

Board Meeting Agenda

24 October 2019

9.30 am to 5.00pm

XRB Offices, Level 7, 50 Manners Street, Wellington

Est. Time	Item	Topic	Objective		Page
A: NON-PUBLIC SESSION					
10.30 am	Morning tea				
B: PUBLIC SESSION					
11.00 am	3	<u>ISA 315 (Revised)</u>			
	3.1	Board meeting summary paper	Note	Paper	
	3.2	Update on IAASB ISA 315 (Revised)	Note	Paper	
	3.3	ISA 315 (Revised) pre PIOB approval	Note	Paper	
	3.4	ISA 315 (Revised) conforming amendments	Note	Paper	
11.30 am	4	<u>Meet with IOD</u>			
	4.1	Board meeting summary paper	Note	Paper	
12.30 pm	Lunch				
1.15 pm	5	<u>NZ SRE 2410</u>			
	5.1	Board meeting summary paper	Note	Late	
	5.2	Evaluation of submissions received	Consider	Late	
		File 2 - Submissions received	Consider	Late	
2.00 pm	6	<u>NZAuASB SAP implementation plan</u>			
	6.1	Board meeting summary paper	Note	Paper	
	6.2	Implementation plan 2019/2020	Approve	Paper	
	6.3	NZAuASB SAP 2019-2024	Approve	Paper	
2.30 pm	7	<u>Review of SPI</u>			
	7.1	Board meeting summary paper	Note	Paper	
	7.2	Draft project plan	Note	Paper	
2.45	8	<u>Conforming amendments from Code to ISAs NZ</u>			
	8.1	Board meeting paper	Note	Paper	
	8.2	Draft ITC	Approve	Paper	
3:00 pm	Afternoon tea				
3.15 pm	9	<u>FMA QA review findings</u>			
	9.1	Board meeting summary paper	Note	Late	
	9.2	Issues paper	Consider	Late	
3.45 pm	10	<u>KAM report plan</u>			
	10.1	Board meeting summary paper	Note	Paper	
	10.2	Information sheet on joint project	Note	Paper	
	10.3	Draft questions	Note	Paper	
	10.4	Stakeholder engagement plan	Note	Paper	

Est. Time	Item	Topic	Objective		Page
4.15 pm	11	<u>FMA subsequent events matter</u>			
	11.1	Board meeting summary paper	Note	Paper	
	11.2	Compelling reason test	Consider	Paper	
	11.3	Draft ITC and ED – subsequent events	Approve	Paper	
4.45 pm	12	<u>Environmental Scanning</u>			
	12.1	International monitoring update	Note	Paper	
	12.2	Domestic monitoring update	Note	Paper	
C: NON-PUBLIC SESSION					

Next meeting: 5 December 2019, Wellington

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO. 3.1
Meeting date: 24 October 2019
Subject: ISA 315 (Revised)
Date: 11 October 2019
Prepared By: Sylvia van Dyk

☐ **Action Required**

☒ **For Information Purposes Only**

Agenda Item Objectives

For the Board to

- RECEIVE an update of the amendments the IAASB made to ED ISA 315 (Revised) in finalising the standard; and
- NOTE the conforming amendments approved by the IAASB.

Background

1. In its September 2019 meeting, the IAASB approved the revisions to ISA 315 (Revised), as well as the related conforming amendments. The revised ISA will be effective for audits of financial statements for periods beginning on or after December 15, 2021. Once the Public Interest Oversight Board's (PIOB) confirmation that due process was followed is received, the IAASB will formally release the standard.
2. The voting results on the approval is noted in the IAASB September meeting report at agenda 2.8.
3. We have prepared a summary of the amendments the IAASB made to ED ISA 315 (Revised), for the Board's information. We intend to bring a New Zealand standard for approval to the Board at the December meeting.
4. With reference to feedback obtained from the technical reference group (agenda 2.8.1) as well as the NZAuASB submission on the ED ISA 315 (Revised), we have not identified any compelling reason amendments to the international standard and are not aware of any identified by the AUASB that have not been addressed in the final version of ISA 315 (Revised). We will liaise further with the AUASB staff on this before the December meeting.
5. A close to final version of ISA 315(Revised) is available at agenda 3.3. The mark-ups in this version are the final mark-ups the Board considered when approving the standard.
6. A close to final IAASB approved conforming amendments is available at agenda 3.4.

Matters to Consider

7. The issues paper at agenda 3.2 provides a summary of the changes the IAASB made to ED ISA 315 (Revised).
8. Key changes to highlight are (the changes are described in more detail in agenda 3.2):
 - The format of the standard (requirements and application material)
 - The change in the definition of significant risk
 - Explanation of the identification of risks of material misstatement and the threshold, which has been included in the proposed conforming amendments to ISA 200 and reiterated in paragraph A202
 - The reference to the inherent risk factors in the requirement to obtain an understanding of the entity and the applicable financial reporting framework
 - Reinstatement of the extant requirement for the auditor to consider other controls that the auditor considers are appropriate to test the design and implementation of, to enable the auditor to meet the objectives of paragraph 17 with respect to risks at the assertion level, based on the auditor's professional judgment
 - substantial changes to the application material, in particular moving paragraphs within the application material to reflect the revised flow of the requirements.

