

Auditing Disclosures – Changes to Various ISAs

(Extracts of extant standards with mark-up for Disclosures changes highlighted in yellow)¹

ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

Definitions

13. For purposes of the ISAs, the following terms have the meanings attributed below:

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

¹ Other mark-ups shown in this document that have not been highlighted relate to the Auditor Reporting Exposure Draft.

ISA 210, *Agreeing the Terms of Audit Engagements*

Agreement on Audit Engagement Terms

10. Subject to paragraph 11, the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include: (Ref: Para. A22–A25) **[NO CHANGE PROPOSED TO THE REQUIREMENT FOR DISCLOSURES]**
- (a) The objective and scope of the audit of the financial statements;
 - (b) The responsibilities of the auditor;
 - (c) The responsibilities of management;
 - (d) Identification of the applicable financial reporting framework for the preparation of the financial statements; and
 - (e) Reference to the expected form and content of any reports to be issued by the auditor, including, if the auditor is not required to communicate key audit matters but intends to do so, a statement that the auditor intends to communicate key audit matters; and (Ref: Para. A23a)
 - (f) A statement that there may be circumstances in which a report may differ from its expected form and content.

Agreement on Audit Engagement Terms

*Audit Engagement Letter or Other Form of Written Agreement*² (Ref: Para. 10–11)

Form and Content of the Audit Engagement Letter

A23. The form and content of the audit engagement letter may vary for each entity. Information included in the audit engagement letter on the auditor's responsibilities may be based on ISA 200.³ Paragraphs 6(b) and 12 of this ISA deal with the description of the responsibilities of management. In addition to including the matters required by paragraph 10, an audit engagement letter may make reference to, for example:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, ISAs, and ethical and other pronouncements of professional bodies to which the auditor adheres.
- The form of any other communication of results of the audit engagement.
- The requirement for the auditor to communicate key audit matters in the auditor's report in accordance with proposed ISA 701.⁴
- The fact that because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements

² In the paragraphs that follow, any reference to an audit engagement letter is to be taken as a reference to an audit engagement letter or other suitable form of written agreement.

³ ISA 200, paragraphs 3–9

⁴ Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

may not be detected, even though the audit is properly planned and performed in accordance with ISAs.

- Arrangements regarding the planning and performance of the audit, including the composition of the engagement team.
- The expectation that management will provide written representations (see also paragraph A13).
- **The expectation that management will provide support for the disclosures in the financial statements, including for those disclosures generated by systems or processes that are not part of the general ledger system.**
- The agreement of management to make available to the auditor draft financial statements, **including the related notes to the financial statements**, and any accompanying other information in time to allow the auditor to complete the audit in accordance with the proposed timetable.
- The agreement of management to inform the auditor of facts that may affect the financial statements, of which management may become aware during the period from the date of the auditor's report to the date the financial statements are issued.
- The basis on which fees are computed and any billing arrangements.
- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein.

Appendix 1

Example of an Audit Engagement Letter

The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with International Financial Reporting Standards. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in this ISA. It will need to be varied according to individual requirements and circumstances. It is drafted to refer to the audit of financial statements for a single reporting period and would require adaptation if intended or expected to apply to recurring audits (see paragraph 13 of this ISA). It may be appropriate to seek legal advice that any proposed letter is suitable.

To the appropriate representative of management or those charged with governance of ABC Company:⁵

[The objective and scope of the audit]

⁵ The addressees and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons – see paragraph A21.

You⁶ have requested that we audit the financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

~~Our audit will be conducted with t~~ The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our expressing an opinion on the financial statements. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (ISAs) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

[The responsibilities of the auditor]

We will conduct our audit in accordance with ~~International Standards on Auditing (ISAs).~~ Those standards require that we comply with ethical requirements, ~~and~~ As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the planning and performing of the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit also involves ~~We also:~~

- ~~performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of~~ Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- ~~In making our risk assessments, we~~ Obtain an understanding of ~~consider~~ internal control relevant to the entity's preparation of the financial statements ~~audit~~ in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.⁷ However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the financial statements that we have identified during the audit.
- ~~An audit also includes evaluating~~ Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates ~~and related disclosures made by management,~~ as well as
- ~~evaluating~~ Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

⁶ Throughout this letter, references to "you," "we," "us," "management," "those charged with governance" and "auditor" would be used or amended as appropriate in the circumstances.

