

Auditing Disclosures – Revised Proposed Requirements in ISA 315 (Revised), ISA 330 and ISA 700 (Revised) (Marked from Exposure Draft)

[For Reference Only]

ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

Requirements

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

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The Entity's Internal Control

Components of Internal Control

Control environment

14. The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether:
 - (a) Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior; and
 - (b) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control, and whether those other components are not undermined by deficiencies in the control environment. (Ref: Para. A76–A86)

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The information system, including the related business processes, relevant to financial reporting, and communication

18. The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following areas: (Ref: Para A89–A89a)
 - (a) The classes of transactions in the entity's operations that are significant to the financial statements;
 - (b) The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
 - (c) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form, or could be within or outside of the general and subsidiary ledgers;

- (d) How the information system captures events and conditions, other than transactions, that are significant to the financial statements;
- (e) The financial reporting process used to prepare the entity's financial statements, including:
 - (i) The preparation of significant accounting estimates and disclosures; and
 - ~~(+)(ii)~~ The recording of information in accounting records that are outside the general and subsidiary ledgers; and
- (f) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments, and other information from accounting records that are outside the general and subsidiary ledgers. (Ref: Para. ~~A89~~A90–A93)

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Application and Other Explanatory Material

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

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

The Information System, Including Related Business Processes, Relevant to Financial Reporting (Ref: Para. 18)

A89. The information system relevant to financial reporting objectives, which includes the accounting system, consists of the procedures and records designed and established to:

- Initiate, record, process, and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets, liabilities, and equity;
- Resolve incorrect processing of transactions, for example, automated suspense files and procedures followed to clear suspense items out on a timely basis;
- Process and account for system overrides or bypasses to controls;
- Transfer information from transaction processing systems to the general ledger;
- Capture information relevant to financial reporting for events and conditions other than transactions, such as the depreciation and amortization of assets and changes in the recoverability of accounts receivables; and
- Ensure information required to be disclosed by the applicable financial reporting framework is accumulated, recorded, processed, summarized and appropriately reported in the financial statements.

A89a. ~~Information in the f~~Financial statements may contain information from accounting records¹ that are outside the general and subsidiary ledgers. Examples of such accounting records include:~~systems or processes that are not part of the general ledger system. These systems or processes may include:~~

- Relevant information produced by Aan entity's risk management system.
- ~~Production of v~~Valuation information reports produced by management's experts relating to, for example, the disclosure of the fair value of an amount that is recorded on the balance sheet at cost.
- Models or other calculations used to develop estimates recognized or disclosed in the financial statements, including the underlying data and assumptions used in those models, for example, assumptions developed internally that may affect an asset's useful life, or that may be affected by factors outside the control of the entity, such as interest rate data.
- Sensitivity analyses derived from financial models to demonstrate that management has considered alternative assumptions.
- An entity's relevant underlying tax records and returns.
- Analysis to support management's use of the going concern basis of accounting or management's assessment of the entity's ability to continue as a going concern.

¹ Paragraph 5(a) of ISA 500, *Audit Evidence*, defines accounting records.

ISA 330, *The Auditor's Responses to Assessed Risks*

Requirements

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

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Substantive Procedures

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Substantive Procedures Related to the Financial Statement Closing Process

20. The auditor's substantive procedures shall include the following audit procedures related to the financial statement closing process:

- (a) Agreeing or reconciling information, including classes of transactions, account balances and disclosures in the financial statements, ~~including disclosures,~~ with the underlying accounting records, including, as applicable, those relevant accounting records that are outside the general and subsidiary ledgers and information from systems or processes that are not part of the general ledger system; and
- (b) Examining material journal entries and other adjustments made during the course of preparing the financial statements. (Ref: Para. A52)

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Adequacy of Presentation and Disclosure

24. The auditor shall perform audit procedures to evaluate whether the overall presentation of the financial statements, including the related disclosures, is in accordance with the applicable financial reporting framework. This evaluation shall include consideration of whether the financial statements are presented in a manner that reflects the appropriate:

- The appropriate Classification and description of financial information and the underlying transactions and events, including in disclosures; and
- The appropriate Form, arrangement structure, and content of the financial statements. (Ref: Para. A59)

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Documentation

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30. The auditor's documentation shall demonstrate that ~~the financial statements~~ information, including classes of transactions, account balances and disclosures in the financial statements, agrees or reconciles with the underlying accounting records including, as applicable, those relevant accounting records that are outside the general and subsidiary ledgers.

