

INTOSAI



*Directriz de
auditoría financiera
– Evaluación de
equivocaciones
identificadas durante
la auditoría*

INTOSAI PROFESSIONAL STANDARDS COMMITTEE

PSC-SECRETARIAT

RIGSREVISIONEN • LANDGREVEN 4 • P.O. BOX 9009 • 1022 COPENHAGEN K • DENMARK
TEL.: +45 3392 8400 • FAX: +45 3311 0415 • E-MAIL: INFO@RIGSREVISIONEN.DK

INTOSAI



INTOSAI General Secretariat - RECHNUNGSHOF
(Austrian Court of Audit)
DAMPFSCHIFFSTRASSE 2
A-1033 VIENNA
AUSTRIA
Tel.: ++43 (1) 711 71 • Fax: ++43 (1) 718 09 69

E-MAIL: intosai@rechnungshof.gv.at;
WORLD WIDE WEB: <http://www.intosai.org>

Nota de Práctica¹ para la [propuesta]² Norma Internacional de Auditoría [*International Standard on Auditing (ISA)*] 450 (revisada) – Evaluación de equivocaciones identificadas durante la auditoría

Fundamentos

Esta Nota de Práctica proporciona orientaciones suplementarias a los auditores del sector público sobre la Norma Internacional de Auditoría (ISA) 450 (revisada) “Evaluación de las equivocaciones identificadas durante la auditoría”. Esta Nota de Práctica se lee en conjunto con la ISA correspondiente. La Nota de Práctica entra en vigor en la misma fecha que la ISA.

Descripción de la ISA

La [Propuesta] ISA 450 (revisada) proporciona orientaciones sobre la evaluación de equivocaciones identificadas durante la auditoría de estados financieros. La (propuesta) ISA 320 (revisada), “La importancia en la planificación y la realización de una auditoría” trata sobre la determinación de la importancia y su aplicación en la planificación y realización de una auditoría de estados financieros. La (propuesta) ISA 450 (revisada) explica cómo se aplica la importancia a la evaluación de irregularidades identificadas durante la auditoría.

La (propuesta) ISA 450 revisada y con nueva redacción entra en vigor para las auditorías de estados financieros en períodos que comiencen en o antes del (insertar fecha).³

Contenido de la Nota de Práctica

- P1. La Nota de Práctica proporciona directrices adicionales para los auditores del sector público en relación con los temas siguientes:
- a. Consideraciones globales
 - b. Definiciones
 - c. Acumulación de irregularidades identificadas

¹ Todas las Notas de Prácticas se toman en consideración en conjunto con las Condiciones Generales de las Directrices de Auditoría Financiera.

² Esta Nota de Práctica se desarrolla del borrador de la (propuesta) ISA 450 (revisada), que fue publicada por el *International Auditing Assurance Standards Board* (IAASB) en octubre de 2006. Cabe la posibilidad de que necesite ser actualizada cuando el IAASB apruebe y publique la versión final de la ISA 450 (revisada).

³ Esta fecha no será anterior al 15 de diciembre de 2008.

- d. Consideraciones que surgen durante el transcurso de la auditoría
- e. Comunicación y corrección de irregularidades
- f. Evaluación de los efectos de las irregularidades no corregidas
- g. Evaluación sobre si los estados financieros, tomados en conjunto, están exentos de irregularidades importantes
- h. Documentación
- i. Consideraciones específicas en el entorno de un Tribunal de Cuentas

Aplicabilidad de la ISA en la auditoría del sector público

- P2. La [propuesta] ISA 450 (revisada) es aplicable a los auditores de entidades del sector público en su función de auditores de estados financieros.

Orientaciones adicionales sobre cuestiones del sector público

Consideraciones globales

- P3. Los objetivos de una auditoría de estados financieros del sector público no suelen limitarse a expresar una opinión sobre si los estados financieros han sido preparados, en todos los aspectos importantes, de acuerdo con el marco aplicable de información financiera (es decir, el ámbito de la ISA). Los objetivos pueden incluir responsabilidades de auditoría y de información, por ejemplo, relacionadas con informar sobre si el auditor ha encontrado casos de incumplimiento de mandatos, incluidos el presupuesto y la rendición de cuentas y/o la información relacionada con la eficacia del control interno. Además de evaluar las irregularidades los auditores del sector público también pueden evaluar casos de incumplimiento de mandatos, y desviaciones o deficiencias del control.
- P4. La (propuesta) ISA 450 (revisada) contiene consideraciones específicas para las entidades del sector público. Se exponen en los párrafos A18 y A19.

