THE REQUIREMENTS]
***

Application and Other Explanatory Material

…

Preconditions for an Audit

…

Agreement of the Responsibilities of Management (Ref: Par. .06(b))

A9. An audit in accordance with GAAS is conducted on the premise that management has acknowledged and understands that it has the responsibilities set out in paragraph 6(b). [fn 5] The auditor may assist in preparing the financial statements, in whole or in part, based on information provided to the auditor by management during the performance of the audit. [fn *] However, the concept of an independent audit requires that the auditor's role does not involve assuming management's responsibility for the preparation and fair presentation of the financial statements or assuming responsibility for the entity's related internal control and that the auditor has a reasonable expectation of obtaining the information necessary for the audit ***(including information obtained from outside of the general and subsidiary ledgers)*** in so far as management is able to provide or procure it. Accordingly, the premise is fundamental to the conduct of an independent audit. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and recording the terms of the audit engagement in paragraphs .09–.10..

…

Agreement on Audit Engagement Terms

…

Audit Engagement Letter or Other Form of Written Agreement[10] (Ref: Para. 10)

…

Form and Content of the Audit Engagement Letter

.A23 The form and content of the audit engagement letter may vary for each entity. Information included in the audit engagement letter on the auditor's responsibilities may be based on section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. [fn 11] Paragraph *.06b* of this section addresses the description of the responsibilities of management. In addition to including the matters required by paragraph .10, an audit engagement letter may make reference to, for example, the following:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, GAAS, and ethical and other pronouncements of professional bodies to which the auditor adheres

---

[fn 11] ***Paragraphs .04–.10*** of section 200.

- The form of any other communication of results of the audit engagement

- Arrangements regarding the planning and performance of the audit, including the composition of the audit team

- The expectation that management will provide written representations (see also paragraph .A11)

- ***The expectation that management will provide access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, including an expectation that management will provide access to information relevant to disclosures***

- The agreement of management to make available to the auditor draft financial statements ~~and any other accompanying other information~~, ***including all information relevant to their preparation and fair presentation, whether obtained from within or outside of the general and subsidiary ledgers (including all information relevant to the preparation and fair presentation of disclosures), and the other information,[1] if any,*** in time to allow the auditor to complete the audit in accordance with the proposed timetable

- The agreement of management to inform the auditor of events occurring or facts discovered subsequent to the date of the financial statements, of which management may become aware, that may affect the financial statements

- The basis on which fees are computed and any billing arrangements

- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein, as may be evidenced by their signature on the engagement letter

[1] ***As defined in AU-C section 720, The Auditor's Responsibilities Relating to Other Information***

AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*

Requirements

Discussion among the Engagement Team

15. Section 315 requires a discussion among the key engagement team members, including the engagement partner, and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion. [fn 4] This discussion should include an exchange of ideas or brainstorming among the engagement team members about how and where the entity's financial statements ***(including the individual statements and the disclosures)*** might be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated. The discussion should occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity, and should, in particular, also address (Ref: par. .A12–.A13)

***

Application and Other Explanatory Material

…

Characteristics of Fraud (Ref: Para. 3)

A6. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as ~~the following~~ ***intentionally***:

- Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives
- Inappropriately adjusting assumptions and changing judgments used to estimate account balances
- Omitting, advancing, or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period
- ***Omitting, obscuring or misstating disclosures required by the applicable financial reporting framework, or disclosures that are necessary to achieve fair presentation.***
- Concealing~~, or not disclosing,~~ facts that could affect the amounts recorded in the financial statements.
- Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity
- Altering records and terms related to significant and unusual transactions

…

Discussion among the Engagement Team (Ref: Para. 15)

A13. The discussion may lead to a thorough probing of the issues, acquiring of additional evidence as necessary, and consulting with other team members and, if appropriate, specialists in or outside the firm. The discussion may include the following matters:

- ***A consideration of the risk that management may attempt to present disclosures in a manner that may obscure a proper understanding of the matters disclosed (for example by using unclear or ambiguous language).***
- A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation
- A consideration of any unusual or unexplained changes in behavior or lifestyle of management or employees that have come to the attention of the engagement team
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud
- A consideration of how an element of unpredictability will be incorporated into the nature, timing, and extent of the audit procedures to be performed
- A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity's financial statements to material misstatement due to fraud and whether certain types of audit procedures are more effective than others
- A consideration of any allegations of fraud that have come to the auditor's attention

AU-C Section 260, *The Auditor's Communication with Those Charged with Governance*

Requirements

[NO CHANGE TO THE REQUIREMENTS]

***

Application and Other Explanatory Material

…

Planned Scope and Timing of the Audit (Ref: Par. 11)

A18. Care is ***necessary*** ~~required~~ when communicating with those charged with governance about the planned scope and timing of the audit so as not to compromise the effectiveness of the audit, particularly where some or all of those charged with governance are involved in managing the entity. For example, communicating the nature and timing of detailed audit procedures may reduce the effectiveness of those procedures by making them too predictable. Certain factors described in paragraph .A39 may be relevant in determining the nature and extent of this communication.

...

.A20 Matters communicated may include the following:

- How the auditor proposes to address the significant risks of material misstatement, whether due to fraud or error
- The auditor's approach to internal control relevant to the audit including, when applicable, whether the auditor will express an opinion on the effectiveness of internal control over financial reporting
- The application of materiality in the context of an audit, as discussed in section 320, *Materiality in Planning and Performing an Audit*
- ***The auditor's planned approach to addressing the implications on the individual statements and the disclosures of any significant changes within the applicable financial reporting framework or in the entity's environment, financial condition or activities.***
- If the entity has an internal audit function, how the auditor and the internal auditors can work together in a constructive and complementary manner, including any planned use of the work of the internal audit function in obtaining audit evidence and the nature and extent of any planned use of internal auditors to provide direct assistance.

A21. Other planning matters that it may be appropriate to discuss with those charged with governance include:

- the views of those charged with governance about the following matters:

  — The appropriate person(s) in the entity's governance structure with whom to communicate

— The allocation of responsibilities between those charged with governance and management

— The entity's objectives and strategies and the related business risks that may result in material misstatements

— Matters those charged with governance consider as warranting particular attention during the audit and any areas for which they request additional procedures to be undertaken

— Significant communications ***between the entity and*** ~~with~~ regulators.

— Other matters those charged with governance believe are relevant to the audit of the financial statements

- the attitudes, awareness, and actions of those charged with governance concerning (a) the entity's internal control and its importance in the entity, including how those charged with governance oversee the effectiveness of internal control, and (b) the detection or the possibility of fraud.
- the actions of those charged with governance in response to developments in law, accounting standards, corporate governance practices, and other related matters.

- the actions of those charged with governance in response to developments in accounting standards, corporate governance practices, exchange listing rules, and related matters***, and the effect of such developments on, for example, the overall presentation, structure and content of the financial statements, including:***

  — ***The relevance, reliability, comparability and understandability of the information presented in the financial statements; and***

  — ***Considering whether the financial statements are undermined by the inclusion of information that is not relevant or that obscures a proper understanding of the matters disclosed***.

- the actions of those charged with governance in response to previous communications with the auditor.

