



Standards on Auditing

December 1, 2023

SA 320

Materiality in Planning and Performing an Audit

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1. Scope of SA 320

- This Standard on Auditing (SA) deals with the **auditor's responsibility** to **apply** the concept of **materiality** in **planning and performing an audit** of financial statements.
- **SA 320** covers the **concept of materiality**, however, **SA 450** explains how materiality is applied in evaluating the **effect of identified misstatements** on the audit and of **uncorrected misstatements**, if any, on the financial statements.

Objective

- The **objective of the auditor** is to **apply** the **concept of materiality appropriately** in **planning and performing** the audit.

2. Materiality in the context of an Audit

❖ The concept of materiality is **applied** by the auditor

both in **planning and performing** the audit,
and

- ✓ in **evaluating** the effect of **identified misstatements on the audit**
- ✓ and of **uncorrected misstatements**, if any, on the financial statements
- ✓ and in **forming the opinion** in the auditor's report.

❖ In general, **misstatements, including omissions**, are considered to be **material** if they, **individually or in the aggregate**, could **reasonably** be expected to **influence the economic decisions of users** on the basis of the financial statements.

2. Materiality in the context of an Audit (contd.)

- Auditor's determination of materiality
 - ❖ is a matter of **professional judgment**; and
 - ❖ is affected by the auditor's perception of the financial information **needs of users**
 - ❖ In this context, it is **reasonable** for the auditor to assume that **users**:
 - ✓ **Have a reasonable knowledge** of business & economic activities and accounting and study the information with **reasonable diligence**;
 - ✓ **Understand** that financial statements are prepared, presented and audited to **levels of materiality**;
 - ✓ Recognize the **uncertainties inherent** in the measurement of amounts based on the use of **estimates, judgment** and the consideration of **future events**; and
 - ✓ Make **reasonable economic decisions** on the basis of the information in the financial statements.

3. Overall / Performance Materiality

- When **establishing** the **overall audit strategy**
 - A. auditor shall determine **materiality for the financial statements as a whole** (may be termed as ‘Overall materiality’ for the purposes of our discussion)
 - B. auditor shall determine **performance materiality** for purposes of **assessing the risks** of material misstatement and **determining** the **nature, timing and extent** of further audit procedures

Note: If, in the **specific circumstances** of the entity,

- there is one or more **particular classes of transactions, account balances or disclosures**
- for which misstatements of **lesser amounts** than the overall materiality
- could reasonably be **expected to influence** the **economic decisions** of users,
- the auditor **shall also determine** the materiality levels to be applied to those **particular classes of transactions, account balances or disclosures**

*It may be useful for the auditor to obtain an understanding of the **views/expectations** of those charged with governance (TCWG) and management in considering whether such specific circumstances exist.*

3. Overall / Performance Materiality (contd.)

- **Factors that may indicate the existence** of one or more particular classes of transactions, account balances or disclosures which could reasonably be expected to influence the economic decisions of users **include the following:**
 - ❖ Whether **law, regulations or the applicable financial reporting framework** affect users' expectations regarding the measurement or disclosure of certain items
(for example, related party transactions, and the remuneration of management and those charged with governance)
 - ❖ The **key disclosures** in relation to the industry in which the entity operates
(for example, research and development costs for a pharmaceutical company)
 - ❖ Whether **attention** is focused on a **particular aspect** of the **entity's business** that is **separately disclosed** in the financial statements
(for example, a newly acquired business)

4. *Determining Materiality and Concept of Benchmark*

- Determining materiality involves the exercise of **professional judgment**
- A **percentage** is often applied to a **chosen benchmark** as a starting point in determining materiality for the financial statements as a whole
- **Factors** that may affect the **identification** of an **appropriate benchmark** include the following:
 - ❖ **Elements** of the financial statements (*for example*, **assets, liabilities, equity, revenue, expenses**);
 - ❖ Items on which the **attention of the users** of the particular entity's financial statements tends to be **focused** (*for example*, **users may tend to focus on profit, revenue or net assets**);
 - ❖ **Nature of the entity**, where the entity is at in its **life cycle**, and the **industry and economic environment** in which the entity operates;
 - ❖ Entity's **ownership structure** and the **way it is financed** (*for example*, **if an entity is financed solely by debt or equity**);
 - ❖ The relative **volatility** of the benchmark
- Determining a **percentage** to be applied to a chosen benchmark involves the exercise of **professional judgment**