Definiciones

- P5. Como se ha indicado en el anterior párrafo 3, las auditorías de estados financieros de las entidades del sector público pueden incluir objetivos de cumplimiento de mandatos y de eficacia del control interno, según el mandato de auditoría o la legislación. Para estos objetivos, la Nota de Práctica añade las siguientes definiciones adicionales:
- a. Desviación del control: la entidad no sigue un procedimiento de control para una transacción.⁴

⁴ No todas las desviaciones de control representan una deficiencia de control (debilidad de control) puesto que (1) pueden existir controles compensadores, o (2) la frecuencia o la magnitud de la desviación pueden representar una situación aceptable, dado el nivel de riesgo.

- b. Deficiencia de control (debilidad de control): una condición en la que el diseño o la operación de un control no permite que la dirección o los empleados impidan o detecten a tiempo las irregularidades.⁵
- c. Incumplimiento de mandatos: incumplimiento de una ley o reglamentación, incluido un mandato presupuestario, para una transacción.

Acumulación de equivocaciones identificadas

- P6. El párrafo 5 de la (propuesta) ISA 450 (revisada) requiere que el auditor acumule las irregularidades identificadas durante la auditoría, distintas a aquellas que son claramente de escasa importancia, y que distinga entre irregularidades de hecho, irregularidades de juicio e irregularidades proyectadas. En el caso de los objetivos adicionales descritos en el anterior párrafo 3, los auditores del sector público también pueden acumular casos de incumplimiento de mandatos y pueden clasificarlos como de hecho, de juicio o proyectado. Por lo general los auditores del sector público no definen casos de incumplimiento de mandatos o desviaciones de control que son claramente de escasa importancia, ya que todos estos casos o desviaciones normalmente se acumulan y se evalúan.

Consideraciones a medida que avanza la auditoría

- P7. El párrafo 8 de la (propuesta) ISA 450 (revisada) requiere que el auditor realice procedimientos adicionales de auditoría para reevaluar la cantidad de irregularidades restantes, en su caso, después de que la dirección, en respuesta a los descubrimientos del auditor o a petición del auditor, haya examinado una clase de transacciones, el saldo de una cuenta o la comunicación y la corrección de las irregularidades identificadas. Incluso en el caso de que una transacción se presente correctamente en los estados financieros, si la transacción fue ilegítima o el control pertinente no se siguió, por su propia naturaleza representa un incumplimiento de mandato, o una desviación o una deficiencia de control.

Comunicación y corrección de irregularidades

- P8. El párrafo 11 de la (propuesta) ISA 450 (revisada) requiere que el auditor obtenga una representación escrita en la que se haga constar que la dirección considera los efectos de las irregularidades no corregidas en los estados financieros de escasa importancia. Los auditores del sector público también pueden obtener representaciones por escrito sobre el cumplimiento de los mandatos y la eficacia del control interno. Cuando los auditores del sector público encuentran casos de incumplimiento de mandatos o deficiencias de control, la dirección puede modificar tales declaraciones de acuerdo con ello.
- P9. Muchos auditores del sector público comunican todos los casos identificados de incumplimiento de mandatos. Algunos organismos de auditoría del sector público, de acuerdo con el mandato de auditoría, pueden ordenar a la entidad que corrija un caso de incumplimiento de mandatos. En tales casos, los auditores del sector público determinan si su independencia se verá afectada.

⁵ No todas las deficiencias de control surgen de una desviación de control, puesto que algunas de ellas resultan de un diseño inadecuado de los controles.

Evaluación de los efectos de las irregularidades no corregidas

- P10. Al aplicar el párrafo 13 de la (propuesta) ISA 450 (revisada) los auditores del sector público evalúan por separado las irregularidades de los estados financieros, los casos de incumplimiento de mandatos y las desviaciones de control.
- P11. Con respecto a las desviaciones de control, los auditores del sector público determinan si representan deficiencias de control. En dicha evaluación los auditores del sector público evalúan los controles compensadores para determinar si se ha cumplido el objetivo de control.