A18. Care is ***necessary*** ~~required~~ when communicating with those charged with governance about the planned scope and timing of the audit so as not to compromise the effectiveness of the audit, particularly where some or all of those charged with governance are involved in managing the entity. For example, communicating the nature and timing of detailed audit procedures may reduce the effectiveness of those procedures by making them too predictable. Certain factors described in paragraph .A39 may be relevant in determining the nature and extent of this communication.

Qualitative Aspects of the Entity's Significant Accounting Practices (Ref: Para. 12(a))

...

.A24 Financial reporting frameworks ordinarily allow for the entity to make accounting estimates and judgments about accounting policies and financial statement disclosures. Open and constructive communication about qualitative aspects of the entity's significant accounting practices may include comment on the acceptability of significant accounting practices ***and the quality of the disclosures***. The appendix, "Qualitative Aspects of Accounting Practices," identifies matters that may be included in this communication.

AU-C Section 300, *Planning an Audit*

Requirements

[NO CHANGE TO THE REQUIREMENTS]

…

***

Application and Other Explanatory Material

Planning Activities

…

The Audit Plan (Ref: Para. 9)

***A14a. Determining the nature, timing and extent of planned risk assessment procedures, and the further audit procedures, as they relate to disclosures is important in light of both the wide range of information and the level of detail that may be encompassed in those disclosures. Further, certain disclosures may contain information that is obtained from outside of the general and subsidiary ledgers, which may also affect the assessed risks and the nature, timing and extent of audit procedures to address them.*[*]**

A14b. Consideration of disclosures early in the audit assists the auditor in giving appropriate attention to, and planning adequate time for, addressing disclosures in the same way as classes of transactions, events and account balances are addressed. Early consideration may also help the auditor to determine the effects on the audit of:

- ***Significant new or revised disclosures required as a result of changes in the entity's environment, financial condition or activities (for example, ~~a change in the required identification of segments and reporting of segment information arising from~~ disclosures about discontinued operations or a significant business combination);***
- ***Significant new or revised disclosures arising from changes in the applicable financial reporting framework;***
- ***The need for the involvement of an auditor's expert to assist with audit procedures related to particular disclosures (for example, disclosures related to pension or other retirement benefit obligations); and***
- ***Matters relating to disclosures that the auditor may wish to discuss with those charged with governance.***[2]

Appendix

(Ref: Para. 7–8, A9–A12)

…

Significant Factors, Preliminary Engagement Activities, and Knowledge Gained on Other Engagements

---

[*] When the final standard is issued, this paragraph will become paragraph ~~A13~~ A15 and all subsequent paragraphs will be renumbered accordingly.

[2] ***AU-C 260, The Auditor's Communication with Those Charged with Governance, paragraph A13***

Significant Factors, Preliminary Engagement Activities, and Knowledge Gained on Other Engagements

The following examples illustrate significant factors, preliminary engagement activities, and knowledge gained on other engagements:

- The determination of materiality, in accordance with section 320, *Materiality in Planning and Performing an Audit*, and, when applicable, the following:
    - — The determination of materiality for components and communication thereof to component auditors in accordance with section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*
    - — The preliminary identification of significant components and material classes of transactions, account balances, and disclosures
- Preliminary identification of areas in which there may be a higher risk of material misstatement
- The effect of the assessed risk of material misstatement at the overall financial statement level on direction, supervision, and review
- The manner in which the auditor emphasizes to engagement team members the need to maintain a questioning mind and exercise professional skepticism in gathering and evaluating audit evidence
- Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them
- The discussion of matters that may affect the audit with firm personnel responsible for performing other services to the entity
- Evidence of management's commitment to the design, implementation, and maintenance of sound internal control, including evidence of appropriate documentation of such internal control
- ***Changes within the applicable financial reporting framework, such as changes in accounting standards, which may involve significant new or revised disclosures.***
- Volume of transactions, which may determine whether it is more efficient for the auditor to rely on internal control
- Importance attached to internal control throughout the entity to the successful operation of the business
- ***The process(es) management uses to identify and prepare the disclosures required by the applicable financial reporting framework, including disclosures containing information that is obtained from outside of the general and subsidiary ledgers.***

- Significant business developments affecting the entity, including changes in IT and business processes; changes in key management; and acquisitions, mergers, and divestments

- Significant industry developments, such as changes in industry regulations and new reporting requirements

- ~~Significant changes in the financial reporting framework, such as changes in accounting standards.~~

- Other significant relevant developments, such as changes in the legal environment affecting the entity

AU-C Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*

Requirements

…

The Required Understanding of the Entity and Its Environment, Including the Entity's Internal Control

The Entity and Its Environment

…

The Entity's Internal Control

Components of Internal Control

…

.19 *The information system, including the related business processes, relevant to financial reporting, and communication.* The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following areas:

a. The classes of transactions in the entity's operations that are significant to the financial statements.

b. The procedures within both IT and manual systems by which those transactions are initiated, authorized, recorded, processed, corrected as necessary, transferred to the general ledger, and reported in the financial statements.

c. The related accounting records supporting information and specific accounts in the financial statements that are used to initiate, authorize, record, process, and report transactions. This includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form.

d. How the information system captures events and conditions, other than transactions, that are significant to the financial statements.

e. The financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures.

f. Controls surrounding journal entries, including nonstandard journal entries used to record nonrecurring, unusual transactions, or adjustments. ~~(Ref: par. .A92–.A96)~~

This understanding of the information system relevant to financial reporting should include relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers. (Ref: Para. A92–A96)

…

Identifying and Assessing the Risk of Material Misstatement

.27 For this purpose, the auditor should

a. identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures ***(including the quantitative ~~or~~ and qualitative aspects of such disclosures)*** in the financial statements; (Ref: par. .A134–.A135c)

b. assess the identified risks and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;

c. relate the identified risks to what can go wrong at the relevant assertion level, taking account of relevant controls that the auditor intends to test; and (Ref: par. .A136–.A138)

d. consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement ~~is of a magnitude that~~ could result in a material misstatement. ***(Ref: Para. A13a)***

***

Application and Other Explanatory Material

Risk Assessment Procedures and Related Activities (Ref: Para. 5)

.A1 Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an understanding of the entity), is a continuous, dynamic process of gathering, updating, and analyzing information throughout the audit. The understanding of the entity establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit when, for example

- assessing risks of material misstatement of the financial statements;
- determining materiality in accordance with section 320, *Materiality in Planning and Performing an Audit*;
- considering the appropriateness of the selection and application of accounting policies and the adequacy of financial statement disclosures;
- Identifying areas ***relating to amounts or disclosures in the financial statements*** for which special audit consideration may be necessary (for example, related party transactions~~, the appropriateness of~~ ***or*** management's ~~use of the~~ ***evaluation*** ~~***assessment***~~ ***of the entity's ability to continue as a*** going concern ~~assumption~~; or ***when*** considering the business purpose of transactions);
- identifying areas for which special audit consideration may be necessary (for example, related party transactions, the appropriateness of management's use of the going concern assumption, considering the business purpose of transactions, or the existence of complex and unusual transactions);
- developing expectations for use when performing analytical procedures;

- responding to the assessed risks of material misstatement, including designing and performing further audit procedures to obtain sufficient appropriate audit evidence; and

- evaluating the sufficiency and appropriateness of audit evidence obtained, such as the appropriateness of assumptions and management's oral and written representations.