5. Performance Materiality

- Performance materiality means
 - ❖ the amount or amounts **set by the auditor**
 - ❖ at **less than** materiality for the financial statements as a whole
 - ❖ to **reduce the probability** to an **appropriately low level**
 - ❖ that the **aggregate** of **uncorrected** and **undetected** misstatements **exceeds** materiality for the financial statements as a whole
- If applicable, performance materiality also refers
 - ❖ to the amounts set by the auditor at less than the materiality level
 - ❖ for particular classes of transactions, account balances or disclosures
- Determination of performance materiality involves exercise of **professional judgment**
- It is **affected** by the auditor's
 - ❖ **understanding of the entity**, including **updates** during the performance of the **risk assessment procedures; effectiveness of controls**; and
 - ❖ the **nature and extent of misstatements** identified in **previous audits** and thereby the auditor's expectations in relation to misstatements in the **current period**

6. Revision in Materiality as the Audit Progresses

- Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) **may need to be revised** as a result of:
 - ✓ A **change in circumstances** that occurred during the audit
(*for example*, a **decision to dispose of a major part of the entity's business**),
 - ✓ **New information**, or a **change in the auditor's understanding** of the entity and its operations **as a result of** performing further audit procedures
(*for example*, if during the audit it appears that **actual financial results** are likely to be substantially different from the anticipated period end financial results that were used initially to determine materiality for the financial statements as a whole)
- If the auditor concludes that a **lower materiality** than that initially determined is appropriate, the **auditor shall determine** whether it is necessary to **revise performance materiality**, **and whether** the nature, timing and extent of the further audit procedures remain appropriate.

7. Documentation

The audit documentation **shall** include the following amounts and the factors considered in their determination:

- Materiality for the financial statements as a whole;
- If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures;
- Performance materiality; and
- Any revision to above amounts as the audit progressed

Knowledge Check

True / False ?

The concept of materiality is only applied during the planning phase of an audit.

True / False ?

Materiality levels for particular classes of transactions, account balances, or disclosures are always the same as materiality for the financial statements as a whole.

True / False ?

Materiality levels are fixed and do not change throughout the audit process.

True / False ?

Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

True / False ?

Performance materiality – is ‘the amount set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.’

Questions?

SA 450

***Evaluation of Misstatements Identified
During the Audit***

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1. Scope of SA 450

This Standard on Auditing (SA) deals with

- the auditor's **responsibility** to **evaluate**
- the **effect** of identified misstatements on the audit and
- of **uncorrected misstatements**, if any, on the financial statements

Objective

- The objective of the auditor is to evaluate:
 - (a) The effect of identified misstatements on the audit; and
 - (b) The effect of uncorrected misstatements, if any, on the financial statements.

2. Meaning of Misstatements

A. Misstatement:

- i. It is a **difference** between
 - the amounts, classification, presentation, or disclosure of a **reported** financial statement item **and**
 - the amount, classification, presentation, or disclosure that is **required** for the item to be **in accordance with the applicable financial reporting framework**
- ii. It also include those **adjustments of amounts, classifications, presentation, or disclosures** that, in the auditor's judgment, are necessary for the financial statements to give a true and fair view or present fairly, in all material respects

B. Uncorrected misstatements:

Misstatements that the auditor has **accumulated during the audit** and that have **not been corrected**.

2. Meaning of Misstatements (contd.)

- ❖ Misstatements can arise from **error or fraud**.
- ❖ Misstatements may result from:
 - An **inaccuracy** in gathering or processing data from which the financial statements are prepared;
 - An **omission** of an amount or disclosure;
 - An **incorrect accounting estimate** arising **from overlooking**, or clear **misinterpretation** of facts;
 - **Judgments** of management concerning accounting estimates **that the auditor considers unreasonable**;
 - Inappropriate **selection and application of accounting policies**

3. Accumulation of Identified Misstatements

- The auditor **shall accumulate** misstatements identified during the audit, **other than** those that are **clearly trivial**
- The auditor **may designate** an amount below which misstatements would be ‘**clearly trivial**’ and would not need to be accumulated because the accumulation of such amounts clearly would not have a material effect on the financial statements
- Matters that are “clearly trivial” will be
 - ❖ of a wholly different (smaller) **order of magnitude** than materiality determined in accordance with SA 320, and
 - ❖ matters that are **clearly inconsequential**, whether taken individually or in aggregate and whether judged by any criteria of **size, nature or circumstances**

Note: When there is any **uncertainty** about whether **one or more items are clearly trivial**, the matter is considered **not to be clearly trivial**.

