

## Auditing Disclosures – Issues and Revised Proposed Requirements in ISA 315 (Revised), ISA 330 and ISA 700 (Revised)

### Objective of the Teleconference

1. The purpose of the teleconference is to consider further proposed changes to the ISA requirements and related application material (as set out in Section B below) to respond to Board comments from the IAASB meeting in December 2014 (the draft decision summary can be found in Section A below). This will enable the Task Force to understand further Board views on the proposed changes to the requirements and will, therefore, assist the Task Force with finalizing the proposed changes to be presented for approval at the March 2015 IAASB meeting.
2. This Agenda Item only addresses revisions to the new proposed requirements and any related application material. In relation to the other proposed changes to the ISAs and materials for Board consideration, the Task Force proposes:
  - In relation to the proposed changes to the application material in ISAs 200,<sup>1</sup> 315 (Revised),<sup>2,3</sup> 320,<sup>4</sup> 330,<sup>5,3</sup> 450<sup>6</sup> and 700 (Revised),<sup>7,3</sup> to present revisions to address matters raised in December 2014, for further discussion at the March 2015 IAASB meeting.
  - To further consider issues raised by respondents to the Exposure Draft (ED), [\*Proposed Changes to the ISAs: Addressing Disclosures in the Audit of Financial Statements\*](#) and Board comments from the December 2014 meeting relating to materiality for disclosures, and to discuss the Task Force's proposals relating to materiality with the Board in March 2015.
  - In relation to proposed changes to the application material not yet discussed with the Board (including in ISAs 210,<sup>8</sup> 240,<sup>9</sup> 260,<sup>10</sup> 300<sup>11</sup> and other ISAs raised by respondents to the ED), the Task Force plans to circulate proposed changes to the Board before the March IAASB meeting to allow Board members to consider if there are any further 'significant issues' in relation to any revisions to the proposed changes in these standards. This will allow Board members the opportunity to raise any matters of significance with the Task Force before the

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<sup>1</sup> ISA 200, *Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing*

<sup>2</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>3</sup> This would cover the other application material with proposed revisions not being discussed in this agenda paper (as it does not relate to a new proposed requirement).

<sup>4</sup> ISA 320, *Materiality in Planning and Performing an Audit*

<sup>5</sup> ISA 330, *The Auditor's Responses to Assessed Risks*

<sup>6</sup> ISA 450, *Evaluation of Misstatements Identified during the Audit*

<sup>7</sup> ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

<sup>8</sup> ISA 210, *Agreeing the Terms of Audit Engagements*

<sup>9</sup> ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

<sup>10</sup> ISA 260 (Revised), *Communication with Those Charged with Governance*

<sup>11</sup> ISA 300, *Planning an Audit of Financial Statements*

papers are finalized for the March 2015 Board and Consultative Advisory Group (CAG) meetings. The revisions to the proposed changes will be discussed at the March 2015 Board meeting, together with the rest of the proposed changes for approval.

- In relation to the Staff Publication, *Addressing Disclosures in the Audit of Financial Statements*, a revised version will be posted for discussion with the rest of the Agenda papers for the March 2015 Board meeting.

#### A. Draft December 2014 IAASB Meeting Decision Summary<sup>12</sup>

Mr. Grabowski introduced the topic by providing a summary of the responses to the Exposure Draft (ED). He also described the progress of the International Accounting Standards Board (IASB) on its Disclosures and Materiality initiatives as relevant to this project. Mr. Grabowski also noted that the Task Force had held meetings with two investor groups, as response letters had not been received from this stakeholder group. He also added that the Small and Medium Practices (SMP) Committee had provided a written response to the agenda papers presented.

##### MOVING FORWARD

Mr. Grabowski noted that the responses could be categorized into three groups as follows:

- 38 respondents supported the IAASB moving forward with the proposed changes.
- 17 respondents supported the changes as proposed but would like more substantial guidance or requirements in certain areas (for example, applying the concept of materiality to disclosures and evaluating misstatements in disclosures).
- 15 respondents did not support moving forward with the proposed changes (with varied reasons for this, including the cost versus benefit of making changes in ten ISAs, or that they did not believe that the changes would result in the behavioral change needed).

Many of those who agreed with moving forward with the proposed changes (with or without further substantial change, as well as some who disagreed) also acknowledged that more needed to be done in due course when others, such as the IASB, had progressed their work in this area.