…

Information Obtained in Prior Periods (Ref: Par. 10)

A19. The auditor's previous experience with the entity and audit procedures performed in previous audits may provide the auditor with information about such matters as:

…

…

…

- ***Those particular types of transactions and other events or account balances (and related disclosures) where the auditor experienced difficulty in performing the necessary audit procedures, for example due to their complexity.***

A19a. As part of the discussion among the engagement team required by paragraph 11, consideration of the disclosure requirements of the applicable financial reporting framework assists in identifying early in the audit where there may be risks of material misstatement in relation to disclosures. Examples of matters the engagement team may discuss include:

- ***Changes in financial reporting requirements that may result in significant new or revised disclosures;***

- ***Changes in the entity's environment, financial condition or activities that may result in significant new or revised disclosures, for example, a significant business combination in the period under audit;***

- ***Disclosures for which obtaining sufficient appropriate audit evidence may have been difficult in the past; and***

- ***Disclosures about complex matters, including those involving significant management judgment as to what information to disclose.***[*]

…

[*] When the final standard is issued, this paragraph will become paragraph A22 and all subsequent paragraphs will be renumbered accordingly.

The Required Understanding of the Entity and Its Environment, Including the Entity's Internal Control

The Entity and Its Environment

Industry, Regulatory and Other External Factors **(Ref: Para. 11(a))**

…

A27. *Regulatory Factors.* Relevant regulatory factors include the regulatory environment. The regulatory environment encompasses, among other matters, the applicable financial reporting framework and the legal and political environment. Examples of matters the auditor may consider include the following:

- Accounting principles and industry-specific practices
- Regulatory framework for a regulated industry***, including requirements for disclosures***
- Laws and regulations that significantly affect the entity's operations, including direct supervisory activities
- Taxation (corporate and other)
- Government policies currently affecting the conduct of the entity's business, such as monetary (including foreign exchange controls), fiscal, financial incentives (for example, government aid programs), and tariffs or trade restrictions policies
- Environmental requirements affecting the industry and the entity's business

…

Nature of the Entity (Ref: Para. 11(b))

A30. An understanding of the nature of an entity enables the auditor to understand such matters as

- whether the entity has a complex structure (for example, with subsidiaries or other components in multiple locations). Complex structures often introduce issues that may give rise to risks of material misstatement. Such issues may include whether goodwill, joint ventures, investments, or investments in entities formed to accomplish specific objectives are accounted for ***and disclosed*** appropriately~~***, and whether adequate disclosure of such issues in the financial statements has been made***~~.
- the ownership, and relationships between owners and other people or entities. This understanding assists in determining whether related party transactions have been ***appropriately*** identified***,*** ~~and~~ accounted for***,*** ~~appropriately~~ ***and adequately disclosed in the financial statements***. Section 550, *Related Parties*, addresses the auditor's considerations relevant to related parties.

A31. Examples of matters that the auditor may consider when obtaining an understanding of the nature of the entity include

- business operations such as

…

- investments and investment activities such as

…

- financing and financing activities such as

…

- financial reporting ***practices*** such as

— accounting principles and industry-specific practices, including ***for*** industry-specific significant ~~categories~~ ***classes of transactions, account balances and related disclosures in the financial statements*** (for example, loans and investments for banks, or research and development for pharmaceuticals).

— revenue recognition ~~practices~~.

— accounting for fair values.

— foreign currency assets, liabilities, and transactions.

— accounting for unusual or complex transactions, including those in controversial or emerging areas (for example, accounting for stock-based compensation).

…

Components of Internal Control—Control Environment (Ref: Para. 14)

…

Effect of the control environment on the assessment of the risks of material misstatement

A82. Some elements of an entity's control environment have a pervasive effect on assessing the risks of material misstatement. For example, an entity's control consciousness is influenced significantly by those charged with governance, because one of their roles is to counterbalance pressures on management in relation to financial reporting that may arise from market demands or remuneration schemes. The effectiveness of the design of the control environment in relation to participation by those charged with governance is therefore influenced by such matters as:

- their independence from management and their ability to evaluate the actions of management.
- whether they understand the entity's business transactions.
- the extent to which they evaluate whether the financial statements are prepared in accordance with the applicable financial reporting framework***, including whether the financial statements include adequate disclosures***.

…

Components of Internal Control—The Information System, Including Related Business Processes, Relevant to Financial Reporting, and Communication

A92a. Financial statements may contain information that is obtained from outside of the general and subsidiary ledgers. Examples of such information may include:

- ***Information obtained from lease agreements disclosed in the financial statements, such as renewal options or future lease payments.***
- ***Information disclosed in the financial statements that is produced by an entity's risk management system.***
- ***Fair value information produced by management's experts and disclosed in the financial statements.***

- ***Information disclosed in the financial statements that has been obtained from models, or from other calculations used to develop estimates recognized or disclosed in the financial statements, including information relating to the underlying data and assumptions used in those models, such as:***
  - ***Assumptions developed internally that may affect an asset's useful life; or***
  - ***Data such as interest rates that are affected by factors outside the control of the entity.***
- ***Information disclosed in the financial statements about sensitivity analyses derived from financial models that demonstrates that management has considered alternative assumptions.***
- ***Information recognized or disclosed in the financial statements that has been obtained from an entity's tax returns and records.***
- ***Information disclosed in the financial statements that has been obtained from analyses prepared to support management's ~~assessment~~ evaluation of the entity's ability to continue as a going concern, such as disclosures, if any, related to events or conditions that have been identified that ~~may cast~~raise ~~significant~~ substantial doubt ~~on~~ about the entity's ability to continue as a going concern.[3]***

A92b. The understanding of the information system relevant to financial reporting required by paragraph 19 of this section (including the understanding of relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers) is a matter of the auditor's professional judgment. For example, certain amounts or disclosures in the entity's financial statements (such as disclosures about credit risk, liquidity risk, and market risk) may be based on information obtained from the entity's risk management system. However, the auditor is not required to understand all aspects of the risk management system, and uses professional judgment in determining the necessary understanding.

…

(Ref: par. 19).

A96. *Considerations specific to smaller, less complex entities.* ***The i***~~I~~nformation system, and related business processes, relevant to financial reporting in small entities***, including relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers,*** ~~are~~ ***is*** likely to be less sophisticated than in larger entities, but ~~their~~ ***its*** role is just as significant. Small entities with active management involvement may not need extensive descriptions of accounting procedures, sophisticated accounting records, or written policies. Understanding the entity's ***information*** systems ***relevant to financial reporting*** ~~and processes~~ may therefore be easier in an audit of smaller entities, and may be more dependent on inquiry than on review of documentation. The need to obtain an understanding, however, remains important.

…

[3] ***See paragraphs 21-22 of ~~ISA~~ AU-C section 570 ~~(Revised)~~.***

A102a. Control activities relevant to the audit may include controls established by management that address risks of material misstatement related to disclosures not being prepared in accordance with the applicable financial reporting framework, in addition to controls that address risks related to account balances and transactions. Such control activities may relate to information included in the financial statements that is obtained from outside of the general and subsidiary ledgers.