4. *Types of Misstatements*

To assist the auditor in evaluating the effect of misstatements accumulated and in communicating misstatements to management and those charged with governance, it may be useful to distinguish between:

- a) ***Factual misstatements***: are misstatements about which there is no doubt
- b) ***Judgmental misstatements***: are differences arising from the **judgments** of management concerning **accounting estimates** that the auditor considers **unreasonable**, or the selection or application of **accounting policies** that the auditor considers **inappropriate**
- c) ***Projected misstatements***: are the **auditor's best estimate** of misstatements in populations, involving the **projection of** misstatements **identified** in audit samples to the **entire populations** from which the samples were drawn

5. Consideration of Identified Misstatements as the Audit Progresses

- A. The auditor shall determine whether the **overall audit strategy** and **audit plan** need to be **revised if**:
- The nature of identified misstatements and the circumstances of their occurrence indicate that **other misstatements may exist**, when aggregated with misstatements accumulated during the audit, **could be material**; or
 - The **aggregate of misstatements** accumulated during the audit **approaches materiality** determined in accordance with SA 320.

In this case, there may be a **greater** than an acceptably low **level of risk** that possible undetected misstatements could **exceed the materiality**.

5. Consideration of Identified Misstatements as the Audit Progresses (contd.)

B. The auditor may **request management** to **examine** a class of transactions, account balance or disclosure in order for management:

- to understand the **cause of a misstatement** identified by the auditor,
- perform procedures to **determine** the amount of the **actual misstatement** in the class of transactions, account balance or disclosure, and
- to make **appropriate adjustments** to the financial statements.

For example, such a request may be made, based on the **auditor's projection of misstatements identified in an audit sample to the entire population** from which it was drawn.

In above situations, the auditor shall perform additional audit procedures to determine whether misstatements remain

6. Communication and Correction of Misstatements

- The auditor shall **communicate** on a timely basis **all misstatements** accumulated during the audit with the appropriate level of **management, unless prohibited by law or regulation**. The auditor shall **request** management to **correct** those misstatements.
- **Timely communication** of misstatements to the appropriate level of management **enables management** to evaluate whether:
 - ❖ the items are misstatements and **take action** as necessary; or
 - ❖ inform the auditor if it **disagrees**.
- The **correction by management** of all misstatements, including those communicated by the auditor, **enables** management
 - ❖ to maintain **accurate accounting books** and records
 - ❖ **reduces the risks of material misstatement of future** financial statements because of the **cumulative effect of immaterial uncorrected misstatements related to prior periods**.

7. Refusal by Management for Correction of Misstatements

If **management refuses** to correct some or all of the misstatements communicated by the auditor,

- auditor shall obtain an **understanding** of **management's reasons** for not making the corrections;
- auditor shall take that **understanding** into account when evaluating whether the **financial statements** as a whole are **free from material misstatement** and;
- this evaluation includes consideration of the **qualitative aspects** of the entity's accounting practices, including indicators of **possible bias in management's judgments**, which may be affected by the auditor's understanding of management's reasons for not making the corrections.

8. Evaluating the Effect of Uncorrected Misstatements

- Prior to evaluating the effect of uncorrected misstatements, the auditor shall **reassess materiality** determined in accordance with SA 320 to confirm whether it **remains appropriate** in the context of the entity's actual financial results.
- The auditor shall determine whether uncorrected misstatements are **material**, individually or in aggregate.
- In making this determination, the auditor shall consider:
 - ❖ the **size and nature** of the misstatements; and
 - ❖ the effect of uncorrected misstatements related to **prior periods**.

8. Evaluating the Effect of Uncorrected Misstatements (contd.)

- The **circumstances** related to **some misstatements** may cause the auditor to evaluate them as **material**, even if they are **lower than the materiality** for the financial statements as a whole.