The Board agreed to progress the proposed changes to finalization, including consideration of strengthening the proposed changes in some areas, because:

- The majority of respondents, including members of the Monitoring Group, had agreed that moving forward with the ISA changes now was important.
- Ms.de Beer endorsed moving forward with the proposed changes now as the Consultative Advisory Group (CAG) had previously emphasized the importance of moving forward with the proposed changes to the ISAs.
- It was noted by some Board members that 'moving forward' was emphasized by investor groups and regulators on various outreach activities in recent months.

<sup>12</sup> These draft minutes from the December 2014 IAASB meeting are still subject to IAASB members' review and, subject to any further changes from this review, will be approved at the March 2015 IAASB meeting.

Mr. Grabowski noted that the SMP Committee had strongly disagreed with moving forward with the proposed ISA changes, but added that further dialogue would be arranged with this group to further understand their concerns.

#### MATERIALITY

Mr. Grabowski explained that, notwithstanding the IAASB's work in this area, some respondents were of the view that the proposed changes could and should go further than what had been proposed, and called for additional requirements or guidance on how to apply the concept of materiality to disclosures, particularly qualitative disclosures. Mr. Grabowski explained that the Task Force had mixed views about the need for new requirements to determine qualitative materiality for disclosures, but nevertheless had agreed to present an illustrative requirement for the Board's consideration. The Board agreed not to proceed with the development of changes to the requirements in ISA 320 and instead to wait for the IASB to progress its work on materiality, at which time the Board could then consider a more holistic review of ISA 320. However, the Board asked that the Task Force consider whether other changes, such as application material to support the existing requirements, could be developed to address qualitative disclosures, whether this was in ISA 320 or ISA 315 (Revised).

#### ELEVATION OF APPLICATION MATERIAL TO REQUIREMENTS IN ISA 330 AND ISA 700

Mr. Grabowski explained that some respondents, particularly regulators, have urged the IAASB to consider whether certain application material in ISA 330 and ISA 700 could be elevated to requirements, particularly in the case of audit procedures that would be expected to be performed on every audit. A few members cautioned the Board about elevating some of this material and asked that further consideration be given to whether the elevation of the application material to requirements would improve auditor behavior. The Board generally agreed to the proposed changes but asked the Task Force to reconsider the articulation of the new requirements (in particular, to clarify the auditor's work effort), and provide additional application material to support such new requirements where relevant. A Board member also asked the Task Force to reconsider whether some of the application material that the Task Force had not elevated, in the relevant paragraphs in ISA 700, should be elevated.

#### ADDITIONAL REQUIREMENTS IN ISA 315 (REVISED)

The Board agreed, in principal, to the Task Force's proposal to add new requirements to ISA 315 (Revised) to clarify that the auditors' understanding of controls over the relevant information systems should extend beyond the general ledger and subsidiary ledgers. The Board, however, asked the Task Force to reconsider the placement of the new requirements. In addition, the Task Force was also asked to reconsider the articulation of the new requirements to clarify what the auditor's action would be.

#### IAASB COMMENTS ON OTHER ISAS

IAASB members generally agreed with the other proposed changes, but noted some areas for further Task Force consideration including:

- ISA 200—reconsideration of some of the terminology used in the revised definition of financial statements.
- ISA 315 (Revised)—reconsideration of the additional guidance added in certain paragraphs in the application material. One Board member also asked the Task Force to consider whether the extant

assertions for presentation and disclosure should be retained in some form in the section on the assertions about other disclosures (i.e., not related to transactions or events, or account balances).

- ISA 450—reconsideration of the new application material in paragraph A13b, for the terminology used, as well as whether this is appropriately articulated in the clarity format. A Board member asked the Task Force to consider whether guidance could be added regarding the communication of misstatements that could be indicative of an internal control deficiency.

#### THE WAY FORWARD

Notwithstanding that other matters arising from the responses to the ED will be presented to the Board in March 2015, it was noted that the most significant comments had been discussed with the Board in December 2014. The Board therefore agreed to proceed on the basis that the Task Force would present the proposed changes to the ISAs for approval in March 2015.

It was also agreed that, if necessary, the Task Force would bring relevant material for Board discussion at the January IAASB teleconference.

At the March 2015 IAASB meeting, the Board will also further consider the way forward on materiality and sufficient appropriate audit evidence, as well as the updated Staff Publication.