Identifying and Assessing the Risks of Material Misstatement

Assessment of Risks of Material Misstatement at the Financial Statement Level (Ref: par. .26a)

A123. Risks at the financial statement level may derive in particular from a deficient control environment (although these risks may also relate to other factors, such as declining economic conditions). For example, deficiencies such as ~~management's~~ ***a*** lack of ***management*** competence ***or lack of oversight over the preparation and fair presentation of the financial statements*** may have a more pervasive effect on the financial statements and may require an overall response by the auditor.

…

The Use of Assertions

A127. In representing that the financial statements are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding ~~the~~ recognition, measurement~~,~~ ***and*** presentation ***of classes of transactions and events, account balances*** and disclosure***s*** ~~of the various elements of financial statements and related disclosures~~.

A127a.The auditor may use the assertions as described ~~above~~ ***in paragraph A128(a)-(b) below*** or may express them differently provided all aspects described ~~above~~ ***below*** have been covered. For example, the auditor may choose to combine the assertions about ***classes o***f transactions and events***, and related disclosures,*** with the assertions about account balances***, and related disclosures***. As another example, there may not be a separate assertion related to cut-off of transactions and events when the occurrence and completeness assertions include appropriate consideration of recording transactions in the correct accounting period. [Moved from paragraph A129]

Assertions about classes of transactions, account balances, and related disclosures

A128. Assertions used by the auditor ~~to~~ ***in*** consider***ing*** the different types of potential misstatements that may occur ***may*** fall into the following ~~three~~ categories~~ and may take the following forms~~:

a. Assertions about classes of transactions and events***, and related disclosures,*** for the period under audit:

(i) Occurrence—transactions and events that have been recorded ***or disclosed,*** have occurred***,*** and ***such transactions and events*** pertain to the entity.

ii. Completeness. All transactions and events that should have been recorded have been recorded***, and all related disclosures that should have been included in the financial statements have been included***.

iii. Accuracy. Amounts and other data relating to recorded transactions and events have been recorded appropriately***, and related disclosures have been appropriately measured and described***.

iv. Cutoff. Transactions and events have been recorded in the correct accounting period.

v. Classification. Transactions and events have been recorded in the proper accounts.

vi. Presentation. Transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

b. Assertions about account balances***, and related disclosures,*** at the period end:

i. Existence. Assets, liabilities, and equity interests exist.

ii. Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

iii. Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded***, and all related disclosures that should have been included in the financial statements have been included***.

iv. ***Accuracy,*** ~~V~~***v***aluation and allocation. Assets, liabilities, and equity interests ~~are~~ ***have been included*** in the financial statements at appropriate amounts~~,~~ and any resulting valuation or allocation adjustments ~~are~~ ***have been*** appropriately recorded***, and related disclosures have been appropriately measured and described***.

v. Classification. Assets, liabilities and equity interests have been recorded in the proper accounts.

vi. Presentation. Assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

~~*c*. Assertions about presentation and disclosure:~~

~~i. Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.~~

~~ii. Completeness—all disclosures that should have been included in the financial statements have been included.~~

~~iii. Classification and understandability—financial information is appropriately presented and described, and disclosures are clearly expressed.~~

~~iv. Accuracy and valuation—financial and other information are disclosed fairly and at appropriate amounts.~~

Assertions about other disclosures

A128a. The assertions described in paragraph A128(a)–(b) above, adapted as appropriate, may also be used by the auditor in considering the different types of potential misstatements that may occur in disclosures not directly related to recorded classes of transactions, events, or account balances. As an example of such a disclosure, the entity may be required to describe its exposure to risks arising from financial instruments, including how the risks arise; the objectives, policies and processes for managing the risks; and the methods used to measure the risks.

~~A129. The auditor may use the assertions as described above or may express them differently provided all aspects described above have been covered. For example, the auditor may choose to combine the assertions about transactions and events with the assertions about account balances.~~
[Moved to paragraph A127a]

…

Process of Identifying Risks of Material Misstatement (Ref: par. .27a)

A134. Information gathered by performing risk assessment procedures, including the audit evidence obtained in evaluating the design of controls and determining whether they have been implemented, is used as audit evidence to support the risk assessment. The risk assessment determines the nature, timing and extent of further audit procedures to be performed. ***In identifying the risks of material misstatement in the financial statements, the auditor exercises professional skepticism in accordance with section 200[4].***

A135. Appendix C provides examples of conditions and events that may indicate the existence of risks of material misstatement***, including risks of material misstatement relating to disclosures***.

A135a. As explained in section 320,[5] materiality and audit risk are considered when identifying and assessing the risks of material misstatement in classes of transactions, account balances and disclosures. The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial reporting needs of users of the financial statements.[6]

A135b. The auditor's consideration of disclosures in the financial statements when identifying risks includes quantitative and qualitative disclosures, the misstatement of which could be material (that is, in general, misstatements are considered to be material if they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements as a whole). Depending on the circumstances of the entity and the engagement, examples of disclosures that will have qualitative aspects and that may be relevant when assessing the risks of material misstatement include disclosures about:

- ***Liquidity and debt covenants of an entity in financial distress.***
- ***Events or circumstances that have led to the recognition of an impairment loss.***
- ***Key sources of estimation uncertainty, including assumptions about the future.***

---

[4] ***Paragraph .17 of section 200.***

[5] ***Paragraph A1 of section 320.***

[6] ***Paragraph 4 of section 320.***

- ***The nature of a change in accounting policy, and other relevant disclosures required by the applicable financial reporting framework, where, for example, new financial reporting requirements are expected to have a significant impact on the financial position and financial performance of the entity.***
- ***Share-based payment arrangements, including information about how any amounts recognized were determined, and other relevant disclosures.***
- ***Related parties, and related party transactions.***
- ***Sensitivity analysis, including the effects of changes in assumptions used in the entity's valuation techniques intended to enable users to understand the underlying measurement uncertainty of a recorded or disclosed amount.***

Considerations specific to smaller entities

A135c. Disclosures in the financial statements of smaller entities may be less detailed or less complex (for example, some financial reporting frameworks allow smaller entities to provide fewer disclosures in the financial statements). However, this does not relieve the auditor of the responsibility to obtain an understanding of the entity and its environment, including internal control, as it relates to disclosures.

…

Material Misstatements (Ref: Par. 27(d))

A138a. Potential misstatements in individual statements and disclosures may be judged to be material due to size, nature or circumstances.

…

Appendix C

(Ref: Para. A40, A135)

Conditions and Events That May Indicate Risks of Material Misstatement

The following are examples of conditions and events that may indicate the existence of risks of material misstatement ***in the financial statements***. The examples provided cover a broad range of conditions and events; however, not all conditions and events are relevant to every audit engagement and the list of examples is not necessarily complete.