Circumstances that may affect the evaluation include the extent to which the misstatement:

- Affects compliance with **regulatory requirements**;
- Affects compliance with **debt covenants** or other contractual requirements;
- Relates to the **incorrect** selection or application of an **accounting policy**;
- **Affects ratios** used to evaluate the entity's financial position, results of operations or cash flows;
- **Affects segment information** presented in the financial statements
- Is significant having regard to the auditor's **understanding** of known **previous communications** to users, for example in relation to forecast earnings;
- Is an **omission of information** not specifically required by the applicable financial reporting framework but which, in the judgment of the auditor, is **important to the users' understanding** of the financial position, financial performance or cash flows of the entity; etc.

9. Communication with Those Charged with Governance

- The auditor shall **communicate** with those charged with governance
 - ❖ **uncorrected misstatements** and
 - ❖ the **effect** that they, individually or in aggregate, may have on the **opinion** in the auditor's report.
- The **effect** of uncorrected misstatements **related to prior periods** on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.
- The auditor's communication shall identify **material uncorrected misstatements individually**.
- The auditor **shall request** that uncorrected misstatements be **corrected**.

10. Written Representation

- The auditor shall request a **written representation** from management and, where appropriate, those charged with governance
 - ❖ whether they **believe the effects of uncorrected misstatements are immaterial**, individually and in aggregate, to the financial statements as a whole.
- A **summary** of such items shall be included in or attached to the written representation.
- Obtaining this **representation does not relieve the auditor** of the **need to form a conclusion** on the effect of uncorrected misstatements.

11. Documentation

The auditor's documentation shall include:

- The **amount below** which misstatements would be regarded as **clearly trivial**
- All **misstatements accumulated** during the audit and **whether** they have been **corrected**
- The auditor's **conclusion** as to whether **uncorrected misstatements are material**, individually or in aggregate, and the **basis for that conclusion**

The auditor's documentation of uncorrected misstatements may take into account:

- The **evaluation** of whether the **materiality levels** for particular classes of transactions, account balances or disclosures, if any, **have been exceeded**
- The **evaluation** of the **effect of uncorrected misstatements** on key ratios or trends, and **compliance** with legal, regulatory and contractual requirements

Knowledge Check

True / False ?

The judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate is considered as misstatement.

True / False ?

Auditor need not reassess the materiality based on actual financial results for evaluating the uncorrected misstatements.

True / False ?

If management believes the uncorrected misstatements identified by the auditor are not misstatements and that fact is stated in written representation obtained in accordance with SA 450, the auditor can leave out such misstatements in forming an opinion on the financial statements.

True / False ?

An omission of information not specifically required by the applicable financial reporting framework but which, in the judgment of the auditor, is important to the users' understanding of the financial position, financial performance or cash flows of the entity is considered as material misstatement irrespective of being lower than the materiality for the financial statements as a whole.

True / False ?

Auditor should communicate to those charged with governance the effect of only current year misstatements not relating to prior years.

Questions?

SA 505

External Confirmations

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5. Negative confirmation request
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7. Refusal by management to send a confirmation request
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1. Scope of SA 505

- This Standard on Auditing **deals with the auditor's use** of external confirmation procedures **to obtain audit evidence** in accordance with the requirements of SA 330 and SA 500
- It **does not address inquiries regarding litigation and claims**. SA 501 deals with obtaining sufficient appropriate audit evidence from such inquiries

2. External Confirmations as audit evidence

- Referring to **SA 500**, **reliability** of audit evidence is **influenced by its source and nature**, and is dependent on the individual circumstances under which it is obtained:
 - ❖ Audit evidence is **more reliable** when it is obtained from **independent sources** outside the entity.
 - ❖ Audit evidence **obtained directly** by the auditor is more reliable than audit evidence obtained indirectly or by inference.
 - ❖ Audit evidence is more reliable when it **exists in documentary form**, whether paper, electronic or other medium.
- Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations **received directly** by the auditor from confirming parties may be **more reliable** than **evidence generated internally by the entity**.
- This SA is intended to **assist the auditor in designing and performing external confirmations procedures** to obtain **relevant and reliable audit evidence**.

3. Meaning of External Confirmations

It refers to **audit evidence** obtained as a

- ✓ **direct written response** to the **auditor**
- ✓ from a **third party** (the confirming party),
- ✓ in **paper form**, or by **electronic** or **other medium**

Examples:

- Bank balances,
- Account Receivable balances,
- Borrowing etc.

