

## **Materiality in the Identification and Evaluation of Misstatements**

### **Introduction**

At the October 2005 IAASB meeting, the Task Force discussed the overall comments received on exposure as well as a number of significant comments and related proposed dispositions. As a result of this discussion, changes made to the proposed ISA are outlined in the following paragraphs.

In addition, the significant comments that were not discussed at the October 2005 IAASB meeting are carried forward in this paper and the Task Force's recommendations are reflected in the revised draft ISAs.

### **An ISA for Materiality and a Separate ISA for Misstatements**

The proposed ISA has been split into two proposed ISAs: *Materiality in Planning and Performing an Audit* (Agenda Item 6-B) and *Evaluation of Misstatements Identified During the Audit* (Agenda Item 6-C). A mark up version of the two proposed ISAs (reflecting all changes made to the Exposure Draft) can be found in Agenda Item 6-F and Agenda Item 6-G. However, the clean version of both documents will be used for purposes of the discussion at the December 2005 IAASB meeting.

At the request of the IAASB, the Task Force has prepared a paper (Agenda Item 6-D) on the potential content of an ISA on forming an opinion on the financial statements, including an indication of the requirements and guidance from other ISAs that could be moved to such an ISA.

### **Conforming Amendments**

The Task Force was asked to consider whether conforming amendments to other ISAs are needed, taking into account the comments received from the Basel Committee and IOSCO on this issue.

The Basel Committee was of the view that the focus on materiality has moved away from a large emphasis on audit risk. It expected to see various conforming amendments related to planning, the objectives of the audit, and communication with those charged with governance.

The Task Force does not believe that conforming amendments are required for the following reasons:

- The concept of materiality is incorporated throughout the *Audit Risk Standards*. The focus of ED-ISA 315 (Redrafted), *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* is on the identification and assessment of the risks of material misstatement at the financial statement and assertion levels and the focus of ED-ISA 330 (Redrafted), *The Auditor's Procedures in Response to Assessed Risks* is on the auditor's response to the assessed risks of material misstatement at the financial statement and assertion levels.
- The Appendix to ED-ISA 300 (Redrafted), *Planning an Audit of Financial Statements* clearly indicates that one of the matters that determine the focus of the engagement team's effort and direction of the audit is the determination of appropriate materiality levels,

including setting materiality for planning purposes and identifying the material components and account balances.

- Proposed ISA 260 (Revised), *The Auditor's Communication with Those Charged with Governance* requires the auditor to communicate directly with those charged with governance an overview of the planned scope and timing of the audit, which includes the concept of materiality and the factors considered in its determination.

IOSCO noted that the concept of management bias should be more fully developed to ensure that the auditor is clearly guided in the ISAs on how to obtain sufficient appropriate audit evidence concerning the qualitative aspects of an entity's accounting practices. IOSCO expected additional coverage of this matter in ISA 315.

The Task Force is of the view that the qualitative aspects of an entity's accounting practices are already covered in the ISAs, as follows:

- Paragraph 12(c) of ED-ISA 315 (Redrafted) requires the auditor to obtain an understanding of the entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor is required to consider whether the accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry. As further explained in paragraph A24, such an understanding encompasses the methods used by the entity to account for significant and unusual transactions and the effect of significant accounting policies in controversial or emerging areas.
- Proposed ISA 260 (Revised) requires the auditor to communicate to those charged with governance the auditor's views about the qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.

The Task Force, however, is proposing that paragraph 5a (b) of ISA 580, *Management Representations* be moved to proposed ISA XXX. Please refer to paragraph 20 Agenda Item 6-C.

### **The Application of the Proposed ISA to Public Sector Entities and in Special Purpose Audits**

The Task Force has liaised with INTOSAI to revise the Public Sector Perspective (PSP) based on comments received. The revised PSPs included in Agenda Item 6-B and Agenda Item 6-C have been forwarded to INTOSAI for review.

The IAASB agreed with the Task Force's conclusion that the ISAs apply to both the audit of financial statements and the audit of other historical financial information. The IAASB, however, acknowledged that the guidance in the ISAs may need to be adapted in the case of an audit of other historical financial information. The IAASB agreed that this fact should not be stated in each ISA, but addressed in proposed ISA 701, *The Independent Auditor's Report on Other Historical Financial Information*. As a result, the related sentence in ED-ISA 320.1 was deleted. For the same reason, the Task Force subsequently concluded that ED-ISA 320.10 should be deleted.