- Operations in regions that are economically unstable (for example, countries with significant currency devaluation or highly inflationary economies)
- Operations exposed to volatile markets (for example, futures trading)
- Operations that are subject to a high degree of complex regulation
- Going concern and liquidity issues, including loss of significant customers
- Constraints on the availability of capital and credit
- Changes in the industry in which the entity operates

- Changes in the supply chain
- Developing or offering new products or services or moving into new lines of business
- Expanding into new locations
- Changes in the entity, such as large acquisitions or reorganizations or other unusual events
- Entities or business segments likely to be sold
- The existence of complex alliances and joint ventures
- Use of off balance sheet finance, investments in entities formed to accomplish specific objectives, and other complex financing arrangements
- Significant transactions with related parties
- Lack of personnel with appropriate accounting and financial reporting skills
- Changes in key personnel, including departure of key executives
- Deficiencies in internal control, especially those not addressed by management
- ***Incentives for management and employees to engage in fraudulent financial reporting***
- Inconsistencies between the entity's IT strategy and its business strategies
- Changes in the IT environment
- Installation of significant new IT systems related to financial reporting
- Inquiries into the entity's operations or financial results by regulatory or government bodies
- Past misstatements, history of errors, or a significant amount of adjustments at period-end
- Significant amount of nonroutine or nonsystematic transactions, including intercompany transactions and large revenue transactions at period-end
- Transactions that are recorded based on management's intent (for example, debt refinancing, assets to be sold, and classification of marketable securities)
- Application of new accounting pronouncements
- Accounting measurements that involve complex processes

- Events or transactions that involve significant measurement uncertainty, including accounting estimates***, and related disclosures***
- ***~~Omission~~Omitting, or obscuring, ~~of~~ significant information in disclosures***
- Pending litigation and contingent liabilities (for example, sales warranties, financial guarantees, and environmental remediation)

AU-C section 320, *Materiality in Planning and Performing an Audit*

Introduction

Materiality in the Context of an Audit

...

6. In planning the audit, the auditor makes judgments about ~~the size of~~ misstatements that will be considered material. These judgments provide a basis for:

a. determining the nature and extent of risk assessment procedures;

b. identifying and assessing the risks of material misstatement; and

c. determining the nature, timing, and extent of further audit procedures.

The materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in the aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality. ~~Although i~~***I***t is not practicable to design audit procedures to detect ***all*** misstatements that could be material solely because of their nature (that is, qualitative considerations)~~,~~***. However, consideration of the nature of potential misstatements in disclosures is relevant to the design of audit procedures to address risks of material misstatement[7]. In addition, when evaluating the effect on the financial statements of all uncorrected misstatements,*** the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence~~, when evaluating their effect on the financial statements~~. [fn 1] ***(Ref: Para.A1a)***

…

Requirements

[NO CHANGE TO THE REQUIREMENTS]

***

Application and Other Explanatory Material

Determining Materiality and Performance Materiality When Planning the Audit

…

Materiality in the Context of an Audit (Ref: Par. .05)

A1a. Identifying and assessing the risks of material misstatement[8] involves the use of professional judgment to identify those classes of transactions, account balances and disclosures, including qualitative disclosures, the misstatement of which could be material (that is, in general, misstatements are considered to be material if they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements as a whole). When considering whether misstatements in qualitative disclosures could be material, the auditor may identify relevant factors such as:

- ***The circumstances of the entity for the period (for example, the entity may have undertaken a significant business combination during the period).***

---

[7] ***See paragraphs A135a-A135b of section 315, Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement.***

[8] ***Paragraph 25 of section 315 requires the auditor to identify and assess the risk of material misstatement at the financial statement and assertion level.***

- ***The applicable financial reporting framework, including changes therein (for example, a new financial reporting standard may require new qualitative disclosures that are significant to the entity).***
- ***Qualitative disclosures that are important to users of the financial statements because of the nature of an entity (for example, liquidity risk disclosures may be important to users of the financial statements for a financial institution).****

…

Determining Materiality and Performance Materiality When Planning the Audit

Materiality Level or Levels for Particular Classes of Transactions, Account Balances, or Disclosures (Ref: par. .10)

A12. Factors that may indicate the existence of one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements include the following:

- Whether law, regulation or the applicable financial reporting framework affect users' expectations regarding the measurement or disclosure of certain items (for example, related party transactions***,*** ~~and~~ the remuneration of management and those charged with governance***, and sensitivity analysis for fair value accounting estimates with high estimation uncertainty***).
- The key disclosures with regard to the industry in which the entity operates (for example, research and development costs for a pharmaceutical company)
- Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements (for example, ~~a newly acquired business~~ ***disclosures about ~~segments~~ discontinued operations or a significant business combination).***

…

* When the final standard is issued, this paragraph will become paragraph A2 and all subsequent paragraphs will be renumbered accordingly.

AU-C Section 330*, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*

Requirements

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

Substantive Procedures Related to the Financial Statement Closing Process

.21 The auditor's substantive procedures should include audit procedures related to the financial statement closing process, such as

a. agreeing or reconciling ***information in*** the financial statements with the underlying accounting records***, including agreeing or reconciling information in disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers*** and

b. examining material journal entries and other adjustments made during the course of preparing the financial statements. (Ref: par. .A57)

…

Adequacy of Presentation ~~and Disclosure~~ ***of the Financial Statements***

26. The auditor should perform audit procedures to evaluate whether the overall presentation of the financial statements~~, including the related disclosures,~~ is in accordance with the applicable financial reporting framework. ***In making this evaluation, the auditor should consider whether the financial statements are presented in a manner that reflects the appropriate***

- ***classification and description of financial information and the underlying transactions, events and conditions, and***
- ***presentation, structure and content of the financial statements. (Ref: par. A72)***

…

Documentation

…

33. The auditor's documentation should demonstrate that ***information in*** the financial statements agree***s*** or reconcile***s*** with the underlying accounting records***, including agreeing or reconciling disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers***.

***

Application and Other Explanatory Material

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

The Nature, Timing, and Extent of Further Audit Procedures (Ref: par. .06)

…

Responding to the Assessed Risks at the Assertion Level (Ref: par. .07a)

…

…

.A14 In addition, certain audit procedures can be performed only at or after the period-end. For example

- agreeing ***or reconciling information in*** the financial statements***, including classes of transactions, account balances and disclosures, with the underlying*** ~~to the~~ accounting records ***including, as applicable, those relevant accounting records that are outside the general and subsidiary ledgers***;
- examining adjustments made during the course of preparing the financial statements, and
- procedures to respond to a risk that at the period-end the entity may have entered into improper sales contracts or transactions may not have been finalized.

.A15 Further relevant factors that influence the auditor's consideration of when to perform audit procedures include

- the effectiveness of the control environment.
- when relevant information is available (for example, electronic files may subsequently be overwritten, or procedures to be observed may occur only at certain times).
- the nature of the risk (for example, if there is a risk of inflated revenues to meet earnings expectations by subsequent creation of false sales agreements, the auditor may examine contracts available on the date of the period-end).
- the period or date to which the audit evidence relates.
- ***the timing of the preparation of the financial statements, particularly for those disclosures that provide further explanation about amounts recorded*** ~~***in the statement of financial position, the statement of comprehensive income,, the statement of changes in equity or the statement of cash flows***~~***in the financial statements.***

…

Substantive Procedures (Ref: par. .18)

…

Substantive Procedures Related to the Financial Statement Closing Process (Ref: par. .21~~b~~)

A57. The nature, and also the extent, of the auditor's ***substantive procedures related to the financial statement closing process, including*** examination of journal entries and other adjustments, depends on the nature and complexity of the entity's financial reporting process and the related risks of material misstatement.