There are two types of External Confirmations:

- Positive confirmation
- Negative confirmation

4. Positive Confirmation Request

- A request that the confirming party **respond directly** to the auditor indicating whether the confirming party **agrees or disagrees** with the information in the request or providing the requested information.
- **If the auditor has determined** that a response to a **positive confirmation** request is **necessary** to obtain **sufficient appropriate audit evidence**, **alternative audit procedures** will **not** provide the **audit evidence** the auditor requires.

*For example: The information available to corroborate management's assertion(s) **is only available outside the entity***

***Specific fraud risk factors**, such as the risk of **management override** of controls, or the risk of **collusion** which can involve employee(s) and/or management, prevent the auditor from relying on evidence from the entity*

- If the auditor does **not obtain such confirmation**, the auditor **shall** determine the **implications** for the audit and the **auditor's opinion** in accordance with SA 705.

5. Negative Confirmation Request

- A request that the confirming party **respond directly** to the auditor only if the confirming party **disagrees** with the information provided in the request.
- Negative confirmations provide **less persuasive audit evidence** than positive confirmations.
- Accordingly, the auditor shall **not use negative confirmation requests** as the sole substantive **audit procedure** to **address** an assessed **risk of material misstatement** (ROMM) at the assertion level **unless all** of the following are present:
 - ✓ The auditor has assessed the **ROMM as low** and has obtained sufficient appropriate audit evidence regarding the **operating effectiveness of controls** relevant to the assertion,
 - ✓ The **population** of items subject to negative confirmation procedures comprises a **large number** of **small, homogeneous**, account balances, transactions or conditions,
 - ✓ A very **low exception rate** is expected,
 - ✓ The **auditor is not aware** of circumstances or conditions that would cause **recipients** of negative confirmation requests to **disregard such requests**.

6. Procedures for sending of Confirmation Request

A. When using external confirmation procedures, the auditor **shall maintain control** over external confirmation requests, **including**:

- Determining the **information** to be confirmed or requested,
- Selecting the **appropriate confirming party**,
- **Designing the confirmation requests**, including determining that requests are properly addressed and **contain return information** for responses to be sent directly to the auditor,
- Sending the requests, including **follow-up requests** when applicable, to the confirming party.

6. Procedures for sending of Confirmation Request (contd.)

B. Factors which can be considered when designing confirmations request include:

- **Assertions** being addressed,
- Specific identified **ROMM**, including fraud risks,
- **Layout and presentation** of the confirmation request,
- **Prior experience** on the audit or similar engagements,
- **Method of communication** (for example, in paper form, or by electronic or other medium),
- **Management's authorization** to the confirming parties to respond to the auditor,
- **Ability** of the intended **confirming party** to confirm or provide the requested information,
- Determining that requests are properly addressed includes **testing the validity** of some or all of the **addresses** on confirmation requests before they are sent out.

7. Refusal by Management to send a confirmation request

If **management refuses** to allow the auditor to **send a confirmation request**, the auditor shall:

- Inquire as to **management's reasons** for the refusal, and the auditor is required to seek audit evidence as to the **validity and reasonableness of the reasons**
- **Evaluate the implications** of management's refusal
 - ❖ on the **auditor's assessment** of the relevant risks of material misstatement, including the **risk of fraud**, and
 - ❖ on the nature, timing and extent of **other audit procedures**.
- Perform **alternative audit procedures** designed to obtain relevant and reliable audit evidence, *for example*:
 - ❖ For accounts receivable balances – examining specific subsequent cash receipts, sales invoices, shipping documentation, and other sales related documents,
 - ❖ For accounts payable balances – examining subsequent cash disbursements or correspondence from third parties, and other records, such as goods receipt notes.

7. Refusal by Management to send a confirmation request (contd.)

Conclusion by Auditor:

If the auditor concludes that

- management's **refusal** to allow the auditor to send a confirmation request is **unreasonable**, or
- he is **unable** to obtain relevant and **reliable audit evidence** from alternative audit procedures,
- the auditor shall
 - ✓ **communicate** with those charged with governance in accordance with **SA 260**
 - ✓ determine the **implications** for the audit and the **auditor's opinion** in accordance with **SA 705**

8. Considerations for Receipt of External confirmations

A. Reliability of responses to Confirmation requests

- If the auditor **identifies factors** that give rise to **doubts about the reliability** of the response to a confirmation request, the auditor **shall obtain further audit evidence to resolve** those doubts.

