Determining Significant Accounts and Disclosures and their relevant Assertions

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Session Objectives

» Discuss criteria, both qualitative and quantitative, for determining significant accounts and disclosures

» Short recap on management and assertions

» Discuss the effect to the audit strategy

» Engage in group activity based on Perfecta LTD case
All disclosures are significant, but not all accounts are significant.

We make a combined risk assessment for each relevant assertion for each significant account and disclosure.

Every account that exceeds materiality must be selected as significant.

We identify and gain an understanding only of the processes and related IT applications that affect significant accounts.

(circle your response in the handouts provided – 5 min available)
Accounts and disclosures are significant if they may contain material misstatements.

To determine this, we consider both:
- Quantitative considerations
- Qualitative considerations

Quantitative considerations are more easily measured while qualitative ones are usually risks associated to the account/disclosure or significance and sensitivity of the information.
Quantitative criteria - examples

» Size of account (the larger the account balance, the greater the possibility that it contains material misstatements)

» Composition of the account

» Volume of the transactions processed through the account
Qualitative criteria - examples

- Susceptibility of loss due to errors or fraud
- Complexity and homogeneity of the transactions
- Nature of the account (e.g., suspense accounts generally warrant greater attention)
- Accounting and reporting complexities or changes
- Exposure to losses
- Likelihood (or possibility) of significant contingent liabilities arising from the activities represented by the account
- Existence of related-party transactions
- Changes from the prior period in account characteristics (e.g., new complexities, subjectivity, IT technology, or types of transactions)
Financial statements represent a very complex and interrelated set of assertions.

“Representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur” ISA Definition

ISA 315 classifies management assertions into 3 categories:
- Assertions relating to classes of transactions;
- Assertions for account balances; and
- Presentation and Disclosure assertions
» **Occurrence:** the transactions actually took place

» **Completeness:** all transactions that should have been recorded are recorded

» **Accuracy:** the transactions were recorded at the appropriate amounts

» **Cutoff:** the transactions have been recorded in the correct accounting period

» **Classification:** the transactions have been recorded in the proper accounts
Management Assertions – Account Balance

» **Existence:** assets, liabilities and equity balances exist.

» **Rights and Obligations:** the entity holds or controls the rights to its assets and owes obligations to its liabilities.

» **Completeness:** all assets, liabilities and equity balances that should have been recorded have been recorded.

» **Valuation and Allocation:** assets, liabilities and equity balances are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.
Management Assertions – Presentation and Disclosure

» **Occurrence**: the transactions have occurred

» **Rights and Obligations**: the transactions pertained to the entity

» **Completeness**: all disclosures that should have been included in the financial statements have been included

» **Valuation and accuracy**: financial and other information is disclosed fairly and at appropriate amounts.

» **Understandability**: financial statements are appropriately presented and described, and information in disclosures is clearly expressed
# Assertions - Summary

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<thead>
<tr>
<th></th>
<th>Transactions</th>
<th>Account Balances</th>
<th>Presentation &amp; Disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Occurrence</td>
<td>★★★</td>
<td>★★</td>
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<tr>
<td>Completeness</td>
<td>★★★</td>
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<tr>
<td>Accuracy</td>
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<td>Cutoff</td>
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<td>Classification</td>
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<td>Existence</td>
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<td>Rights and obligations</td>
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<td>Valuation and allocation</td>
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<tr>
<td>Understandability</td>
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</table>
The extent and nature of audit procedures we perform will vary depending on whether accounts and disclosures are significant or not.

Only for relevant assertions of significant accounts / disclosures we identify and gain an understanding of the processes and related IT applications that affect those significant accounts.
The audit team has identified that **Cash** and **Inventories** are significant accounts for the audit of a small supply store.

You are required to identify the related processes for these accounts

**Cash**
- Cash Receipts
- Cash Disbursements

**Inventories**
- Purchases
- Processing accounts payable
- Cash disbursements
- Physical inventory
- Provisions for obsolete and damaged inventories
Use the “Significant Accounts Work Paper” provided as well as other information provided in the Perfecta LTD case to document what accounts and disclosures are considered significant.

For the selected Significant Accounts and Disclosures, identify the related processes.

(15 min)
Thank you

Q&A