…

Adequacy of Presentation ~~and Disclosure~~ ***of the Financial Statements*** **(Ref: par. .26)**

A72. Evaluating the ~~overall~~ ***appropriate*** presentation***,*** ~~***arrangement***~~ ***structure and content*** of the financial statements, ~~including the related disclosures, relates to whether the individual financial statements are presented in a manner that reflects the appropriate classification and description of financial information, and the form, arrangement, and content of the financial statements and their~~

~~appended notes. This~~ includes, for example, ***consideration of*** the terminology used ***as required by the applicable financial reporting framework***, the ~~amount~~ ***level*** of detail ~~given~~ ***provided***, ***the*** ~~classification of items in the statements,~~ ***aggregation and disaggregation of amounts*** and the bases of amounts set forth.

AU-C Section 450, *Evaluation of Misstatements Identified During the Audit*

Definitions

.04 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

> **Misstatement** – A difference between the ***reported*** amount, classification, presentation, or disclosure of a ~~reported~~ financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud. (Ref: Para. A1)
>
> Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the auditor's professional judgment, are necessary for the financial statements to be presented fairly, in all material respects.

Requirements

[NO CHANGE TO THE REQUIREMENTS]

***

Application and Other Explanatory Material

Definitions

Misstatement (Ref: par. .04)

.A1 Misstatements may result from fraud or error, such as

a. an inaccuracy in gathering or processing data from which the financial statements are prepared,

b. an omission of an amount or disclosure***, including inadequate or incomplete disclosures, and those disclosures required to meet disclosure objectives of certain financial reporting frameworks as applicable***, ~~[9]~~

c. a financial statement disclosure that is not presented in accordance with the applicable financial reporting framework,

d. an incorrect accounting estimate arising from overlooking**,** or clear misinterpretation of**,** facts, ~~and~~

e. judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate~~.~~**,**

f. ***an inappropriate classification, aggregation or disaggregation of information, and***

~~[9] For example, International Financial Reporting Standard 7, *Financial Instruments: Disclosures*, paragraph 42H states that "an entity shall disclose any additional information that it considers necessary to meet the disclosure objectives in paragraph…"~~

g. for financial statements prepared in accordance with a fair presentation framework, the omission of a disclosure necessary for the financial statements to achieve fair presentation beyond disclosures specifically required by the framework. ~~[10]~~

Other examples of misstatements arising from fraud are provided in section 240, *Consideration of Fraud in a Financial Statement Audit.* [fn 5]

Accumulation of Identified Misstatements (Ref: par. .05)

"Clearly Trivial"

A2. ~~The auditor may designate an amount below which misstatements would be clearly trivial and would not need to be accumulated because the auditor expects that the accumulation of such amounts clearly would not have a material effect on the financial statements~~. ***Paragraph 5 requires the auditor to accumulate misstatements identified during the audit other than those that are clearly trivial.*** "Clearly trivial" is not another expression for "not material." ~~Matters~~ ***Misstatements*** that are clearly trivial will be of a wholly different (smaller) order of magnitude***, or of a wholly different nature than those that would be determined to be material,*** ~~than materiality determined in accordance with section 320, and will be matters~~ ***and will be misstatements*** that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any criteria of size, nature or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the ~~matter~~ ***misstatement*** is considered not to be clearly trivial.

Misstatements in Individual Statements

A2a. The auditor may designate an amount below which misstatements of amounts in the individual statements would be clearly trivial, and would not need to be accumulated because the auditor expects that the accumulation of such amounts clearly would not have a material effect on the financial statements. However, misstatements of amounts that are above the designated amount are accumulated as required by paragraph 5. In addition, misstatements relating to amounts may not be clearly trivial when judged on criteria of nature or circumstances, and, if not, are accumulated as required by paragraph 5 of this ~~ISA~~section. [*]

Misstatements in Disclosures

A2b. Misstatements in disclosures may also be clearly trivial whether taken individually or in aggregate, and whether judged by any criteria of size, nature or circumstances. Misstatements in disclosures that are not clearly trivial are also accumulated to assist the auditor in evaluating the effect of such misstatements on the relevant disclosures and the financial statements as a whole. Paragraph A19a provides examples of where misstatements in qualitative disclosures may be material.

~~[10] For example, IFRS requires an entity to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance (International Accounting Standard 1, Presentation of Financial Statements, paragraph 17(c)).See~~

[*] When the final standard is issued, this paragraph will become paragraph A3 and all subsequent paragraphs will be renumbered accordingly.

Accumulation of Misstatements

A2c. Misstatements by nature or circumstances, accumulated as described in paragraphs A2a–A2b, cannot be added together as is possible in the case of misstatements of amounts. Nevertheless, the auditor is required by paragraph 11 to evaluate those misstatements individually and in aggregate (that is, collectively with other misstatements) to determine whether they are material.

A3. To assist the auditor in evaluating the effect of misstatements accumulated during the audit and in communicating misstatements to management and those charged with governance, it may be useful to distinguish between factual misstatements, judgmental misstatements and projected misstatements, described as follows:

- *Factual misstatements* are misstatements about which there is no doubt.

- *Judgmental misstatements* are differences arising from the judgments of management ***including those*** concerning ***recognition, measurement, presentation and disclosure in the financial statements (including*** ~~accounting estimates that the auditor considers unreasonable, or~~ the selection or application of accounting policies***)*** that the auditor considers ***unreasonable or*** inappropriate.

- *Projected misstatements* are the auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire population from which the samples were drawn. Guidance on the determination of projected misstatements and evaluation of the results is set out in section 530, *Audit Sampling*. [fn 6]

…

Communication and Correction of Misstatements (Ref: par. .07–.09)

A6. Timely communication of misstatements to the appropriate level of management is important as it enables management to evaluate whether the ~~items~~ ***classes of transactions, account balances and disclosures*** are misstate***d***~~ments~~, inform the auditor if it disagrees, and take action as necessary. Ordinarily, the appropriate level of management is the one that has responsibility and authority to evaluate the misstatements and to take the necessary action.

…

Evaluating the Effect of Uncorrected Misstatements (Ref: par. .10–.11)

...

A19. Each individual misstatement ***of an amount*** is considered to evaluate its effect on the relevant classes of transactions, account balances or disclosures, including whether the materiality level for that particular class of transactions, account balance or disclosure, if any, has been exceeded.

[fn 6] Paragraphs .13–.14 of section 530, *Audit Sampling*.