## **Management's Responsibility for Determining Materiality and Tolerable Misstatement for Financial Reporting Purposes**

At the October 2005 IAASB meeting, the Task Force reported that some respondents were of the view that the auditor, when determining materiality for planning and performing the audit, should consider materiality that management has determined for internal control and financial reporting purposes because an inappropriate determination of materiality, or its incorrect application, on the part of management represents a risk that may cause the financial statements to be materially misstated.

The Task Force recommended that no amendment be made to ED-ISA 320 and that no conforming changes be made to ED-ISA 315. This recommendation was consistent with the conclusion reached by the IAASB prior to approving the ED-ISA 320. On balance, the IAASB agreed with the Task Force's recommendation. The IAASB, however, requested the Task Force to consider whether the requirements and guidance in ED-ISA 315 are sufficient, or whether an explicit reference should be inserted by way of conforming amendment. The Task Force has carried out a review of the ISA (please refer to Agenda Item 6-E), and remains of the view that no conforming amendments to ED-ISA 315 are needed.

## **The Definition of Materiality (ED-ISA 320.6-7) and Users of Financial Statements (ED-ISA 320.8-10)**

In response to comments received at the October 2005 IAASB meeting, the Task Force made the following amendments to the proposed definitions of materiality, users of financial statements, and misstatement.

### *Materiality*

The Task Force concluded that an ISA definition and reference to the fact that the definition of materiality in the applicable financial reporting framework provides a frame of reference when determining materiality respond to the comments of respondents and the IAASB. This is reflected in the proposed revised text in paragraphs 5 and 8 of proposed ISA 320 (Agenda Item 6-B). In addition, the Task Force reinstated:

- The ED text that limited the meaning of “could ... influence” (as per the IAS 1 definition) to “could reasonably be expected to influence.” Please refer to paragraph 5 of proposed ISA 320 (Agenda Item 6-B).
- The word “economic,” i.e., use the term “economic decisions” in light of the IAASB's view that the term “economic decisions” is well established and assisted in describing the extent of the auditor's responsibility to consider the needs of users of the financial statements when determining materiality. Please refer to paragraph 5 of proposed ISA 320 (Agenda Item 6-B).

### *Users*

The Task Force reinstated the reference, in a footnote, to the IASB Framework that notes that the collective needs of investors as a group is an appropriate frame of reference when determining materiality, in light of the IAASB's view that without this guidance the ISA may be interpreted as requiring the auditor to determine the differing views of materiality held by individual investors. Please refer to paragraph 6 of proposed ISA 320 (Agenda Item 6-B).

### *Misstatement*

The definition addresses both compliance with the applicable financial reporting framework and fair presentation of the financial statements and applies whether or not the applicable financial reporting framework is designed to achieve fair presentation. Please refer to paragraph 3 of proposed ISA XXX (Agenda Item 6-C).

### **Qualitative Aspects of Materiality**

The IAASB agreed with the Task Force's conclusion that the qualitative aspects of materiality are considered in evaluating misstatements, and not when determining materiality for planning and performing an audit. Paragraph 10 of proposed ISA 320 (Agenda Item 6-B) explains that although the auditor is alert for misstatements that could be material because of their nature, it ordinarily is not practical to design audit procedures to detect such misstatements.

The IAASB, however, requested the Task Force to reconsider the proposed revised text, and how the requirement that the auditor should also consider the necessity to determine materiality for particular classes of transactions, account balances and disclosures ties into this guidance. Paragraph 17 of proposed ISA 320 (Agenda Item 6-B) has been expanded to clarify that when there are particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality level for the financial statements as a whole could reasonably be expected to influence the economic decisions of users, the auditor should determine the materiality levels to be applied to those particular classes of transactions, account balances or disclosures.

### **The Percentages of Benchmarks (ED-ISA 320.13-14)**

The IAASB discussed at length whether the examples of percentages of benchmarks should be retained and, if retained, how they should be revised. A small majority of IAASB members were in favor of deleting the examples. Some IAASB members suggested that the guidance be expanded to provide examples of factors that would affect the auditor's determination of the percentage.

