

INTOSAI



*Ligne directrice
d'audit financier –
Évaluation des
anomalies identifiées
au cours de l'audit*

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Note¹ de pratique relative à la [au projet de]² Norme internationale d'audit [*International Standard on Auditing*] (ISA) 450 (révisée et remaniée) – Évaluation des anomalies identifiées au cours de l'audit

Contexte

La présente note de pratique fournit aux auditeurs du secteur public des indications supplémentaires sur la (le projet de) Norme internationale d'audit (ISA) 450 (révisée et remaniée), relative à l'évaluation des anomalies identifiées au cours de l'Audit. Elle doit être lue conjointement avec la norme ISA. La présente note de pratique prend effet à la même date que la norme ISA.

Description de la Norme ISA

La [Le projet de] norme ISA 450 (révisée et remaniée) traite de l'évaluation des anomalies identifiées au cours de l'audit d'états financiers. La [Le projet de] norme ISA 320 (révisée et remaniée), relative au Caractère significatif pour la planification et la mise en œuvre d'un audit traite de la détermination du caractère significatif et de son application au cours de la planification et de la mise en œuvre d'un audit d'états financiers. La [Le projet de] norme ISA 450 (révisée et remaniée) explique comment le caractère significatif est appliqué à l'évaluation des anomalies identifiées au cours de l'audit.

La [Le projet de] norme ISA 450 (révisée et remaniée) s'applique aux audits d'états financiers pour périodes ouvertes à compter du [insérer date]³.

Contenu de la note de pratique

- P1. La présente note de pratique fournit aux auditeurs du secteur public des directives supplémentaires en ce qui concerne :
- a. les considérations générales,
 - b. les définitions,
 - c. l'assemblage des anomalies identifiées,

¹ Toutes les notes de pratique doivent être considérées conjointement avec les considérations générales contenues dans les Lignes directrices sur l'audit financier.

² La présente note de pratique s'inspire de l'exposé-sondage relatif à la [au projet de] norme ISA 450 (révisée et remaniée), publié(e) par l'*International Auditing and Assurance Standards Board* (IAASB) en octobre 2006. Elle aura peut-être besoin d'être mise à jour lorsque l'IAASB approuvera et publiera le texte final de la norme ISA 450 (révisée et remaniée).

³ La date d'entrée en vigueur est provisoire, mais elle ne sera pas antérieure au 15 décembre 2008.

- d. les considérations liées à l'état d'avancement de l'audit,
- e. la communication et la correction des anomalies,
- f. l'évaluation de l'effet des anomalies non corrigées,
- g. l'évaluation de la question de savoir si les états financiers dans leur ensemble ne contiennent pas d'anomalie significative,
- h. la documentation
- i. les considérations propres à un environnement de type Cour des comptes.

Applicabilité de la norme ISA à l'audit des finances publiques

- P2. La [Le projet de] norme ISA 450 (révisée et remaniée) s'applique aux auditeurs des entités du secteur public en leur qualité d'auditeurs des états financiers.

Indications supplémentaires sur les questions relatives au secteur public

Considérations générales

- P3. Les objectifs d'un audit d'états financiers dans le secteur public dépassent souvent l'expression d'un avis sur la question de savoir si les états financiers, dans tous leurs aspects significatifs, ont été élaborés conformément au référentiel comptable applicable (c'est-à-dire l'étendue des normes ISA). Les objectifs peuvent comprendre des tâches supplémentaires d'audit et de communication d'information relatives, par exemple, au fait de signaler si l'auditeur a trouvé des cas de non conformité aux autorisations, y compris en matière de budget et de responsabilité et/ou d'information concernant l'efficacité du contrôle interne. Outre l'évaluation des anomalies, les auditeurs du secteur public peuvent aussi évaluer des cas de non conformité aux autorisations et les écarts et les carences du contrôle.
- P4. La [Le projet de] norme ISA 450 (révisée et remaniée) contient des considérations propres aux entités du secteur public. Celles-ci sont énoncées aux alinéas A18 et A19.

Définitions

- P5. Comme l'explique l'alinéa 3 ci-dessus, les audits des états financiers des entités du secteur public peuvent comprendre des objectifs liés à la conformité aux autorisations et à l'efficacité du contrôle interne selon le mandat de l'audit ou la législation. Pour ces objectifs, la présente note de pratique ajoute les définitions supplémentaires suivantes :
- a. Écart du contrôle – le fait qu'une entité ne suive pas une procédure de contrôle au cours d'une opération⁴.