A19a. In addition, each individual misstatement of a qualitative disclosure is considered to evaluate its effect on the relevant disclosure(s), as well as its overall effect on the financial statements as a whole. The determination of whether a misstatement(s) in a qualitative disclosure is material, in the context of the applicable financial reporting framework and the specific circumstances of the entity, is a matter that involves the exercise of professional judgment. Examples where such misstatements may be material include:

- ***Inaccurate or incomplete descriptions of information about the objectives, policies and processes for managing capital ~~for entities with insurance and banking activities~~.***
- ***The omission of information about the events or circumstances that have led to an impairment loss (for example, a significant long-term decline in the demand for a metal or commodity) ~~in an entity with mining operations~~.***
- ***The incorrect description of an accounting policy relating to a significant item in any of the statements comprising the financial statements~~the statement of financial position, the statement of comprehensive income, the statement of changes in equity or the statement of cash flows~~.***
- ***The inadequate description of the sensitivity of an exchange rate ~~in an entity that undertakes international trading activities~~.***

A19b. In determining whether uncorrected misstatements by nature are material as required by paragraph 11, the auditor considers uncorrected misstatements in amounts and disclosures. Such misstatements may be considered material either individually, or when taken in combination with other misstatements. For example, depending on the misstatements identified in disclosures, the auditor may consider whether:

a. Identified errors are ~~persistent~~ recurring or pervasive; or
b. A number of identified misstatements are relevant to the same matter, and considered collectively may affect the users' understanding of that matter.

This consideration of accumulated misstatements is also helpful when evaluating the financial statements in accordance with paragraph 16(d) of section 700,[11] which requires the auditor to consider whether the overall presentation of the financial statements has been undermined by including information that is not relevant or that obscures a proper understanding of the matters disclosed.

...

.A24 Section 240 explains how the implications of a misstatement that is, or may be, the result of fraud are required to be considered with regard to other aspects of the audit, even if the size of the misstatement is not material in relation to the financial statements. [fn 17] ***Depending on the circumstances, misstatements in disclosures could also be indicative of fraud, and, for example, may arise from:***

- ***Misleading disclosures that have resulted from bias in management's judgments; or***

[11] ***Paragraph 16d of section 700***

- ***Extensive duplicative or uninformative disclosures that are intended to obscure a proper understanding of matters in the financial statements.***

  When considering the implications of misstatements in classes of transactions, account balances and disclosures, the auditor exercises professional skepticism in accordance with AU-C section 200.[12]

[12] ***Paragraph 17 of AU-C section 200.***

AU-C Section 700, *Forming an Opinion and Reporting on Financial Statements*

[to be integrated into AU-C 700 revised draft]

Definitions

12. Reference to *financial statements* in this section means a complete set of general purpose financial statements***.***[13] ~~including the related notes." The related notes ordinarily comprise a summary of the significant accounting policies and other explanatory information.~~ The requirements of the applicable financial reporting framework determine the ***presentation,*** ~~form~~ ***structure*** and content of the financial statements, and what constitutes a complete set of financial statements.

…

Requirements

Forming an Opinion on the Financial Statements

…

16. In particular, the auditor should evaluate whether, in view of the requirements of the applicable financial reporting framework:

a. The financial statements ~~adequately~~ ***appropriately*** disclose the significant accounting policies selected and applied. ***In making this evaluation, the auditor should consider the relevance of the accounting policies to the entity, and whether they have been presented in an understandable manner; (Ref: Para. A7a)***

…

…

d. The information presented in the financial statements is relevant, reliable, comparable, and understandable. ***In making this evaluation, the auditor should consider whether:***

- ***The information that should have been included has been included, and whether such information is appropriately classified, aggregated or disaggregated, and characterized.***
- ***The overall presentation of the financial statements has been undermined by including information that is not relevant or that obscures a proper understanding of the matters disclosed. (Ref: Para. A7b)***

.17 The auditor's evaluation about whether the financial statements achieve fair presentation should also include consideration of the following: ***(Ref: Para A8a–A8c)***

b. Whether the financial statements~~, including the related notes,~~ represent the underlying transactions and events in a manner that achieves fair presentation.

…

Auditor's Report

…

[13] ***AU-C section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards, paragraph 14, sets out the content of financial statements.***

Date of the Auditor's Report

.41 The auditor's report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that

b. all the statements ***and disclosures*** that ***comprise*** the financial statements ~~comprise, including the related notes,~~ have been prepared; and

…

***

Application and Other Explanatory Material

Accounting Policies Appropriately Disclosed in the Financial Statements (Ref: Para. 16(a))

A7a. In evaluating whether the financial statements appropriately disclose the significant accounting policies selected and applied, the auditor's consideration may include~~s~~ matters such as

- ***whether all disclosures related to the significant accounting policies that are required to be included by the applicable financial reporting framework have been disclosed;***
- ***whether the information about the significant accounting policies that has been disclosed is relevant and therefore reflects how the recognition, measurement and presentation criteria in the applicable financial reporting framework have been applied to classes of transactions, account balances and disclosures in the financial statements in the particular circumstances of the entity's operations and its environment; and***
- ***the clarity with which the significant accounting policies have been presented.****

Information Presented in the Financial Statements Is Relevant, Reliable, Comparable and Understandable (Ref: Para. 16(d))

A7b. Evaluating the understandability of the financial statements may include~~s~~ consideration of such matters as whether:

- ***The information in the financial statements is presented in a clear and concise manner.***
- ***The placement of significant disclosures gives appropriate prominence to them (for example, when there is perceived value of entity-specific information to users), and whether the disclosures are appropriately cross-referenced in a manner that would not give rise to significant challenges for users in identifying necessary information.***

Disclosure of the Effect of Material Transactions and Events on the Information Conveyed in the Financial Statements (Ref: par. .16e)

A4. It is common for financial statements prepared in accordance with a general purpose framework to present an entity's financial position, financial performance and cash flows. ~~In~~

* When the final standard is issued, this paragraph will become paragraph A8 and all subsequent paragraphs will be renumbered accordingly.

~~such circumstances, the auditor evaluates whether the financial statements~~ ***Evaluating whether, in view of the applicable financial reporting framework, the financial statements*** provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the entity's financial position, financial performance and cash flows may ***include~~s~~ consideration of such matters as:***

- ***The extent to which the information in the financial statements is relevant and specific to the circumstances of the entity; and***
- ***Whether the disclosures are adequate to assist the intended users to understand:***
  - ***The nature and extent of the entity's potential assets and liabilities arising from transactions or events that do not meet the criteria for recognition (or the criteria for derecognition) established by the applicable financial reporting framework.***
  - ***The nature and extent of risks of material misstatement arising from transactions and events.***
  - ***The methods used and the assumptions and judgments made, and changes to them, that affect amounts presented or otherwise disclosed, including relevant sensitivity analyses.***

Evaluating Whether the Financial Statements Achieve Fair Presentation (Ref: par. .17b)

A8a. Some financial reporting frameworks acknowledge explicitly or implicitly the concept of fair presentation.~~[14]~~ As noted in section 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards,* ***a fair presentation[15] financial reporting framework not only requires compliance with the requirements of the framework, but also acknowledges explicitly or implicitly that it may be necessary for management to provide disclosures beyond those specifically required by the framework.***

~~A4b~~A8b. The auditor's evaluation about whether the financial statements ~~achieve fair presentation~~are fairly presented, considering both ~~in respect of~~ presentation and disclosure, is a matter of professional judgment. This evaluation takes into account such matters as the facts and circumstances of the entity, including changes thereto, based on the auditor's understanding of the entity and the audit evidence obtained during the audit. The evaluation also may include~~s~~ consideration, for example, of the disclosures needed to achieve a fair presentation arising from matters that could be material~~ (that is, in general, misstatements are considered to be material if they could reasonably be expected to influence the economic decisions of the users taken on the basis of the financial statements as a whole)~~, such as the effect of evolving financial reporting requirements or the changing economic environment. In general, misstatements are considered to be material if they could reasonably be expected to influence the economic decisions of the users taken on the basis of the financial statements as a whole.