The Task Force considered the IAASB's comments and concluded that additional percentages could not be easily provided because "lists" of generally accepted/applied percentages information are not readily available. The Task Force has, however, expanded the guidance to explain the relationship between the percentage and the chosen benchmark and has added an additional example relating to a not-for-profit entity. Please refer to paragraph 16 of proposed ISA 320 (Agenda Item 6-B).

### **Significant Comments Carried Forward from the October 2005 IAASB Meeting**

#### **Inherent Uncertainty Associated with the Measurement of Particular Financial Statement Items (ED-ISA 320.16)**

Some respondents explicitly supported the guidance in ED-ISA 320.16, which states that materiality is determined without regard to the degree of inherent uncertainty associated with the measurement of particular items. Several other respondents (ACCA, AUASB, Basel, HKICPA, ICAEW, ICAS, IDW, GT, PWC), however, raised issues in relation to the guidance.

- One respondent (ACCA) was of the view that underlying the example in the paragraph is a large area of debate about the users' understanding of the concept of reasonable assurance and the interaction between materiality and audit risk. This respondent was of the view that without considerably more explanation (for which an ISA is not the place) it is difficult to justify its inclusion.
- Other respondents (AUASB, ICAEW, PWC) believed that the guidance is not particularly helpful to the auditor and is counter-intuitive. A respondent argued that, where an entity operates in an industry with high inherent uncertainty associated with the measurement of a particular item, such as an insurance company with long tail general provisions, the auditor will consider the significant risks of material misstatement associated with that particular item, and determine materiality relevant to that particular item. This respondent, however, did not agree that this will have no effect on materiality determined for the financial statements. If that particular item has a significantly high degree of estimation uncertainty, an incorrect calculation could be so pervasive that it will affect the financial statements as a whole. The auditor might have to consider this factor when determining materiality for the financial statements.
- Another respondent (Basel) noted that the paragraph would benefit from additional considerations for auditors where the financial statements contain a number of estimates.
- One respondent (IDW) suggested that the first sentence of the paragraph should be amended to read: "Materiality is independent of the degree of inherent uncertainty associated with the measurement of particular items." Tolerable error, on the other hand will be directly affected. This should be made clear in the section covering tolerable error. Another respondent (GT) had made a similar comment.

### ***Task Force's Recommendation***

The guidance intended to clarify that the auditor does not adjust materiality determined for planning and performing the audit when, in the case of an accounting estimate, the range of reasonable outcomes is larger than materiality. The Task Force is of the view that the concept will be more easily understood in the context of the guidance in proposed ISA 540, *Auditing Accounting Estimates and related Disclosures (Other than Those Involving Fair Value Measurements and Disclosures)* and accordingly has deleted ED-ISA 320.16.

### **Tolerable Error (ED-ISA 320.20-21)**

Many respondents raised issues about the guidance on tolerable error in ED-ISA 320.20 and 21.

Given that misstatements may be due to error or fraud, some respondents (Deloitte, FEE, IAA) recommended that the term "tolerable error" should be replaced by "tolerable misstatement," and that conforming amendments should be made to ISA 530, "Audit Sampling and Other Means of Testing," and elsewhere as necessary. Other respondents (HKICPA, PWC) were of the view that the term "tolerable error" should be replaced by "planning materiality."

Many respondents (AICPA, AUASB, CGA Canada, CPA Australia, Deloitte, FEE, FEI, HKICPA, IAA, IOSCO, KPMG, PWC) were of the view that the requirements and guidance should explain (a) how the levels of tolerable error relate to materiality, (b) the factors that affect the determination of the levels of tolerable error, (c) how the levels of tolerable error may be

determined, and (d) how tolerable error is used in performing the audit. Specific comments included the following:

- One respondent (Deloitte) questioned ED-ISA 320.20, which states that “[t]he auditor should determine one or more levels of tolerable error for classes of transactions, account balances and disclosures.” ED-ISA 320.21, however, refers to ED-ISA 320.17, where it is contemplated that the auditor may establish more than one level of materiality when there are particular items that warrant materiality levels lower than the materiality level determined for the financial statements as a whole.
  - One possible interpretation is that multiple levels of tolerable error are only required when there are multiple levels of materiality as contemplated in ED-ISA 320.17.
  - Another interpretation is that multiple levels of tolerable error may be necessary for classes of transactions, account balances and disclosures to ensure that the aggregate misstatement in the financial statements is not material. In other words, even if there are no ED-ISA 320.17-type lower levels of materiality, it may still be necessary to establish more than one level of tolerable error for classes of transactions, account balances or disclosures.
  - The ambiguity arises because multiple levels of tolerable error may be necessitated by multiple levels of materiality, by multiple classes of transactions, account balances and disclosures, or by both.
- One respondent (Deloitte) was of the view that audit risk is the key concept linking tolerable error and materiality. Levels of tolerable error should be determined for classes of transactions, account balances and disclosures in a way that ensures that, if the risk that such levels could be exceeded is acceptably low, in aggregate, the risk that the total misstatement in the financial statements could exceed materiality will also be acceptably low.
- One respondent (CNCC) noted that the concept of tolerable error is linked to statistical sampling, and that this link should be made clear in ED-ISA 320.20. Another respondent (FEE) was of the view that it is necessary to include different definitions for tolerable error for sample sizes as compared to classes of transactions, account balances and disclosures.

### ***Task Force’s Recommendation***

The purpose of the requirement and guidance on tolerable error was to require the auditor, in performing risk assessment and further audit procedures, to allow for the possibility that the aggregate of individually immaterial misstatements could be material. In practice, various terms are used to describe this concept. Reference to the term “tolerable error” in the ED created confusion and requests for additional guidance on the approach to be followed in determining tolerable error.

To eliminate confusion, the Task Force has expanded the guidance in ED-ISA 320.20-21 to explain the concept in general terms (i.e., without reference to the term “tolerable error”). Please refer to paragraph 21 of proposed ISA 320 (Agenda Item 6-B).

### **Categorization of Misstatements (ED-ISA 320.31)**

Many respondents took the view that the categorization of misstatements in ED-ISA 320.31 should be revised. (ACCA, AICPA, AUASB, Basel, CICA, CNCC, DNR, E&Y, FEE, GT,

HKICPA, ICAEW, ICAS, IDW, PAAB, PKF, PWC.) Most of these respondents were concerned about the misstatements involving subjective decisions as a subset of known misstatements.

- One respondent (GT) was of the view that the different categories of misstatements should be described earlier in the ISA, i.e., when the nature and causes of misstatements are discussed.
- Many respondents (ACCA, AICPA, AUASB, CNCC, DNR, FEE, HKICPA, ICAEW, IDW, PKF, PWC) did not believe that a misstatement involving subjective decisions is a known misstatement. They were of the view that a misstatement can only be known if it is a misstatement of fact. If the misstatement has arisen because there is a difference between management's and the auditor's judgment concerning an estimate, the quantum of the misstatement can not be known for a fact. This is because it is not known, for a fact, which of the two estimates is the correct one and hence what the misstatement is. Another respondent (E&Y) suggested that the ISA explain why misstatements involving subjective decisions are considered to be known misstatements. Two respondents (FEE, IDW) suggested that the terms "presumed known misstatement," with subcategories "presumed misstatements of fact" and "presumed misstatements involving subjective decisions," are used until such misstatements are confirmed as misstatements. Other respondents suggested "misstatements of fact," "misstatements involving subjective decisions" (as two separate categories), and "projected misstatements."
- One respondent (AICPA) noted that a difference between management's and the auditor's accounting estimate is more appropriately categorized as a likely misstatement, i.e., a misstatement that the auditor considers likely to exist based on an extrapolation of audit evidence obtained. This respondent argued that a sample result is based on a probability assessment, so the nature of the misstatement arising from this process should be the same in either subjective or objective (sample) estimation. It is inconsistent that a probability assessment of a subjective estimate would result in a known misstatement, whereas a probability assessment of an objective estimate would result in a likely misstatement.
- One respondent (CNCC) noted that the term "material misstatement of fact" is used in ISA 720, "Other Information in Documents Containing Audited Financial Statements" for incorrectly stated or presented information, which the auditor identified by reading other information in documents containing audited financial statements. The nature of these material misstatements of facts are different from that of the misstatements of fact discussed in ED-ISA 320.31. The respondent suggested that the same term should not be used for both.
- One respondent (Basel) suggested deleting the words "misinterpretation of facts" in the misstatements of fact subcategory because, by definition, an interpretation involves the use of judgment and is therefore subjective. The respondent was of the view that interpretations should form part of the misstatements involving subjective decisions.
- Two respondents (FEE, PWC) suggested that the IAASB use terms that are close to describing the actual guidance. The term "likely misstatement" is applied to a misstatement that might exist from an extrapolation for audit evidence, i.e., a "projected misstatement." These respondents suggested that the term "likely misstatement" should be replaced by "projected misstatement."