⁴ Tous les écarts du contrôle ne représentent pas des carences du contrôle (faiblesse du contrôle) puisque (1) il peut y avoir des contrôles compensateurs ou bien (2) la

- b. Carence du contrôle (faiblesse du contrôle) – situation où la conception ou le fonctionnement d'un contrôle ne permet pas à la direction ou aux employés de prévenir ou de détecter les anomalies en temps opportun.⁵
- c. Cas de non-conformité aux autorisations – le fait de ne pas se conformer à la loi ou à la réglementation, y compris l'autorité budgétaire, au cours d'une opération.

Assemblage des anomalies identifiées

- P6. L'alinéa 5 de la [du projet de] norme ISA 450 (révisée et remaniée) exige que l'auditeur totalise les anomalies identifiées au cours de l'audit, autres que celles qui sont clairement insignifiantes, en faisant la distinction entre les anomalies factuelles, les anomalies de jugement et les anomalies possibles. Pour ce qui est des objectifs supplémentaires définis à l'alinéa 3 ci-dessus, les auditeurs du secteur public peuvent également totaliser les cas de non-conformité aux autorisations et peuvent les classer selon qu'elles sont factuelles, de jugement et possibles. En règle générale, les auditeurs du secteur public ne définissent pas les cas de non-conformité aux autorisations ou les écarts du contrôle qui sont manifestement insignifiants, car tous ces cas et écarts sont normalement totalisés et évalués.

Considérations liées à l'état d'avancement de l'audit

- P7. L'alinéa 8 de la [du projet de] norme ISA 450 (révisée et remaniée) exige que l'auditeur mette en œuvre des procédures d'audit complémentaires pour réévaluer la quantité d'anomalies restantes, s'il y en a, après que la direction, réagissant aux conclusions de l'auditeur ou à la demande de celui-ci, a examiné une catégorie d'opérations, un solde de compte ou une information fournie, et a corrigé les anomalies constatées. Même dans le cas où une opération est correctement présentée dans les états financiers, si elle est illégale ou que le contrôle n'a pas été respecté, elle représente de par sa nature un cas de non-conformité aux autorisations, un écart ou une carence du contrôle.

Communication et correction des anomalies

- P8. L'alinéa 11 de la [du projet de] norme ISA 450 (révisée et remaniée) exige que l'auditeur obtienne une déclaration écrite indiquant que la direction considère que les effets des anomalies non corrigées sont sans importance. Les auditeurs du secteur public peuvent aussi obtenir des déclarations écrites sur la conformité aux autorisations et sur l'efficacité du contrôle interne. Lorsque les auditeurs du secteur public constatent des cas de non-conformité aux autorisations ou des carences du contrôle, la direction peut modifier ces déclarations en conséquence.
- P9. Beaucoup d'auditeurs du secteur public communiquent tous les cas de non-conformité aux autorisations identifiés. Certaines institutions de contrôle des finances publiques peuvent, selon le mandat de l'audit, ordonner à l'entité de corriger tout cas de non-conformité aux autorisations. Dans ces cas-là, les

fréquence et l'importance de l'écart peuvent représenter une situation acceptable étant donné le niveau de risque.

⁵ Toutes les carences du contrôle ne proviennent pas d'un écart du contrôle, puisque certaines carences du contrôle sont dues à une mauvaise conception du contrôle.

auditeurs du secteur public déterminent si leur indépendance sera compromise.

Évaluation de l'effet des anomalies non corrigées

- P10. Lorsqu'ils appliquent l'alinéa 13 de la [du projet de] norme ISA 450 (révisée et remaniée) les auditeurs du secteur public évaluent séparément les anomalies relatives aux états financiers, les cas de non conformité aux autorisations et les écarts en matière de contrôle.
- P11. Dans le cas des écarts en matière de contrôle, les auditeurs du secteur public déterminent s'ils représentent des carences du contrôle. Dans leur estimation, les auditeurs du secteur public évaluent des contrôles compensateurs afin de déterminer si les objectifs du contrôle ont été atteints.