Application and Other Explanatory Material

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

The Nature, Timing and Extent of Further Audit Procedures (Ref: Para. 6)

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Responding to the Assessed Risks at the Assertion Level (Ref: Para. 7(a))

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Timing

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A14. Further relevant factors that influence the auditor's consideration of when to perform audit procedures include the following:

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

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Substantive Procedures (Ref: Para. 18)

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Substantive Procedures Related to the Financial Statement Closing Process (Ref: Para. 20)

A52. The nature, and also the extent, of the auditor's substantive procedures related to the financial statement closing process, depends on the nature and complexity of the entity's financial reporting process and the related risks of material misstatement.

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Adequacy of Presentation and Disclosure (Ref: Para. 24)

A59. Evaluating the appropriate form, structure and content of the financial statements~~overall presentation of the financial statements relates to whether the financial statements, including disclosures, are presented in a manner that reflects:~~

~~The appropriate classification and description of financial information and the underlying transactions and events; and~~

~~The appropriate form, arrangement, and content of the financial statements.~~ This includes, for example, consideration of the terminology used as required by the applicable financial reporting

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framework, the level of detail provided, the aggregation and disaggregation of amounts, ~~and the classification of items in the financial statements,~~ and the bases of amounts set forth.

ISA 700, *Forming an Opinion and Reporting on Financial Statements*

Requirements

Forming an Opinion on the Financial Statements

10. The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.^{2, 3}
11. In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:
 - (a) The auditor's conclusion, in accordance with ISA 330, whether sufficient appropriate audit evidence has been obtained;⁴
 - (b) The auditor's conclusion, in accordance with ISA 450, whether uncorrected misstatements are material, individually or in aggregate;⁵ and
 - (c) The evaluations required by paragraphs 12–15.
12. The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. (Ref: Para. A1–A3)
13. In particular, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework:
 - (a) The financial statements appropriately disclose the significant accounting policies selected and applied. This evaluation shall include consideration of the relevance of the accounting policies to the entity, and whether they have been presented in an understandable manner.; (Ref: Para. A3a)
 - (b) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
 - (c) The accounting estimates made by management are reasonable;
 - (d) The information presented in the financial statements is relevant, reliable, comparable, and understandable. This evaluation of the information presented in the financial statements shall include consideration of whether:
 - All relevant information has been included, and that such information is appropriately classified, aggregated or disaggregated, and characterized.

² ISA 200, paragraph 11

³ Paragraphs 35–36 deal with the phrases used to express this opinion in the case of a fair presentation framework and a compliance framework respectively.

⁴ ISA 330, *The Auditor's Responses to Assessed Risks*, paragraph 26

⁵ ISA 450, *Evaluation of Misstatements Identified during the Audit*, paragraph 11

- The overall presentation of the financial statements is not undermined by including information that is not relevant or that obscures a proper understanding of the matters disclosed. (Ref: Para. A3b)
 - (e) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and (Ref: Para. A4)
 - (f) The terminology used in the financial statements, including the title of each financial statement, is appropriate.
14. When the financial statements are prepared in accordance with a fair presentation framework, the evaluation required by paragraphs 12–13 shall also include whether the financial statements achieve fair presentation. The auditor's evaluation as to whether the financial statements achieve fair presentation shall include consideration of: (Ref: Para A4a–A4c)
- (a) The overall presentation, structure and content of the financial statements; and
 - (b) Whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.
15. The auditor shall evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework. (Ref: Para. A5–A10)

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Application and Other Explanatory Material

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

- A1. Management makes a number of judgments about the amounts and disclosures in the financial statements.
- A2. ~~Proposed~~ ISA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.⁶ In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of 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, causes the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the auditor's evaluation of 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 (for example, 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 making accounting estimates.
- A3. ISA 540 addresses possible management bias in making accounting estimates.⁷ Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on

⁶ ~~Proposed~~ ISA 260 (Revised), *Communication with Those Charged with Governance*, Appendix 2

⁷ ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, paragraph 21

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.