⁷ This sentence would be modified, as appropriate, in circumstances when the auditor also has responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with ISAs.

[The responsibilities of management and identification of the applicable financial reporting framework (for purposes of this example it is assumed that the auditor has not determined that the law or regulation prescribes those responsibilities in appropriate terms; the descriptions in paragraph 6(b) of this ISA are therefore used).]

Our audit will be conducted on the basis that [management and, where appropriate, those charged with governance]⁸ acknowledge and understand that they have responsibility:

- (a) For the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards;⁹
- (b) For such internal control as [management] determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error;
- (c) To provide us with:
 - (i) Access to all information of which [management] is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - (ii) **Appropriate support for the disclosures in the financial statements, including for those disclosures generated by systems or processes that are not part of the general ledger system.**
 - (iii) Additional information that we may request from [management] for the purpose of the audit; and
 - (iv) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from [management and, where appropriate, those charged with governance], written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation from your staff during our audit.

[Other relevant information]

[Insert other information, such as fee arrangements, billings and other specific terms, as appropriate.]

[Reporting]

[Insert appropriate reference to the expected form and content of the auditor's report, including where applicable the intent of an auditor of financial statements of an entity other than a listed entity to communicate key audit matters if not otherwise required to do so. This section may also include reference

⁸ Use terminology as appropriate in the circumstances.

⁹ Or, if appropriate, "For the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards"

to the auditor's required reporting responsibilities in relation to going concern, other information and key audit matters.]

The form and content of our report may need to be amended in the light of our audit findings.

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

XYZ & Co.

Acknowledged and agreed on behalf of ABC Company by

(signed)

.....

Name and Title

Date

ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

Discussion among the Engagement Team

15. ISA 315 requires a discussion among the engagement team members and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion.¹⁰ This discussion shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. The discussion shall occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity. (Ref: Para. A10–A11) [NO CHANGE PROPOSED TO THE REQUIREMENT FOR DISCLOSURES]

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

- A10. Discussing the susceptibility of the entity's financial statements to material misstatement due to fraud with the engagement team:
- Provides an opportunity for more experienced engagement team members to share their insights about how and where the financial statements may be susceptible to material misstatement due to fraud.
 - Enables the auditor to consider an appropriate response to such susceptibility and to determine which members of the engagement team will conduct certain audit procedures.
 - Permits the auditor to determine how the results of audit procedures will be shared among the engagement team and how to deal with any allegations of fraud that may come to the auditor's attention.
- A11. The discussion may include such matters as:
- An exchange of ideas among engagement team members about how and where they believe the entity's financial statements, **including disclosures required by the applicable financial reporting framework,** may be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated.
 - A consideration of circumstances that might be indicative of earnings management and the practices that might be followed by management to manage earnings that could lead to fraudulent financial reporting.
 - A consideration of the known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalize committing fraud.
 - A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation.

¹⁰ ISA 315, paragraph 10

- A consideration of any unusual or unexplained changes in behavior or lifestyle of management or employees which have come to the attention of the engagement team.
- An emphasis on the importance of maintaining a proper state of mind throughout the audit regarding the potential for material misstatement due to fraud.
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud.
- A consideration of how an element of unpredictability will be incorporated into the nature, timing and extent of the audit procedures to be performed.
- A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity's financial statements, including disclosures required by the applicable financial reporting framework, to material misstatement due to fraud and whether certain types of audit procedures are more effective than others.
- A consideration of any allegations of fraud that have come to the auditor's attention.
- A consideration of the risk of management override of controls.