Communication avec les personnes constituant le gouvernement d'entreprise

- P12. Les alinéas 15 à 17 de la [du projet de] norme ISA 450 (révisée et remaniée) traitent de la communication des anomalies non corrigées aux personnes constituant le gouvernement d'entreprise. En outre, les auditeurs du secteur public peuvent communiquer les cas de non-conformité aux autorisations aux personnes constituant le gouvernement d'entreprise. Les auditeurs du secteur public peuvent également communiquer les anomalies, les cas de non-conformité aux autorisations et les carence du contrôle à d'autres parties, telles que les représentants de l'administration publique.
- P13. Lorsqu'ils communiquent avec les personnes constituant le gouvernement d'entreprise, comme le définit l'alinéa 12 ci-dessus, il est probable que les auditeurs du secteur public communiquent toutes les anomalies, même celles qui ont été corrigées par l'entité, ainsi que toutes les carences du contrôle et tous les cas de non conformité aux autorisations. L'entité du secteur public peut ne former qu'une partie réduite de la structure plus large du contrôle dans le secteur public. Par conséquent, les carences du contrôle peuvent avoir des répercussions plus étendues. Le choix des personnes avec lesquelles les auditeurs du secteur public communiquent les cas de non-conformité aux autorisations et des carences du contrôle repose sur le jugement professionnel et dépend de facteurs tels que :

- l'usage dans l'environnement du secteur public ;
- la nature et le nombre des cas ;
- la question de savoir si des cas semblables peuvent exister au sein de l'entité ou dans d'autres entités dont les personnes constituant le gouvernement d'entreprise ont la responsabilité.

Lorsqu'ils communiquent avec les personnes constituant le gouvernement d'entreprise, les auditeurs du secteur public utilisent des méthodes de communication de l'information pertinentes pour leur juridiction. Les auditeurs du secteur public peuvent aussi être appelés à faire une déposition devant les législateurs au sujet des résultats de l'audit d'état financier.

Évaluation de la question de savoir si les états financiers dans leur ensemble ne contiennent pas d'anomalie significative

P14. Si l'auditeur du secteur public se prononce, ou ne peut pas se prononcer, sur la question de savoir si les états financiers dans leur ensemble contiennent des anomalies significatives, l'alinéa 19 de la [du projet de] norme ISA 450 (révisée et remaniée) exige que l'auditeur examine l'effet de cette situation sur l'avis exprimé dans son rapport d'audit. Dans le secteur public, cette exigence est applicable aux anomalies. Lorsque les auditeurs du secteur public ont des tâches supplémentaires de communication de l'information, chacune de ces tâches peut être évaluée séparément. À titre d'exemple, si les auditeurs du secteur public sont tenus de signaler les cas de non-conformité aux autorisations, leur évaluation de la question de savoir si l'entité s'est conformée aux autorisations peut être séparée de leur évaluation de la question de savoir si les états financiers dans leur ensemble ne contiennent pas d'anomalie significative. Toutefois, les anomalies et les cas de non-conformité aux autorisations peuvent aussi être interdépendants et accroître potentiellement les risques d'anomalie significative et vice versa. À titre d'exemple, les anomalies peuvent représenter des cas de non-conformité aux autorisations législatives et connexes.⁶

Documentation

P15. L'alinéa 20 de la [du projet de] norme ISA 450 (révisée et remaniée) contient des exigences relatives à la documentation concernant les anomalies. Les auditeurs du secteur public documentent également :

- d. les écarts du contrôle et le fait de savoir s'ils représentent des carences du contrôle ;
- e. les carences du contrôle qui ne proviennent pas d'écarts du contrôle ;
- f. les cas identifiés de non-conformité aux autorisations ;
- g. les conclusions relatives à la question de savoir s'il faut signaler les cas de non-conformité aux autorisations et les carences du contrôle, et le fondement de ces conclusions.

Considérations propres à un environnement de type Cour des comptes

P16. Dans un environnement de type Cour des comptes, le rapport des auditeurs est souvent jugé et utilisé afin d'en déterminer les répercussions juridiques individuelles pour les personnes responsables des actes financiers, y compris les questions importantes, les carences en matière de contrôle, et les cas de non-conformité aux autorisations. Par conséquent, dans un environnement de type Cour des comptes, lorsque les auditeurs du secteur public évaluent les anomalies, les cas de non-conformité aux autorisations et d'écart du contrôle identifiés au cours de l'audit, ils identifient également les personnes responsables des actes financiers et du respect des conditions légales.

