

Evaluating misstatements (Lecture A856 – 5.00 minutes)

During the audit, the auditor will document all misstatements identified on an 'audit error schedule' or 'summary of unadjusted errors schedule' and will discuss these errors with management and, where applicable, those charged with governance.

The auditor must consider the effect of uncorrected misstatements on the financial statements as a whole in line with ISA (UK) 450 *Evaluation of Misstatements Identified During the Audit*. This is achieved by:

- Recording all uncorrected misstatements identified during the detailed audit fieldwork on an unadjusted error schedule unless the misstatements are clearly trivial. The 'clearly trivial' benchmark is set at the planning stage of the audit and must be documented on file.
- Consider whether the identified misstatements indicate the presence of other misstatements within the financial statements which may be material when aggregated. If this is the case, the audit plan and audit strategy should be revised accordingly. Where the audit plan and strategy has been revised, the reasons for such revision should be documented.
- Assess the materiality of the uncorrected misstatements keeping in mind that it is not just about the numbers where materiality is concerned. If a material disclosure is either inadequate or has not been made (for example, a material related party disclosure), this will also be regarded as an uncorrected misstatement which should be corrected. Disclosures which are inconsistent with the financial statements (including those in the directors' report and/or strategic report) should also be corrected.
- Report all misstatements identified to an appropriate level of management or, where applicable, to those charged with governance.
- Request that all misstatements are corrected.
- If management refuse to correct some, or all, of the misstatements, the auditor must consider their reasons for refusing to correct them and take these into account when establishing whether the misstatements are material both in isolation and in the aggregate.
- Revisit the materiality levels calculated at the planning stage and, where applicable, revised during the detailed audit fieldwork to assess whether they remain appropriate at the completion stage having regard to the audit conclusions and evidence in each area.
- Report any uncorrected misstatements to those charged with governance and explain the effect that this may have on the audit opinion.
- Request a written representation from those charged with governance that they believe the effects of uncorrected misstatements are immaterial.

A copy of the uncorrected misstatements must be supplied to those charged with governance. This usually accompanies the letter of comment or is supplied beforehand.

Reporting

Once the above procedures have been completed, the auditor must consider the impact of the uncorrected misstatements on the audit opinion. Where the impact is immaterial, an unqualified opinion can be expressed. Where the impact is material, the qualification will all depend on the materiality and pervasiveness of the uncorrected errors.

If the uncorrected misstatements are material but not pervasive, a qualified 'except for' opinion may be expressed. If the uncorrected misstatements are material and pervasive an adverse or disclaimer of opinion may be expressed.

Uncorrected misstatements which are immaterial do not need to be dealt with in the auditor's report by way of an Emphasis of Matter paragraph. Some audit files have been criticised for including an Emphasis of Matter paragraph dealing with uncorrected misstatements. This is technically incorrect on two counts:

- Immaterial misstatements do not need to be brought to the attention of the shareholders because they are immaterial.
- An Emphasis of Matter paragraph is only used to draw attention to a fundamentally important issue that has been adequately presented or disclosed in the financial statements.