## B. Proposed Changes to ISA Requirements

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

3. No changes had been proposed to the requirements in ISA 315 (Revised) as presented in the ED.
4. In the responses to the ED, and as noted in [Agenda Item 7-A](#) for the December 2014 IAASB meeting, respondents requested additional guidance on specific considerations for internal controls over the preparation of financial statement disclosures. In response, the Task Force proposed further amendments to the requirements in paragraph 18(e)–(f) of ISA 315 (Revised) to reinforce the requirements around the auditor’s understanding of internal control over the preparation of disclosures, in particular in relation to those disclosures that were prepared from information that is outside the general and subsidiary ledgers.
5. The new proposed requirements were discussed with the Board in December 2014. A Board member requested that the Task Force consider whether the proposed changes might be better placed elsewhere in the requirement. In addition, the Task Force was asked to clarify the auditor’s actions in relation to the new requirements.
6. The Task Force further debated the objective of the proposed changes, and explored moving the proposed changes. The Task Force concluded that the original placement of the changes was appropriate. However, the Task Force has articulated the proposed changes differently in order to clarify the work effort. In addition, and on further reflection, the Task Force agreed that, in view of the changes being proposed to emphasize ‘information from accounting records that are outside the general and subsidiary ledgers,’ the phrase should also be included in paragraph 18(c) in relation to accounting records.
7. The following sets out the revisions to address the concerns raised for IAASB discussion:

[Showing changes made to extracts of ISA 315 (Revised) to respond to comments at the December 2014 IAASB meeting in mark-up; paragraph numbering relates to the relevant standard]

## 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) ~~This includes~~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~~This includes information from accounting records that are outside the general and subsidiary ledgers. (Ref: Para. A89A90–A93)

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Control activities relevant to the audit

20. The auditor shall obtain an understanding of control activities relevant to the audit, being those the auditor judges it necessary to understand in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks. An audit does not require an understanding of all the control activities related to each significant class of transactions, account balance, and disclosure in the financial statements or to every assertion relevant to them. (Ref: Para. A96–A102)

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#### **Application and Other Explanatory Material**

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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. Financial statements may contain information from accounting records<sup>13</sup> that are outside the general and subsidiary ledgers. Examples of such accounting records include:

- Relevant information produced by an entity's risk management system.
- Valuation information 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.

#### **Matter for IAASB Consideration**

1. The IAASB is asked:
  - (a) For its views on the revisions to the proposed changes to the requirements in ISA 315 (Revised) as set out above.
  - (b) Whether there are any other matters relating to these paragraphs in ISA 315 (Revised) that the Task Force should consider.

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<sup>13</sup> Paragraph 5(a) of ISA 500, *Audit Evidence*, defines accounting records.

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

8. A limited change to the requirements was proposed in the ED. A summary of the responses to this proposed change was set out in paragraphs 47–49 of [Agenda Item 7-A](#) for the December 2014 IAASB meeting. In essence, respondents requested that further consideration be given to elevating paragraph A59 of ISA 330 to a requirement as this was an activity that the auditor would be expected to undertake in all instances. The Task Force agreed with the respondents' view and proposed further changes for Board discussion in December 2014.
9. The Board generally did not disagree with the additional proposed requirements, but requested that further consideration be given to the drafting of the requirements.
10. A Board member also asked the Task Force to consider again whether the material that had been elevated in paragraph 24 of ISA 330 should be included as a requirement, or whether the material was more appropriate as application material. The Task Force reconsidered the appropriateness of the elevation, and remains of the view that these would be activities an auditor would undertake on all audits and therefore that it was appropriate to elevate the material to a requirement. The Board also suggested various editorials for Task Force consideration.
11. The following sets out the Task Force's proposed revisions to address the matters raised by the IAASB's recent discussions:<sup>14</sup>

*[Showing changes made to extracts of ISA 330 to respond to comments at the December 2014 IAASB meeting in mark-up; paragraph numbering relates to the relevant standard]*

### **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, with the underlying accounting records, including, as applicable, those relevant accounting records that are outside the general and subsidiary ledgers; 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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<sup>14</sup> The Task Force will be addressing any instances of the extension of the term "financial statements" at the March 2015 meeting.

## 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:

- Classification and description of financial information and the underlying transactions and events, including in disclosures; and
- Form, arrangementstructure, 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 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.

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## 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))

...

### 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.

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*Substantive Procedures* (Ref: Para. 18)

...

*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, arrangementsstructure, and content of the financial statements includes, for example, consideration of the terminology used as required by the applicable financial reporting framework, the level of detail provided, the aggregation and disaggregation of amounts, and the bases of amounts set forth.