One respondent (KPMG) noted that the term “undetected misstatements” in ED-ISA 320.27 is not defined. The respondent was concerned that this lack of guidance could result in varying interpretations and thus inconsistencies in practice. It was suggested that the proposed ISA should include additional guidance on how the auditor would practically carry out the requirements of ED-ISA 320.27, and when specific undetected misstatements need to be considered, e.g., sampling risk arising from the application of representative sampling.

Other respondents (ACCA, FEE, HKICPA, ICAEW, IDW) were of the view that the ED draws an arbitrary line by requiring auditors to request correction of all known misstatements, which includes misstatements involving subjective decisions, while further investigation of misstatements by management is limited to likely misstatements. In practice, management and auditors may seek to resolve many misstatements involving subjective decisions and likely misstatements at different stages during the audit (perhaps altering the preliminary categorization of misstatements involving subjective decision to misstatements of fact).

Some respondents (FSR, HKICPA, PWC) questioned the requirement for the auditor to request management to examine a class of transactions, account balance or disclosure where the auditor evaluates the amount of likely misstatement in that class of transactions, account balance or disclosure as material, either individually or in aggregate with other misstatements (see ED-ISA 320.32). They were also concerned about the related guidance (ED-ISA 320.33). One respondent (FSR) was of the view that management’s correction of likely misstatements should be sufficient since appropriate use of sampling techniques would make the point estimate – the aggregate of known and likely misstatements – the best estimate of the misstatements. Two respondents (HKICPA, PWC) added that management has a choice either to correct the likely misstatements or to do more work with regard to those classes of transactions, account balances or disclosures.

On the other hand, one respondent (Deloitte) suggested that it is made clear that it is not sufficient for management to simply correct all the likely misstatements without examining the classes of transactions, account balances or disclosures. Two respondents (DNR, Horwath) were of the view that management should perform the examination, but that the auditor does not have to perform further audit procedures, unless management has disclosed additional information that makes further audit procedures necessary.

### ***Task Force’s Recommendation***

In response to the comments received, the Task Force recommends that proposed ISA XXX establishes requirements and provides guidance on (a) accumulating misstatements identified during the audit (including how they should be categorized), (b) considering accumulated misstatements as the audit progresses, (c) communicating accumulated misstatements to management, and (d) requesting management to correct accumulated misstatements. To avoid confusion, the Task Force is of the view that the term “known misstatement” should not be used. This could be achieved by establishing three categories of misstatements (i.e., factual misstatements, judgmental misstatements, and projected misstatements), and clearly describing each of these categories. Please refer to paragraph 7 of proposed ISA XXX (Agenda Item 6-C).



**Prior period Uncorrected Misstatements (ED-ISA 320.36(c))**

Several respondents (CNCC, Deloitte, GT, ICAS, KPMG, PWC) identified a need for guidance on the method of evaluating prior period uncorrected misstatements and the effect it has on the auditor's evaluation of current period uncorrected misstatements.

***Task Force's Recommendation***

There are two recognized methods of evaluating prior period uncorrected misstatements – the first method adopts a more “balance sheet view,” (sometimes referred to as the “iron curtain method”) and the other a more “income statement view” (sometimes referred to as the “rollover method”). The Task Force recognizes the merits of both methods, and that both methods are used in practice by auditors. The Task Force does not believe that the IAASB, on its own, can mandate the use of one method over the other. There are significant implications for financial reporting when moving from one method to another, and regulators and investors need to pave the path to transition to make such changes possible. The Task Force therefore recommends that ISA XXX:

- Do not prescribe a method for evaluating prior period uncorrected misstatements; and
- Explain that the cumulative effect of immaterial uncorrected misstatements related to prior periods may have a material effect on the current period's financial statements. Therefore, the auditor considers both (a) the adjustment(s) necessary to correct misstatements in the ending balance sheet, even if they arose in whole or part in prior periods and (b) the adjustment(s) necessary to correct misstatements affecting the current income statement.

Please refer to paragraph 17 of proposed ISA XXX (Agenda Item 6-C).