⁶ L'IAASB examine la possibilité de déplacer le présent alinéa pour le mettre dans le [projet de] norme ISA 700 (remaniée). Dans ce cas-là, le présent alinéa sera mis dans la note de pratique correspondante.

*Proposed Redrafted International Standard on
Auditing*

ISA 450 (Revised), Evaluation of
Misstatements Identified during the
Audit



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The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved the exposure draft of proposed International Standard on Auditing (ISA) 450 (Redrafted), “Evaluation of Misstatements Identified during the Audit” for publication in October 2006. **The proposed ISA may be modified in light of comments received before being issued in final form.**

The objective of the IAASB is to serve the public interest by setting high-quality auditing and assurance standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The mission of IFAC is to serve the public interest, strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession’s expertise is most relevant.

Copies of the exposure draft may be downloaded free-of-charge from the IFAC website at <http://www.ifac.org>.

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EXPOSURE DRAFT
PROPOSED INTERNATIONAL STANDARD ON AUDITING 450
(REVISED AND REDRAFTED)
EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT
(Effective for audits of financial statements for periods beginning on or after [date])*

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* See footnote 1.

International Standard on Auditing (ISA) 450 (Revised), “Evaluation of Misstatements Identified during the Audit” should be read in the context of the “Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services,” which sets out the authority of ISAs.

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the evaluation of misstatements identified during the audit of financial statements. ISA 320, “Materiality in Planning and Performing an Audit” deals with the determination of materiality and its application in planning and performing an audit of financial statements. This ISA explains how materiality is applied in evaluating misstatements identified during the audit.

Effective Date

2. This ISA is effective for audits of financial statements for periods beginning on or after [date].¹

Objective

3. The objective of the auditor is to evaluate:
 - (a) The effect of identified misstatements on the audit; and
 - (b) The effect of uncorrected misstatements on the financial statements and whether the financial statements as a whole are free from material misstatement.

Definitions

4. For purposes of the ISAs, the following terms have the meanings attributed below:
 - (a) Error – An unintentional misstatement in the financial statements.
 - (b) Factual misstatements – Misstatements about which there is no doubt.
 - (c) Judgmental misstatements – Differences arising from management’s judgments concerning accounting estimates that the auditor considers unreasonable, or the selection or application of accounting policies that the auditor considers inappropriate.
 - (d) Misstatement – A difference between the 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. Misstatements can arise from error or fraud and may result from:
 - (i) An inaccuracy in gathering or processing data from which the financial statements are prepared;
 - (ii) An omission of an amount or disclosure;
 - (iii) An incorrect accounting estimate arising from overlooking or clear misinterpretation of facts; and
 - (iv) Management’s judgments concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate.

¹ This date will not be earlier than December 15, 2008.

When the auditor expresses an opinion on whether the financial statements give a true and fair view or are presented fairly, in all material respects, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor's judgment, are necessary for the financial statements to give a true and fair view or present fairly, in all material respects.

- (e) Projected misstatements – The auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire populations from which the samples were drawn. Guidance on the determination of projected misstatements and evaluation of the results is set out in ISA 530, "Audit Sampling and Other Means of Testing."
- (f) Uncorrected misstatements – Misstatements that the auditor has accumulated during the audit and that management has not corrected.

Requirements

Accumulation of Identified Misstatements

- 5. The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial, distinguishing between factual misstatements, judgmental misstatements and projected misstatements. (Ref: Para. A1-A2)

Considerations as the Audit Progresses

- 6. The auditor shall consider whether the overall audit strategy and audit plan need to be revised if the nature of identified misstatements and the circumstances of their occurrence are indicative that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material. (Ref: Para. A3)
- 7. The auditor shall also determine whether the overall audit strategy and audit plan need to be revised if the aggregate of misstatements accumulated during the audit approaches the materiality level or levels. (Ref: Para. A4)
- 8. If management, in response to the auditor's findings or at the auditor's request, has examined a class of transactions, account balance or disclosure and corrected misstatements that were found, the auditor shall perform further audit procedures to reevaluate the amount of misstatements remaining, if any. (Ref: Para. A5)

Communication and Correction of Misstatements

- 9. The auditor shall communicate all misstatements accumulated during the audit to the appropriate level of management on a timely basis and request management to correct them. (Ref: Para. A6-A8)
- 10. If management refuses to correct some or all of the misstatements communicated to it by the auditor, the auditor shall obtain an understanding of management's reasons for not making the corrections and shall take that into account when evaluating whether the financial statements as a whole are free from material misstatement. (See paragraph 17.)

