

ASA 450
(October 2009)

Explanatory Statement

ASA 450 Evaluation of Misstatements Identified during the Audit

Issued by the **Auditing and Assurance Standards Board**



Australian Government

Auditing and Assurance Standards Board

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For approval

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**Reasons for Issuing Auditing Standard ASA 450
*Evaluation of Misstatements Identified during the Audit***

The Auditing and Assurance Standards Board (AUASB) issues Auditing Standard ASA 450 *Evaluation of Misstatements Identified during the Audit* pursuant to the requirements of the legislative provisions and the Strategic Direction explained below.

The AUASB is an independent statutory board of the Australian Government established under section 227A of the *Australian Securities and Investments Commission Act 2001*, as amended (ASIC Act). Under section 336 of the *Corporations Act 2001* (the Act), the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

Under the Strategic Direction given to the AUASB by the Financial Reporting Council (FRC), the AUASB is required to have regard to any programme initiated by the International Auditing and Assurance Standards Board (IAASB) for the revision and enhancement of the International Standards on Auditing (ISAs) and to make appropriate consequential amendments to the Australian Auditing Standards. The IAASB has undertaken a programme to redraft, and in some cases, revise, in “clarity” format, the entire suite of ISAs. Accordingly, the AUASB has decided to revise and redraft the Australian Auditing Standards using the equivalent redrafted ISAs.

The Auditing Standard conforms with ISA 450 *Evaluation of Misstatements Identified during the Audit*.

Operative Date

ASA 450 *Evaluation of Misstatements Identified during the Audit* is operative for financial reporting periods commencing on or after 1 January 2010.

Purpose of Auditing Standard ASA 450 *Evaluation of Misstatements Identified during the Audit*

The purpose of the Auditing Standard is to establish requirements and to provide application and other explanatory material to auditors regarding the auditor’s responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial report.

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Main Features

The Auditing Standard:

- (a) requires the identification, accumulation and consideration of identified misstatements during the audit;
- (b) requires communication of identified misstatements to management for correction;
- (c) requires evaluation of uncorrected misstatements that have not been corrected by management and communication of such misstatements to those charged with governance;
- (d) directs the auditor to obtain a written representation from management, and where appropriate, those charged with governance, regarding the effects of any uncorrected misstatements; and
- (e) describes the required audit documentation.

Preamble and Overall Objectives

ASA 450 is to be read in conjunction with ASA 101 *Preamble to Australian Auditing Standards*, which sets out the intentions of the AUASB on how the Australian Auditing Standards, operative for financial reporting periods commencing on or after 1 January 2010, are to be understood, interpreted and applied. ASA 450 is to be read also in conjunction with ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*.

Process of making Australian Auditing Standards

The AUASB's Strategic Direction, *inter alia*, provides that the AUASB develop Australian Auditing Standards that:

- have a clear public interest focus and are of the highest quality;
- use the International Standards on Auditing (ISAs) of the International Auditing and Assurance Standards Board (IAASB) as the underlying standards;
- conform with the Australian regulatory environment; and

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- are capable of enforcement.

In implementing the FRC's Strategic Direction, the AUASB has undertaken a process of revision and redrafting of the Australian Auditing Standards that has:

- updated the form, layout and content of the Australian Auditing Standards;
- addressed the legal enforceability of mandatory obligations;
- maintained clarity of the auditor's obligations;
- incorporated appropriate references to Australian laws and regulations;
- clearly identified, by use of the prefix "Aus", AUASB additions to paragraphs in the requirements or the application and other explanatory material; and
- included other amendments as necessary.

Consultation Process prior to issuing the Auditing Standard

The AUASB has consulted publicly as part of its due process in developing the Auditing Standard. Exposure Draft ED 18/08 *Proposed Auditing Standard: Evaluation of Misstatements Identified during the Audit* (Re-issuance of ASA 320), was issued on 10 November 2008 with a 30 day comment period.

As an integral part of its consultation with the public, the AUASB sought comments on specific questions including:

- the completeness and accuracy of references in the Auditing Standard to relevant laws and regulations;
- the significant costs, if any, and benefits, of compliance with any additional requirements under the Auditing Standard; and
- whether or not there exist any matters of public interest affecting the issuance of the Auditing Standard.

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Submissions were received by the AUASB and these were considered as part of the development and finalisation of the Auditing Standard.

Regulation Impact Statement

A *Regulation Impact Statement* (RIS) has been prepared in connection with the redrafting of Australian Auditing Standards in “clarity” format, including ASA 450 *Evaluation of Misstatements Identified during the Audit*.

The RIS considered both expected benefits and expected costs of the introduction of clarified auditing standards, including comments provided by stakeholders during the redrafting process. It concluded that expected benefits to users of audit services, users of audit reports, auditors and the Australian economy in general are, on balance, likely to outweigh expected costs.

Main Differences from ASA 320 *Materiality and Audit Adjustments* (April 2006)

The main differences between the Auditing Standard and the Auditing Standard that it supersedes, ASA 320 *Materiality and Audit Adjustments* (April 2006), are:

1. Auditing Standard ASA 450 is written in the “clarity” format using the equivalent International Standard on Auditing (ISA 450 *Evaluation of Misstatements Identified during the Audit*) as the underlying Auditing Standard. Consequently, the format, layout, and paragraph numbering styles are different from the extant Auditing Standard.
2. The following requirements included in the Auditing Standard are in part, or full, additional to the extant Auditing Standard:
 - (a) If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor shall obtain an understanding of management’s reasons for not making the corrections and shall take that understanding into account when evaluating whether the financial report as a whole is free from material misstatement. (Ref: Para. 9);
 - (b) 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

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in the auditor's report, unless prohibited by law or regulation. The auditor's communication shall identify material uncorrected misstatements individually. The auditor shall request that uncorrected misstatements be corrected. (Ref: Para.12);

- (c) The auditor shall also communicate with those charged with governance the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial report as a whole. (Ref: Para.13); and
 - (d) The auditor shall include in the audit documentation:
 - (i) The amount below which misstatements would be regarded as clearly trivial;
 - (ii) All misstatements accumulated during the audit and whether they have been corrected; and
 - (iii) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion. (Ref: Para.15)
3. The following requirement included in the extant Auditing Standard ASA 320 is included in Auditing Standard ASA 705 *Modifications to the Opinion in the Independent Auditor's Report*:
- (a) The auditor shall express a modified opinion in accordance with ASA 701 *Modifications to the Auditor's Report*, if:
 - (i) those charged with governance refuse to adjust the financial report for material misstatements; and
 - (ii) the results of extended audit procedures do not enable the auditor to conclude that the aggregate of uncorrected misstatements is not material. (Extant Ref: Para. 34)
4. Certain guidance material in the extant Auditing Standard has been elevated to requirements.

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5. To improve clarity, certain requirements and guidance in the extant Auditing Standard have been re-written, however, the equivalent meanings have been retained.
6. Application and other explanatory material linked to the additional requirements listed in 2. above is also included in the Auditing Standard.

For approval