It includes:

- ❖ Whether the confirmation is obtained from the **sources external** to the entity,
- ❖ Whether the confirmation **received directly** by the auditor,
- ❖ Whether the confirmations receive from **originally intended confirmation party**,
- ❖ In case **response** is received **electronically**, auditor need to **validate** the identity of sender's information through alternate procedures including **calling** procedures, **website verification** etc.,
- ❖ If the **confirming party uses third party** to coordinate and provide the **response to confirmation requests**, then auditor need to **address the risks** that:
 - The response **may not** be from the **proper source**;
 - A respondent **may not be authorized** to respond; and
 - The **integrity** of the transmission may have been **compromised**.

8. Considerations for Receipt of External confirmations (contd.)

A.1 ICAI Notification on External Confirmations through Third Party Vendors

- ICAI issued a notification dated September 7th 2022, clarifying that the auditors are advised to seek **direct confirmation** from **concerned banks** due to the following reasons:
 - ✓ use of third-party vendors leads to the risk that the **information provided** by third-party vendors may **not be authentic and complete**
 - ✓ it is **not clear** as to who will be **responsible** in case there is **failure of IT controls** at the end of third-party vendors

A.2 Restrictive language:

A response to a confirmation request may contain restrictive language regarding its use. Such restrictions do not necessarily invalidate the reliability of the response as audit evidence

8. Considerations for Receipt of External confirmations (contd.)

B. Unreliable responses

- **If the auditor determines** that a response to a confirmation request is **not reliable**, the auditor shall **evaluate the implications** on the assessment of the ROMM, including the **risk of fraud**, and **on the related nature, timing and extent of other audit procedures**.

C. Exceptions to Confirmation

- Exceptions noted in responses to confirmation requests **may indicate misstatements** or potential misstatements in the **financial statements**. When a misstatement is identified, the auditor is required by **SA 240** to **evaluate** whether such misstatement is **indicative of fraud**.
- Exceptions may provide a guide to the quality of responses from similar confirming parties or for similar accounts. Exceptions also **may indicate a deficiency**, or deficiencies, in the **entity's internal control over financial reporting**.

8. Considerations for Receipt of External confirmations (contd.)

D. Oral Confirmation

- An oral response to a confirmation request **does not meet the definition** of an external confirmation because it is **not a direct written response** to the auditor.
- However, upon obtaining an oral response to a confirmation request, the auditor may, depending on the circumstances, **request** the confirming party to **respond in writing directly** to the auditor.
- If **no such response is received**, the auditor seeks other **alternate audit evidence** to support the information in the oral response, as mentioned in **case of non-response**.

E. No Response to Confirmation

- In the case of each non-response, the auditor shall **perform alternative audit procedures** to obtain relevant and reliable audit evidence, ***for example***:
For accounts receivable balances – examining specific subsequent cash receipts, sales invoices, shipping documentation, and other sales related documents.

Note: A **non-response** to a confirmation request **may indicate** a previously **unidentified ROMM**. In such situations, the auditor may need to **revise the assessed ROMM** at the assertion level, and **modify planned audit procedures**, in accordance with SA 315.

Knowledge Check

True / False ?

The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

True / False ?

If the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.

True / False ?

Negative confirmations provide more persuasive audit evidence than positive confirmations.

True / False ?

An oral response to a confirmation request meets the definition of an external confirmation.

True / False ?

A response to a confirmation request may contain restrictive language regarding its use. Such restrictions do not necessarily invalidate the reliability of the response as audit evidence.

Questions?

SA 580

Written Representations

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1. Scope of SA 580

- This Standard on Auditing (SA) deals with the **auditor's responsibility to obtain written representations from management** and, where appropriate, **those charged with governance**

2. Objectives of the auditor

- to obtain written representations from management / TCWG **that they believe that they have fulfilled their responsibilities** for
 - ❖ for the preparation of the financial statements and
 - ❖ for the completeness of the information provided to the auditor
- to **support other audit evidence** relevant to the financial statements / specific assertions by means of written representations; and
- to respond appropriately to written representations provided by the management/ TCWG **or when management/ TCWG refuse** to provide requested written representations.