#### **Matter for IAASB Consideration**

2. The IAASB is asked:
  - (a) For its views on the revisions to the proposed changes to the ISA requirements in ISA 330 as set out above.
  - (b) Whether there are any other matters relating to these paragraphs in ISA 330 that the Task Force should consider.

## **ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements***

12. No new requirements for ISA 700 (Revised) were proposed in the ED. A summary of the responses to the ED can be found in paragraphs 42–43 of [Agenda Item 7-A](#) from the December 2014 IAASB meeting. In summary, respondents strongly encouraged the Board to consider the elevation of some application material to requirements to further help encourage behavioral changes needed. The Task Force responded by presenting new requirements for IAASB consideration at the December 2014 IAASB meeting.
13. The Board generally agreed with the elevation of application material to the requirements when the auditor would be undertaking the procedures on all audits. Although some Board members agreed that certain of the changes were helpful, in particular to emphasize auditor consideration of disclosures that are not relevant, matters were raised variously about:
  - The action that would be required of the auditor, as in some cases it was not clear.
  - The understandability of what the auditor was required to do—it was noted that in some cases what the auditor needed to do was clearer in the application material.
  - The underlying accounting requirements for some of the changes.
  - The concept of completeness being missing in paragraph 13(d).
  - The consistency as regards which application material should be elevated.
14. The Task Force deliberated further revisions to address matters raised by Board members. Accordingly, the Task Force proposes revisions to:
  - Strengthen the requirements by clarifying the auditor's actions.
  - Include the concept of completeness (in terms of the applicable financial reporting framework) by referring to the inclusion of all relevant accounting policies and disclosures.
  - Eliminate duplications and clarify the requirements through various editorial changes.

The Task Force also had the view that the changes were sufficiently supported by underlying accounting requirements where relevant.
15. The Task Force also revisited the application material that supports the new proposed requirements, reinstated some previously deleted application material, and expanded where necessary to provide further clarity to auditors about what they are required to do. In terms of the consistency as regards which application material had been elevated, the Task Force again considered whether there was any more application material that should be elevated, but continues to have the view that the changes as proposed are sufficient and that further application material should not be elevated.
16. The following sets out the revisions for IAASB discussion:<sup>12</sup>

*[Showing changes made to ISA 700 (Revised) to respond to comments at the December 2014 IAASB meeting in mark-up; paragraph numbering relates to the relevant standard]*

## 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.<sup>15, 16</sup>
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;<sup>17</sup>
  - (b) The auditor's conclusion, in accordance with ISA 450, whether uncorrected misstatements are material, individually or in aggregate;<sup>18</sup> 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. ~~ility of, these disclosures. (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 in the financial statements—is appropriately classified, aggregated or disaggregated, and characterized; ~~disclosed in an understandable manner; and does not omit information that is relevant in view of the requirements of the applicable financial reporting framework.~~
    - The ~~disclosures undermine the~~ overall presentation of the financial statements is not undermined by including information that is not relevant or that ~~is presented in a manner that may obscure~~ 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. ISA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.<sup>19</sup> 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.

<sup>15</sup> ISA 200, paragraph 11

<sup>16</sup> 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.

<sup>17</sup> ISA 330, *The Auditor’s Responses to Assessed Risks*, paragraph 26

<sup>18</sup> ISA 450, *Evaluation of Misstatements Identified during the Audit*, paragraph 11

<sup>19</sup> ISA 260 (Revised), *Communication with Those Charged with Governance*, Appendix 2

A3. ISA 540 addresses possible management bias in making accounting estimates.<sup>20</sup> 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.

**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.\*

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

A3**a**. Evaluating the understandability of the financial statements includes consideration of matters such as whether:

- 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 **internally** cross-referenced in a manner that would not give rise to significant challenges for users in identifying necessary information.

**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:

- The extent to which the information in the financial statements is relevant and specific to the circumstances of the entity; and

<sup>20</sup> ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, paragraph 21

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

- Whether 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.<sup>21</sup> As noted in paragraph 7(b) of this ISA, a fair presentation<sup>22</sup> 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.<sup>23</sup>

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 as the facts and circumstances of the entity, including changes thereto, based on the auditor’s 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.
- Consistency with appropriate industry practice, or whether any departures are relevant to the entity’s circumstances and therefore warranted.

**Matter for IAASB Consideration**

3. The IAASB is asked:
- (a) For its views on the revisions to the proposed changes to the ISA requirements in ISA 700 (Revised) as set out above.
  - (b) Whether there are any other matters relating to these paragraphs in ISA 700 (Revised) that the Task Force should consider.