ISA 260, *Communication with Those Charged with Governance*

Matters to Be Communicated

The Auditor's Responsibilities in Relation to the Financial Statement Audit

14. The auditor shall communicate with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, including that: [NO CHANGE PROPOSED TO THE REQUIREMENT FOR DISCLOSURES]
- (a) The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance; and
 - (b) The audit of the financial statements does not relieve management or those charged with governance of their responsibilities. (Ref: Para. A9–A10)

Planned Scope and Timing of the Audit

15. The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor. (Ref: Para. A11–A15) [NO CHANGE PROPOSED TO THE REQUIREMENT FOR DISCLOSURES]

Planned Scope and Timing of the Audit (Ref: Para. 15)

A11. Communication regarding the planned scope and timing of the audit may:

- (a) Assist those charged with governance to understand better the consequences of the auditor's work, to discuss issues of risk and the concept of materiality with the auditor, and to identify any areas in which they may request the auditor to undertake additional procedures; and
- (b) Assist the auditor to understand better the entity and its environment.

A11a. Communicating significant risks identified by the auditor helps those charged with governance understand those matters and why they require special audit consideration. The communication about significant risks may assist those charged with governance in fulfilling their responsibility to oversee the financial reporting process.*

A12. Matters communicated may include:[^]

- How the auditor proposes to address the significant risks of material misstatement, whether due to fraud or error.

* When the final standard is issued, this paragraph will become paragraph A12 and all subsequent paragraphs will be renumbered accordingly.

[^] Conforming amendments to this paragraph also were proposed in the Exposure Draft, Proposed ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor's Report Thereon*. The IAASB will consider feedback from that consultation in determining whether such changes continue to be appropriate as it finalizes both proposed ISA 260 (Revised) and proposed ISA 720 (Revised).

- Assessed risks of material misstatement other than identified significant risks that are anticipated to have the greatest effect on the overall audit strategy or on the audit plan, including on the efforts of the engagement team.
- The auditor's approach to internal control relevant to the audit.
- The application of the concept of materiality in the context of an audit.¹¹
- The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results, including the use of an auditor's expert.¹²
- Significant changes to the applicable financial reporting framework or the entity that may affect the required disclosures in the financial statements.

¹¹ ISA 320, *Materiality in Planning and Performing an Audit*

¹² See ISA 620, *Using the Work of an Auditor's Expert*.

ISA 580, *Management Representations*

Appendix 2

(Ref: Para. A21)

Illustrative Representation Letter

The following illustrative letter includes written representations that are required by this and other ISAs in effect for audits of financial statements for periods beginning on or after December 15, 2009. It is assumed in this illustration that the applicable financial reporting framework is International Financial Reporting Standards; the requirement of ISA 570¹³ to obtain a written representation is not relevant; and that there are no exceptions to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

(Entity Letterhead)

(To Auditor)

(Date)

This representation letter is provided in connection with your audit of the financial statements of ABC Company for the year ended December 31, 20XX¹⁴ for the purpose of expressing an opinion as to whether the financial statements are presented fairly, in all material respects, (or *give a true and fair view*) in accordance with International Financial Reporting Standards.

We confirm that (, *to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves*):

Financial Statements

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated [insert date], for the preparation of the financial statements in accordance with International Financial Reporting Standards; in particular the financial statements are fairly presented (or *give a true and fair view*) in accordance therewith.
- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable. (ISA 540)
- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of International Financial Reporting Standards. (ISA 550)
- All events subsequent to the date of the financial statements and for which International Financial Reporting Standards require adjustment or disclosure have been adjusted or disclosed. (ISA 560)
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter. (ISA 450)

¹³ ISA 570, "Going Concern."

¹⁴ Where the auditor reports on more than one period, the auditor adjusts the date so that the letter pertains to all periods covered by the auditor's report.

- [Any other matters that the auditor may consider appropriate (see paragraph A10 of this ISA).]

Information Provided

- We have provided you with:
 - Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - Appropriate support for the disclosures in the financial statements, including for those disclosures generated by systems or processes that are not part of the general ledger system.
 - Additional information that you have requested from us for the purpose of the audit; and
 - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud. (ISA 240)
- We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
 - Management;
 - Employees who have significant roles in internal control; or
 - Others where the fraud could have a material effect on the financial statements. (ISA 240)
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others. (ISA 240)
- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements. (ISA 250)
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (ISA 550)
- [Any other matters that the auditor may consider necessary (see paragraph A11 of this ISA).]

Management

Management