3. Meaning of Written Representations

A written statement by management **provided to the auditor**

- ✓ to **confirm** certain matters or to **support other audit evidence**
- ✓ it **does not include** financial statements, the assertions therein, or supporting books and records

4. Written Representation as an Audit Evidence

- Written representations are **necessary information** that the auditor **requires** in connection with the **audit** of the entity's financial statements. Accordingly, similar to responses to inquiries, **written representations are audit evidence**.
- Although written representations provide necessary audit evidence, they **do not provide sufficient appropriate audit evidence on their own** about any of the matters with which they deal.
- Fact that management has provided reliable written representations **does not affect the nature or extent of other audit evidence** that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.

5. Management from whom written representations requested

- The auditor **shall request** written representations from management
 - ❖ with **appropriate responsibilities** for the financial statements and
 - ❖ **knowledge** of the matters concerned
- Appropriate individuals may vary depending on the governance structure of the entity, and relevant law or regulation; however, **management** or **those charged with governance** is often the **responsible party**, *For example chief executive officer or chief financial officer.*
- In some cases, management may decide to make **inquiries** of others who participate in **preparing and presenting** the financial statements and assertions therein, including **individuals who have specialized knowledge** relating to the matters. Such individuals may include:
 - ❖ An **actuary** responsible for actuarially determined accounting measurements.
 - ❖ **Staff engineers** who may have responsibility for and **specialized knowledge** about environmental liability measurements.
 - ❖ **Internal counsel** who may provide information essential to provisions for legal claims.

6. Qualifying language - Written Representations

- In some cases, management may include in the written representations **qualifying language** to the effect that representations are made to the **best of its knowledge and belief**.
- It is reasonable for the auditor to accept such wording **if** the auditor is **satisfied** that the representations are being made
 - ❖ by those with **appropriate responsibilities** and
 - ❖ **knowledge** of the matters included in the representations.

7. Written representations about Management's Responsibilities

- The auditor shall **request management to provide** a written representation that it **has fulfilled its responsibility**,
 - ❖ for the **preparation of the financial statements in accordance with the applicable financial reporting framework**, including where relevant their fair presentation, as set out in the terms of the audit engagement,
 - ❖ for the completeness of transactions and information provided to the auditor:
 - ✓ Management has **provided the auditor with all relevant information and access** as agreed in the terms of the audit engagement,
 - ✓ **All transactions have been recorded** and are **reflected** in the **financial statements**
- In addition to above, the **auditor may consider it necessary to request** management to provide a written representation that it has communicated to the auditor **all deficiencies in internal control** of which management is aware

7. Written representations about Management's Responsibilities (contd.)

- The auditor may request to **provide** a written representation to **reconfirm** the **acknowledgement** and **understanding of management of its responsibilities** in the terms of **the audit engagement**, when:
 - ❖ Those who **signed** the **terms** of the **audit engagement** on behalf of the entity **no longer** have the relevant **responsibilities**
 - ❖ The **terms** of the audit engagement were **prepared in a previous year**
 - ❖ There is any indication that management **misunderstands those responsibilities**; or
 - ❖ **Changes in circumstances** make it appropriate to do so.

8. Other Written Representations

If, in addition to written representations required by other SAs, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the **financial statements** or one or more **specific assertions**, the auditor shall request such other representations.

They may include the representation about the following:

A. Additional Written Representation about Financials Statement:

- Whether the **selection and application** of **accounting policies** are **appropriate**
- Whether following **matters** have **been recognized, measured, presented or disclosed** in accordance with that **framework**:
 - ❖ Plans or intentions that may affect the **carrying value or classification** of assets and liabilities
 - ❖ **Liabilities**, both actual and contingent
 - ❖ **Title** to, or **control** over, assets, the **liens** or **encumbrances** on assets, and **assets pledged as collateral**; and
 - ❖ Aspects of **laws, regulations and contractual agreements** that may affect the financial statements, including **non-compliance**.

8. Other Written Representations (contd.)

B. Additional Written Representation about Specific Assertions:

- The auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements,
- to **support an understanding** that the auditor has **obtained** from **other audit evidence** of **management's judgment or intent** in relation to, or the completeness of, a specific assertion.

For Example

If the intent of management is important to the valuation basis for investments, it may not be possible to obtain sufficient appropriate audit evidence without a written representation from management about its intentions.

9. Communication of threshold amount to management

- **SA 450** requires the auditor to **accumulate misstatements** identified during the audit, other than those that are **clearly trivial**;
- The auditor may determine a **threshold above** which misstatements **cannot be regarded** as **clearly trivial**;
- In the same way, the auditor may consider **communicating** to management a **threshold** for purposes of the **requested written representations**.