**Management Bias (ED-ISA 320.40 (Second Bullet))**

The concept of management bias relating to accounting estimates was first introduced in paragraphs 76(b), 80 and 81 of ISA 240, “The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements.” ED-ISA 540 contained requirements and guidance on the auditor's determination and documentation of misstatements and indicators of possible management bias relating to individual accounting estimates. ED-ISA 320 explained that, during the audit, the auditor is alert for possible bias in management's judgments, since the cumulative effect of a lack of neutrality, together with uncorrected misstatements, may cause the financial statements as a whole to be materially misstated. Although not one respondent opposed including the concept of management bias in ED-ISA 320, and some respondents explicitly supported its inclusion, they raised issues in relation to the proposed guidance.

- Some respondents (HKICPA, ICAEW) were of the view that the concept should be dealt with earlier in the ISA. Two respondents (ICAS, INTOSAI) suggested that it be addressed in the Nature and Causes of Misstatements section (see ED-ISA 320.4). Two respondents (CEBS, IOSCO) noted that it is an important aspect of determining “planning materiality” and, therefore, should be addressed in the section on Determining Materiality for the Financial Statements as a Whole when Planning the Audit. Another respondent (CICA) suggested that it be included in the circumstances (“qualitative factors”) listed in ED-ISA 320.37.

- A respondent (E&Y) requested more specific guidance on possible management bias in making accounting estimates. This respondent suggested a stronger link to the guidance on indicators of possible management bias in proposed ISA 540. Another respondent (CICA) made a similar comment.
- A respondent (IDW) noted that ED-ISA 320.35 relates to all uncorrected misstatements and, therefore, includes those resulting from possible management bias. ED-ISA 320.39 requires the auditor to “consider both the evaluation of the uncorrected misstatements required in paragraph 35 and the qualitative aspects of the entity’s accounting practices” in evaluating whether the financial statements as a whole are free of material misstatement. Further explanation of the qualitative aspects of the entity’s accounting practices is provided. However, is the auditor not double counting any possible management bias? Especially where estimates appear to the auditor as either over or under cautious?
- A respondent (AICPA) noted that neither ED-ISA 320 nor ED-ISA 540 concludes whether possible management bias is a misstatement. This respondent was of the view that, if indicators of management bias are present, the auditor should undertake sufficient audit procedures to be satisfied that the accounting estimates are neutral and thus free of bias. The auditor uses a neutral estimate for purposes of assessing the reasonableness of management’s estimates and differences, if any, are evaluated as uncorrected misstatements.
- A respondent (GT) was of the view that a separate evaluation of the uncorrected misstatements and the qualitative aspects of the entity’s accounting practices at the end of the engagement is not necessary. Such matters should be discussed in the context of planning and performing the audit and in forming the final opinion, including the analytical procedures performed at or near the end of the engagement, which corroborate the auditor’s conclusions with regard to individual components or elements of the financial statements and assist in arriving at an overall conclusion as to the reasonableness of the financial statements as a whole.
- Two respondents (FEE, IAA) commented on the examples of possible management bias in the second bullet of ED-ISA 320.40 (or referred to their comments on ED-ISA 540 in this regard).

### ***Task Force’s Recommendation***

Proposed ISA 540 presumes that the consideration of the effect of the presence of indicators of possible management bias on whether the risk assessment remains appropriate and whether the financial statements as a whole are free of material misstatement takes place in ISA XXX (see paragraph 93 of proposed ISA 540 – Agenda Item 2-B of the October 2005 meeting). Proposed ISA 540 does not contain requirements or guidance in this regard; it cross refers to the considerations in ISA XXX. ED-ISA 320, however, does not contain such requirements or guidance.

The Task Force agrees with the Accounting Estimates Task Force’s conclusion that indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates (see paragraph 93 of proposed ISA 540 – Agenda Item 2-B of the October 2005 meeting).

The Task Force does not agree that proposed ISA XXX should provide requirements or guidance on the consideration whether, based on the presence of indicators of management bias, the risk assessment remains appropriate. The Task Force however, has revised the guidance on evaluating whether the financial statements as a whole are free of material misstatement in proposed ISA XXX, to further clarify the link between proposed ISA 540 and proposed ISA XXX. Please refer to paragraph 24 of Agenda Item 6-C.

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