Management Representations

- 11. The auditor shall obtain written representation from management whether it believes the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representations. (Ref: Para. A9)

Evaluating the Effect of Uncorrected Misstatements

12. Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess the materiality level or levels used in planning and performing the audit to confirm whether they remain appropriate in the context of the entity's actual financial results. (Ref: Para. A10-A11)
13. The auditor shall evaluate whether uncorrected misstatements are material, individually or in aggregate. In making this evaluation, the auditor shall consider the size and nature of the misstatements, both in relation to particular classes of transactions, account balances and disclosures and the financial statements as a whole, and the particular circumstances of their occurrence. (Ref: Para. A12-A16)
14. The auditor shall also consider the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole. (Ref: Para. A17)

Communication with Those Charged with Governance

15. The auditor shall communicate with those charged with governance² uncorrected misstatements and the effect that they may have on the opinion in the auditor's report, and request their correction. The written representation obtained from management in accordance with paragraph 11 shall form part of this communication. In communicating the effect that material uncorrected misstatements may have on the opinion in the auditor's report, the auditor shall address them individually. (Ref: Para. A20)
16. The auditor shall communicate with those charged with governance the reasons for, and the implications of a failure to correct misstatements, having regard to the size and nature of the misstatement judged in the surrounding circumstances, including possible implications in relation to future financial statements. (Ref: Para. A21)
17. The auditor shall communicate with those charged with governance the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

Evaluating Whether the Financial Statements as a Whole are Free from Material Misstatement

18. The auditor shall evaluate whether the financial statements as a whole are free from material misstatement. In making this evaluation, the auditor shall consider both the results of the evaluation of the uncorrected misstatements and the qualitative aspects of the entity's accounting practices. (Ref: Para. A22-23)
19. If the auditor concludes that, or is unable to conclude whether, the financial statements as a whole are materially misstated, the auditor shall consider the effect thereof on the opinion in the auditor's report. (Ref: Para. A24)

Documentation

20. The auditor shall document:

² In accordance with ISA 260 (Revised), "Communication with Those Charged with Governance," if this matter has been communicated with person(s) with management responsibilities, and those person(s) also have governance responsibilities, the matter need not be communicated again with those same person(s) in their governance role.

- (a) The amount below which misstatements would be regarded as clearly trivial;
- (b) All misstatements accumulated during the audit, distinguishing between factual misstatements, judgmental misstatements and projected misstatements, and whether they have been corrected by management; and
- (c) The auditor's conclusion as to whether uncorrected misstatements, individually or in aggregate, cause the financial statements as a whole to be materially misstated, and the basis for that conclusion. (Ref: Para. A25)

* * *

Application and Other Explanatory Material

Accumulation of Identified Misstatements (Ref: Para. 5)

- A1. 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. "Clearly trivial" is not another expression for not material. Matters that are "clearly trivial" will be of a wholly different (smaller) order of magnitude than materiality used in planning and performing the audit, and will be matters 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 is considered not "clearly trivial."
- A2. The distinction between factual misstatements, judgmental misstatements and projected misstatements assists the auditor in considering the effects of misstatements accumulated during the audit and in communicating them to management and those charged with governance.

Considerations as the Audit Progresses (Ref: Para. 6-8)

- A3. A misstatement may not be an isolated occurrence. Evidence that other misstatements may exist include, for example, where the auditor identifies that a misstatement arose from a breakdown in internal control or from inappropriate assumptions or valuation methods that have been widely applied by the entity.
- A4. If the aggregate of misstatements accumulated during the audit approaches the materiality levels or levels, there may be a greater than an acceptably low level of risk that possible undetected misstatements, when taken with the aggregate of misstatements accumulated during the audit, could exceed the materiality level. Undetected misstatements could exist because of the presence of sampling risk (the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population was subjected to the same audit procedure) and non-sampling risk (the risk that the auditor may misinterpret audit evidence and thus not recognize misstatements when they occur).
- A5. The auditor may request management to examine a class of transactions, account balance or disclosure, for example, based on the auditor's projection of misstatements identified in an audit sample to the entire population from which it was drawn.

Communication and Correction of Misstatements (Ref: Para. 9-10)

- A6. Timely communication of misstatements to the appropriate level of management is important as it enables management to evaluate whether the items are misstatements, inform

the auditor if they disagree, 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.