Accounting Policies Appropriately Disclosed in the Financial Statements (Ref: Para. 13(a))

A3a. The auditor's evaluation of whether the financial statements appropriately disclose the significant accounting policies selected and applied includes consideration of matters such as whether all relevant information in the accounting policies has been disclosed, as well the clarity with which they have been presented. The relevance of accounting policies to the entity is a matter of professional judgment, and takes into account whether the accounting policies reflect the application of the underlying recognition criteria and measurement bases for items included in the financial statements in the particular circumstances of the entity's operations and the environment in which it is operating.~~the relevance of the accounting policies to the entity, and the clarity with which they have been presented.~~*

Information Presented in the Financial Statements Is Relevant, Reliable, Comparable and Understandable (Ref: Para. 13(d))

A3b. Evaluating the understandability ~~and relevance of the information presented in of~~ the financial statements includes consideration of matters such as whether:

- ~~• The financial statements, including disclosures, are appropriately classified and characterized, and presented in a clear and concise manner, but do not omit relevant information.~~
- ~~• The disclosures undermine the overall presentation of the financial statements by including information that is not relevant or that is presented in a manner that may obscure a proper understanding of the matters disclosed.~~
- The information in the financial statements is presented in a clear and concise manner.
- The placement of significant disclosures gives appropriate prominence to them (for example, when there is perceived value of entity-specific information to users), and whether the disclosures are appropriately cross-referenced in a manner that would not give rise to significant challenges for users in identifying necessary information~~to draw attention to related matters, where appropriate.~~

Disclosure of the Effect of Material Transactions and Events on the Information Conveyed in the Financial Statements (Ref: Para. 13(e))

A4. It is common for financial statements prepared in accordance with a general purpose framework to present an entity's financial position, financial performance and cash flows. Evaluating whether in view of the applicable financial reporting framework, the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the entity's financial position, financial performance and cash flows includes consideration of such matters as:

* When the final standard is issued, this paragraph will become paragraph A4 and all subsequent paragraphs will be renumbered accordingly.

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

Evaluating Whether the Financial Statements Achieve Fair Presentation (Ref: Para. 14)

- A4a. Some financial reporting frameworks acknowledge explicitly or implicitly the concept of fair presentation.⁸ As noted in paragraph 7(b) of this ISA, a fair presentation⁹ financial reporting framework not only requires compliance with the requirements of the framework, but also acknowledges explicitly or implicitly that it may be necessary for management to provide disclosures beyond those specifically required by the framework.¹⁰
- A4b. The auditor's evaluation about whether the financial statements achieve fair presentation, both in respect of presentation and disclosure, is a matter of professional judgment. This evaluation takes into account such matters ~~such~~ as the facts and circumstances of the entity, including changes thereto, based on the auditor's knowledge-understanding of the entity and the audit evidence obtained during the audit. The evaluation also includes consideration, for example, of the disclosures needed to achieve a fair presentation arising from matters that may be relevant to the economic decisions of the users of the financial statements, such as evolving financial reporting requirements or the changing economic environment.
- A4c. Evaluating whether the financial statements achieve fair presentation includes, for example and as appropriate, discussions with management and those charged with governance about their views on why a particular presentation was chosen, as well as alternatives that may have been considered. The discussions may include, for example:
- The degree to which the amounts in the financial statements are aggregated or disaggregated, and whether the presentation of amounts or disclosures obscures useful information, or results in misleading information.

⁸ For example, International Financial Reporting Standards (IFRSs) note that fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses.

⁹ See ISA 200, paragraph 13(a).

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

- Consistency with appropriate industry practice, or whether any departures are relevant to the entity's circumstances and therefore warranted.