Comunicación a los encargados de la gobernanza

- P12. Los párrafos 15 a 17 de la (propuesta) ISA 450 (revisada) tratan sobre la comunicación de irregularidades no corregidas a los encargados de la gobernanza. Además, los auditores del sector público pueden comunicar casos de incumplimiento de mandatos y deficiencias de control a los encargados de la gobernanza. Los auditores del sector público también pueden comunicar equivocaciones, casos de incumplimiento de mandatos y deficiencias de control a terceras partes, por ejemplo a funcionarios de la Administración pública.
- P13. Al comunicar a los encargados de la gobernanza o a otros, mencionados en el anterior párrafo 12, se puede esperar que los auditores del sector público comuniquen todas las irregularidades, incluso aquellas que han sido corregidas por la entidad, y todas las deficiencias de control y todos los casos de incumplimiento de mandatos. La entidad del sector público puede constituir una parte limitada de la estructura de control más amplia del sector público. Por lo tanto, las deficiencias de control pueden tener implicaciones desde una perspectiva más amplia. La determinación de los auditores del sector público acerca de a quién comunicar los incumplimientos de mandatos y las deficiencias de control se basa en un criterio de juicio profesional y se lleva a cabo de conformidad con los siguientes factores:

- La práctica en el entorno del sector público
- La naturaleza y el número de casos
- Si es probable que existan casos similares en la entidad o en otras entidades de las que sean responsables los encargados de la gobernanza.

Al comunicarse con los encargados de la gobernanza, los auditores del sector público utilizan modalidades de información relevantes para su jurisdicción. Los auditores del sector público también pueden ser llamados a testificar ante el poder legislativo acerca de los resultados de la auditoría de los estados financieros.

Evaluación sobre si los estados financieros en su conjunto están exentos de irregularidades importantes

- P14. Si el auditor llega a la conclusión de que los estados financieros en su conjunto contienen irregularidades importantes, o si no puede concluir tal cosa, el párrafo 19 de la (propuesta) IISA 450 (revisada) requiere que el auditor tome en consideración el efecto que ello produce en la opinión que

aparece en el informe del auditor. En el sector público este requisito es relevante con respecto a las irregularidades. Cuando los auditores del sector público tienen responsabilidades adicionales de información, cada responsabilidad de informar puede evaluarse por separado. Por ejemplo, si a los auditores del sector público se les exige que informen sobre los casos de incumplimiento de mandatos, su evaluación sobre si la entidad ha cumplido los mandatos puede separarse de su evaluación acerca de si los estados financieros en su conjunto están exentos de irregularidades importantes. Sin embargo, las irregularidades y los casos de incumplimiento de mandatos también pueden interrelacionarse, aumentando potencialmente los riesgos de irregularidades importantes y vice versa. Por ejemplo, las irregularidades pueden representar casos de incumplimiento de mandatos.⁶

Documentación

- P15. El párrafo 20 de la (propuesta) ISA 450 (revisada) contiene requisitos de documentación con respecto a las irregularidades. Los auditores del sector público también documentan lo siguiente:
- a. Desviaciones de control identificadas, y comprobar si representan deficiencias de control.
 - b. Deficiencias de control que no se originan en desviaciones de control.
 - c. Casos identificados de incumplimiento de mandatos.
 - d. Conclusiones referentes a si hay que informar sobre incumplimientos de mandatos y deficiencias de control, y la base de tales conclusiones.

Consideraciones específicas en el entorno de un Tribunal de Cuentas

- P16. En el entorno de un Tribunal de Cuentas, a menudo el informe de los auditores se juzga y se utiliza para determinar las implicaciones jurídicas personales de los responsables de los actos financieros, incluyendo las áreas significativas, los incumplimientos de mandatos y las deficiencias de control. Por lo tanto, los auditores del sector público en el entorno de un Tribunal de Cuentas, al evaluar las irregularidades, los incumplimientos de mandatos y las desviaciones de control que se identifiquen durante la auditoría, también identifican a los responsables de los actos financieros y del cumplimiento de los requisitos legales.

⁶ El IAASB está tomando en consideración trasladar este párrafo a la Propuesta de ISA700 (revisado). Si ocurre tal cosa, este párrafo se trasladará a la correspondiente Nota de Práctica.

*Proposed Redrafted International Standard on
Auditing*

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



International Federation
of Accountants

International Auditing and Assurance Standards Board
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

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).



International Federation of Accountants

545 Fifth Avenue, 14th Floor, New York, NY 10017 USA

Tel +1 (212) 286-9344 Fax +1(212) 286-9570 www.ifac.org