- A7. Laws or regulations may prevent the auditor from communicating certain misstatements to management, or others, within the entity. For example, laws or regulations may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act. In such circumstances it may be appropriate for the auditor to seek legal advice.
- A8. The correction by management of all misstatements communicated by the auditor assists management in maintaining accurate accounting books and records and reduces the risks of material misstatement of financial statements because of the cumulative effect of immaterial uncorrected misstatements related to prior periods.

Management Representations (Ref: Para. 11)

- A9. Because management is responsible for adjusting the financial statements to correct material misstatements, it is important that the auditor obtain written representation from management whether any uncorrected misstatements, other than those that are clearly trivial, are in management's opinion immaterial, both individually and in the aggregate. In some circumstances, management may not believe that certain of the uncorrected misstatements are misstatements. For that reason, management may want to add to their written representation words such as: "We do not agree that items ... and ... constitute misstatements because [description of reasons]."

Evaluating the Effect of Uncorrected Misstatements (Ref: Para. 12-14)

- A10. The auditor's initial determination of the materiality level or levels is often based on estimates of the entity's financial results, because the actual financial results may not yet be known. Therefore, prior to the auditor's evaluation of the effect of uncorrected misstatements, the materiality level or levels used in planning and performing the audit are reassessed based on the actual financial results.
- A11. ISA 320 explains that, as the audit progresses, the materiality level or levels are revised in the event of the auditor becoming aware of information during the audit that would have caused the auditor to have determined different materiality level or levels initially. Thus, any significant revision of the materiality level or levels is likely to have been made before the auditor applies the materiality level or levels in evaluating the effect of uncorrected misstatements. However, as explained in ISA 320, if the materiality level or levels are revised to lower amount or amounts, the lower amount or amounts determined for purposes of assessing risks of material misstatements and designing further audit procedures, and the appropriateness of the nature, timing and extent of further audit procedures, are reconsidered to ensure that sufficient appropriate audit evidence is obtained on which to base the audit opinion.
- A12. Each misstatement is considered separately 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.
- A13. If an individual misstatement is judged to be material, it is unlikely that it can be offset by other misstatements. For example, if revenue has been materially overstated, the financial statements as a whole will be materially misstated, even if the effect of the misstatement on earnings is completely offset by an equivalent overstatement of expenses. It may be

appropriate to offset immaterial misstatements within an account balance or class of transactions; however, the risk that further undetected misstatements may exist is considered before concluding that offsetting such immaterial misstatements is appropriate.³

A14. Determining whether a classification misstatement is material requires the use of professional judgment and the evaluation of qualitative considerations, such as the effect of the classification misstatement on debt or other contractual covenants, the effect on individual line items or sub-totals on the effect on key ratios. There may be circumstances where the auditor concludes that a classification misstatement is not material in the context of the financial statements as a whole, even though it may exceed the materiality level or levels applied in evaluating other misstatements. For example, a misclassification between balance sheet line items may not be considered material in the context of the financial statements as a whole when the amount of the misclassification is small in relation to the size of the related balance sheet line items and the misclassification does not affect the income statement or any key ratios.

A15. The circumstances related to some misstatements may cause the auditor to evaluate them as material, individually or when considered together with other misstatements accumulated during the audit, even if they are lower than the materiality level for the financial statements as a whole (or for a particular class of transactions, account balance or disclosure, if any). Circumstances that may affect the evaluation include the extent to which the misstatement:

- Affects compliance with regulatory requirements;
- Affects compliance with debt covenants or other contractual requirements; or
- Relates to the incorrect selection or application of an accounting policy that has an immaterial effect on the current period's financial statements but is likely to have a material effect on future periods' financial statements.
- Masks a change in earnings or other trends, especially in the context of general economic and industry conditions;
- Affects ratios used to evaluate the entity's financial position, results of operations or cash flows;
- Affects segment information presented in the financial statements (e.g., the significance of the matter to a segment or other portion of the entity's business that has been identified as playing a significant role in the entity's operations or profitability);
- Has the effect of increasing management compensation, for example, by ensuring that the requirements for the award of bonuses or other incentives are satisfied;
- Is a misclassification between certain account balances affecting items disclosed separately in the financial statements (e.g., misclassification between operating and non-operating income or recurring and non-recurring income items; or a misclassification between restricted and unrestricted resources in a not-for-profit entity);

³ The identification of a number of immaterial misstatements within an account balance or class of transactions may require the auditor to reassess the risk of material misstatement for that account balance or class of transactions.