~~[14] For example, International Financial Reporting Standards (IFRSs) note that fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses.~~

[15] ***Paragraph 14 of section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards***

A4c. Evaluating whether the financial statements achieve fair presentation may include, for example, discussions with management and those charged with governance about their views on why a particular presentation was chosen, as well as alternatives that may have been considered. The discussions may include, for example:

- ***The degree to which the amounts in the financial statements are aggregated or disaggregated, and whether the presentation of amounts or disclosures obscures useful information, or results in misleading information.***
- ***Consistency with appropriate industry practice, or whether any departures are relevant to the entity's circumstances and therefore warranted.***

.A9 As described in section 200, ~~Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards,~~ a *financial reporting framework* is a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements. The auditor's professional judgment concerning the fairness of the presentation of the financial statements is applied within the context of the financial reporting framework. Without that framework, the auditor would have no consistent standard for evaluating the presentation of financial position, results of operations, and cash flows in financial statements.

Auditor's Report (Ref: par. .22)

…

Date of the Auditor's Report (Ref: par. 41)

…

.A40 Because the auditor's opinion is provided on the financial statements, and the financial statements are the responsibility of management, the auditor is not in a position to conclude that sufficient appropriate audit evidence has been obtained until evidence is obtained that all the statements ***and disclosures*** that the financial statements comprise~~, including the related notes,~~ have been prepared, and management has accepted responsibility for them.

.A41 *Considerations specific to governmental entities.* In some circumstances, final approval of the financial statements by governmental legislative bodies (or subsets of such legislative bodies) is required before the financial statements are issued. In these circumstances, final approval by such legislative bodies (or subsets of such legislative bodies) is not necessary for the auditor to conclude that sufficient appropriate audit evidence has been obtained. The date of approval of the financial statements, for purposes of GAAS, is the earlier date on which those with the recognized authority determine that all the statements ***and disclosures*** that the financial statements comprise~~, including the related notes,~~ have been prepared and that those with the recognized authority have asserted that they have taken responsibility for them.

CONFORMING AMENDMENTS TO OTHER AU-C SECTIONS

Note: The following are conforming amendments to other AU-C sections as a result of the approval of the amendments to GAAS for "Addressing Disclosures in the Audit of Financial Statements." These amendments will become effective at the same time as the amendments to the AU-C sections in this document, and are shown with marked changes from the latest approved versions of the AU-C sections that are amended. The footnote numbers within these amendments may not align with the amended AU-C sections, and reference should be made to those AU-C sections.

AU-C section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

Application and Other Explanatory Material

…

A19. Inquiries of management about changes in circumstances may include, for example, inquiries about whether:

- accounting policies relating to accounting estimates have changed as a result of changes ~~to~~ ***within*** the requirements of the applicable financial reporting framework or otherwise.

AU-C Section 580, *Written Representations*

Exhibit A — Illustrative Representation Letter

(Ref: Para. A21)

Illustrative Representation Letter

.A35 The following illustrative letter includes written representations that are required by this and other AU-C sections in effect for audits of financial statements for periods ending on or after December 15, 2012. It is assumed in this illustration that the applicable financial reporting framework is accounting principles generally accepted in the United States, that the requirement in section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, to obtain a written representation is not relevant, and that no exceptions exist to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

(Entity Letterhead)
(To Auditor)
(Date)

This representation letter is provided in connection with your audit of the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, for the purpose of expressing an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States (U.S. GAAP).

…

Information Provided

- We have provided you with:[16]
  - Access to all information, of which we are aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation and other matters; (par. .11*a*)
  - Additional information that you have requested from us for the purpose of the audit; (par. .11*a*) and
  - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence. (par. .11*a*)

…

16 If the auditor has included other matters relating to management's responsibilities in the audit engagement letter in accordance with section 210, **Agreeing the Terms of Audit Engagements,** ***consideration may be given to including these matters in the written representations from management or those charged with governance.***

AU-C Section 705
Modifications to the Opinion in the Independent Auditor's Report
Requirements

…

Basis for Opinion

…

.19 If there is a material misstatement of the financial statements that relates to ~~narrative~~ ***qualitative*** disclosures, the auditor shall include in the basis for modification paragraph an explanation of how the disclosures are misstated.

Application and Other Explanatory Material

…

Circumstances When a Modification to the Auditor's Opinion Is Required

Nature of Material Misstatements (Ref: Para. 6(a))

…

.A3 Section 450 defines a misstatement as a difference between the ***reported*** amount, classification, presentation, or disclosure of a ~~reported~~ financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Accordingly, a material misstatement of the financial statements may arise in relation to the following:

…

Appropriateness of the Selected Accounting Policies

.A4 With regard to the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise***, for example,*** when

(a) The selected accounting policies are not consistent with the applicable financial reporting framework***;*** ~~or~~

---

16 If the auditor has included other matters relating to management's responsibilities in the audit engagement letter in accordance with section 210, Agreeing the Terms of Audit Engagements, consideration may be given to including these matters in the written representations from management or those charged with governance.

b. ***The financial statements do not correctly describe an accounting policy relating to a significant item*** ~~***in the statement of financial position, the statement of comprehensive income, the statement of changes in equity or the statement of cash flows***~~***therein; or***
c. The financial statements~~, including the related notes,~~ do not represent ***or disclose*** the underlying transactions and events in a manner that achieves fair presentation.
...
Appropriateness of the Financial Statement Presentation or Appropriateness or Adequacy of Disclosures in the Financial Statements
A7. In relation to the appropriateness or adequacy of disclosures in the financial statements, material misstatements of the financial statements may arise when:

(c) The financial statements do not provide the ***additional*** disclosures necessary to achieve fair presentation ***beyond disclosures specifically required by the applicable financial reporting framework***; or

Paragraph A19a of section 450 provides further examples of material misstatements in qualitative disclosures that may arise.

AU-C Section 800
Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks

Definitions
…
.08 Reference to *financial statements* in this section means "a complete set of special purpose financial statements, including the related notes. [fn 1] ~~The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information.~~ The requirements of the applicable financial reporting framework determine the ***presentation, structure,*** ~~form~~ and content of the financial statements, and what constitutes a complete set of financial statements.

AU-C Section 805 ***Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement***

Definitions
…
.06 For purposes of this section, reference to
a. an *element of a financial statement* or an *element* means an *element, account, or item of a financial statement*. (Ref: par. .A4)

b. a single financial statement or to a specific element of a financial statement includes the related ~~notes~~ ***disclosures***. The related ~~notes~~ ***disclosures*** ordinarily comprise ~~a summary of significant accounting policies and other~~ explanatory ***or other descriptive*** information relevant to the financial statement or the specific element.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 Section 200 defines the term *historical financial information* as information expressed in financial terms regarding a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past. It also defines the term *financial statements* as a structured representation of historical financial information, including ~~related notes~~ ***disclosures***, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement. ***Disclosures comprise explanatory or other descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement, or in the notes~~, or incorporated therein by cross-reference~~.*** [Fn 6]

[fn 6] Paragraph .14 of section 200.