10. Communication with those charged with governance

SA 260 requires the auditor to communicate with those charged with governance

- ❖ the written representations
- ❖ which the auditor has requested from management

11. Date of and Period(s) covered by written representations

- The date of the written representations shall be as near as practicable to, **but not after**, the **date of the auditor's report** on the financial statements.
- Written representations shall be for all financial statements and period(s) **referred to in the auditor's report**.
- It may be appropriate for the auditor to **obtain** a written representation about a **specific assertion** in the financial statements **during the course of the audit**. In such case, it may be necessary to request an updated written representation.
- The written representations are for **all periods** referred to in the **auditor's report** because management needs **to reaffirm** that the written representations **it previously made** with respect to **the prior periods remain appropriate**.
- The auditor and management **may agree** to a **form of written representation** that **updates** written representations **relating to the prior periods** by **addressing** whether there are any **changes** to such written representations and, if so, what they are.

11. Date of and Period(s) Covered by written representations (Contd.)

- Situations may arise where current management **were not present during all periods** referred to in **the auditor's report**
 - ❖ Such persons may assert that they are **not in a position** to **provide some or all of the written representations** because they were not in place during the period
 - ❖ this fact, however, does **not diminish** such persons' **responsibilities for the financial statements** as a whole
 - ❖ Accordingly, the requirement for the auditor to request from them written representations that **cover the whole of the relevant period(s)** still applies

12. Form of written representation

The written representations **shall be** in the **form of a representation letter** addressed to the auditor. **If law or regulation requires** management to **make written public statements** about its responsibilities, and the auditor **determines** that its an appropriate form of written representations in respect of some or all of the required representations, those matters need not be included in the representation letter.

Factors that may affect the auditor's determination include :

- Whether the statement includes **confirmation** of the fulfillment of the **management responsibilities**,
- Whether the statement has been **given or approved** by those from whom the auditor requests the **relevant written representations**.
- Whether a copy of the statement is **provided** to the auditor as near as practicable to, **but not after, the date of the auditor's report** on the financial statements.

13. Doubt as to reliability of written representations

- If the auditor has **concerns** about the competence, integrity, ethical values or diligence of management, or about its commitment, the auditor shall **determine the effect** that such **concerns** may have on the **reliability of representations and audit evidences**
- If written representations are **inconsistent with other audit evidence**,
 - ❖ the auditor shall **perform audit procedures** to attempt to **resolve the matter**
 - ❖ If the **matter remains unresolved**,
 - ✓ the auditor shall **reconsider the assessment** of the competence, integrity, ethical values or diligence of management, or of its commitment to and shall **determine the effect** that this may have on the **reliability of representations and audit evidence** in general
- If the auditor concludes that the written representations **are not reliable**,
 - ❖ the auditor shall take **appropriate actions**, including **determining the possible effect** on the **opinion** in the auditor's report in accordance with **SA 705**

14. Requested written representations not provided

If management does not provide one or more of the requested written representations, the auditor shall:

- **Discuss** the matter with management;
- **Re-evaluate the integrity** of management and evaluate the effect that this may have on the reliability of representations and audit evidence in general; and
- **Take appropriate actions**, including **determining** the **possible effect on the opinion** in the auditor's report in accordance with **SA 705**, having regard to the requirement of this SA

- The auditor **shall disclaim an opinion** on the financial statements in accordance with SA 705 **if**:
 - ❖ The auditor concludes that there is **sufficient doubt** about the integrity of management such that the written representations required by this SA are not reliable; or
 - ❖ Management **does not provide** the written representations required by this SA.

Knowledge Check

True / False ?

Auditor's report can be dated before the date of the written representations.

True / False ?

Management may approach relevant experts – actuaries, internal counsel, staff engineers who have specialized knowledge relating to the matters about which written representations are requested.

True / False ?

Auditor may request management to provide a written representation that it has communicated to the auditor all deficiencies in internal control of which management is aware.

True / False ?

The auditor can accept written representation made by management using qualifying language “to the best of its knowledge and belief”, if such representation is made by those with appropriate responsibilities and knowledge of the matters included in the representations.

True / False ?

During the course of audit, if a written representation is obtained about a specific assertion in the financial statements, the auditor is not required to obtain an updated written representation as at the date of the auditor's report.

Questions?

Thank You