- Is significant having regard to the auditor’s understanding of known previous communications to users, for example in relation to forecast earnings;
- Relates to items involving particular parties (e.g., whether external parties to the transaction are related to members of the entity’s management);
- Is an omission of information not specifically required by the applicable financial reporting framework but which, in the judgment of the auditor, is important to the users’ understanding of the financial position, financial performance or cash flows of the entity;
- Affects other information that will be communicated in documents containing the audited financial statements (e.g., information to be included in a “Management Discussion and Analysis” or an “Operating and Financial Review”) that may reasonably be expected to influence the economic decisions of the users of the financial statements. ISA 720, “Other Information in Documents Containing Audited Financial Statements” deals with the auditor’s consideration of other information, on which the auditor has no obligation to report, in documents containing audited financial statements.

These circumstances are only examples; not all are likely to be present in all audits nor is the list necessarily complete. The existence of any circumstances such as these does not necessarily lead to a conclusion that the misstatement is material.

A16. ISA 240, “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements” explains how the implications of a misstatement that is, or may be, the result of fraud ought to be considered in relation to other aspects of the audit, even if the effect of the misstatement is not material to the financial statements.

A17. The cumulative effect of immaterial uncorrected misstatements related to prior periods may have a material effect on the current period’s financial statements. There are different acceptable approaches to the auditor’s evaluation of such uncorrected misstatements on the current period’s financial statements. Using the same evaluation approach provides consistency from period to period.

Considerations Specific to Public Sector Entities (Ref: Para. 12-14)

A18. In the case of an audit of a public sector entity, the evaluation of the materiality of a misstatement may also be affected by legislation or regulation and additional responsibilities for the auditor to report other matters, including, for example, fraud.

A19. Furthermore, issues such as public interest, accountability, probity and ensuring effective legislative oversight, in particular, are considered when assessing whether an item is material by virtue of its nature. This is particularly so for items that relate to compliance with regulation, legislation or other authority.

Communication with Those Charged with Governance (Ref: Para. 15-16)

A20. Where there is a large number of small uncorrected misstatements, the auditor may communicate the number and overall monetary effect of the uncorrected misstatements, rather than the details of each individual uncorrected misstatement.

A21. To reduce the possibility of misunderstandings, the auditor may request a written representation from those charged with governance that explains why uncorrected misstatements brought to their attention have not been corrected. Obtaining this

representation does not, however, relieve the auditor of the need to form a conclusion on the effect of uncorrected misstatements.

Evaluating Whether the Financial Statements as a Whole are Free from Material Misstatement (Ref: Para. 18-19)

A22. In considering the qualitative aspects of the entity's accounting practices, the auditor recognizes that management makes a number of judgments about the amounts and disclosures in the financial statements. During the audit, the auditor is alert for possible bias in management's judgments. The auditor may conclude that the cumulative effect of a lack of neutrality, together with the effect of uncorrected misstatements, cause the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the auditor's evaluation whether the financial statements as a whole are materially misstated include the following:

- The selective correction of misstatements brought to management's attention during the audit (e.g., correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings).
- Possible management bias in the making of accounting estimates.

A23. ISA 540 (Revised), "Auditing Accounting Estimates and Related Disclosures (Other Than Those Involving Fair Value Measurements and Disclosures)" addresses possible management bias in making accounting estimates. Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

A24. ISA 705, "Modifications to the Opinion in the Independent Auditor's Report" deals with circumstances that may result in a modification to the auditor's opinion on the financial statements, the type of opinion appropriate in the circumstances, and the content of the auditor's report when the auditor's opinion is modified.

Documentation (Ref: Para. 20)

A25. The following factors may affect the manner in which the auditor documents the auditor's conclusion, and the basis thereof, as to whether uncorrected misstatements, individually or in the aggregate, cause the financial statements as a whole to be materially misstated:

- (a) The consideration of the aggregate effect of uncorrected misstatements on the financial statements as a whole;
- (b) The evaluation of whether the materiality level for a particular class of transactions account balance or disclosure, if any, has been exceeded; and
- (c) The evaluation of the effect of uncorrected misstatements on key ratios or trends, and compliance with legal, regulatory and contractual requirements (e.g., debt covenants).



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