Recommendations

9. We recommend that the Board note the update of the amendments the IAASB made to the ED ISA 315 (Revised) in finalising the standard, and the conforming amendments approved by the IAASB.

Material Presented

Agenda item 3.1	Board Meeting Summary Paper
Agenda item 3.2	Summary of amendments to ED ISA 315(Revised)
Agenda item 3.3	Close to final ISA 315(Revised)
Agenda item 3.4	ISA 315 (Revised) conforming amendments

Background

In its September 2019 meeting, the IAASB approved the revisions to ISA 315 (Revised), as well as the related conforming amendments. The revised ISA will be effective for audits of financial statements for periods beginning on or after December 15, 2021. Once the Public Interest Oversight Board's (PIOB) confirmation that due process was followed is received, the IAASB will formally release the standard.

Changes to the ED-315

The IAASB received seventy-two responses to ED-315 from a broad range of stakeholders. An overarching theme throughout the responses related to the complexity of the proposals, as well as the scalability and proportionality of the proposed standard. There were also many comments related to individual aspects of the proposals, some supporting the specific changes that had been proposed, while other comments highlighted concerns or disagreement.

To address these concerns, the finalised version of the standard contains numerous changes to the ED. Most of these changes resulted from the IAASB adopting a new drafting approach to enhance the clarity of the standard and make it shorter. However there have been some changes to the substance of the ED-315 (including adding new definitions and changing certain aspects of some of the requirements).

The new drafting approach

The new approach to redrafting ISA 315 (Revised) presents some of the requirements in tables with revised application material, which has also been enhanced in structure and content to provide enhanced support to the requirements. In addition, examples have been included in boxes within the application material to assist with understanding and scalability of the requirements.

In this context, the IAASB has focused on the content of the requirements (the 'what') alongside the development of supporting explanations of 'why' required procedures are performed (the explanations of "why" have mainly been presented and separately highlighted in the application material). In summary the new standard includes the following components:

- 'What' the auditor is required to do. This has formed the basis of the new proposed requirements (amended where necessary).
- Definitions, describing the meaning of specific words or terms used within the standard, including common characteristics, which support the application of the requirements.
- 'Why' the auditor is required to perform the required procedure. The 'why' has been presented in the application material, except when the 'why' is a necessary threshold for the execution of the requirement in which case it is included in the requirement; regardless, the 'why' forms an integral part of the understanding of the requirements.
- 'How' the requirement should be applied. These aspects have been incorporated into the application material where they have been identified, with supporting revisions and enhancements to the application material as necessary.

Also, some of the "why" and "how" material included in the ED (e.g. some of the introduction paragraphs) are now taken out of the standard and included in guidance material expected to be released together with the new standard (the guidance material is to include a "First Time Implementation Guide" as well as a "Frequently Asked Questions").

Changes to definitions included in ED -315

There are a couple of new definitions added to the definitions included in ED-315. However, these are minor new definitions without significant impact on the standard.

Most of the changes to definition are editorial in nature with the exception of the change to the definition of significant risk. To better align the definition of a significant risk to its related application material, the IAASB supported a revision to the definition that emphasises that the auditor considers the **combination** of magnitude and likelihood in determining whether an identified risk of material

misstatement is a significant risk. This change is consistent with the Board's feedback to the ED-315 whereby they support a magnitude AND likelihood approach to identify significant risks as opposed to the proposed magnitude OR likelihood approach of ED-315.

Changes to requirements of ED-315

The following changes are incorporated into the new standard (compared to ED-315):

- a) Paragraph 17—to rearticulate the auditor's considerations in relation to corroborating and contradictory information to clarify that the scope of this requirement is evidence that is corroborative or contradictory to management's assertions.
- b) Paragraph 18(a)—the explicit requirement to include inquiries of 'individuals within the internal audit function' (from the extant standard) has been reinstated.
- c) Inherent risk factors (paragraphs 23 and 48)—the IAASB reconsidered how reference to the inherent risk factors, in the requirement to obtain an understanding of the entity and the applicable financial reporting framework, has been articulated, to address some concerns expressed about potential inconsistency between the articulation in the requirement and the definition of inherent risk factors. Accordingly, paragraph 23 has been revised to replace "How events and conditions are subject to, or affected by, the inherent risk factors" with "the inherent risk factors that affect susceptibility to misstatement of assertions, and how they do so." This revision replaces "events and conditions" in the requirement, with "inherent risk factors" (i.e., as defined, "the characteristics of events or conditions ..."). A corresponding revision has also been made to the requirement for assessing inherent risk (paragraph 48), which now requires the auditor to take into account how, and the degree to which, inherent risk factors affect the susceptibility to misstatement of relevant assertions. The Task Force is of the view that these clarifications will also assist practitioners in understanding how the inherent risk factors are applied at the different stages of the risk assessment process.
- d) Paragraph 31A(b)—moved the requirement relating to understanding the sources of information used in the entity's process to monitor the system of internal control into the 'table' for the overall requirement for understanding the entity's process to monitor the system of internal control
- e) Reinstated the extant requirement for the auditor to consider other controls that the auditor considers are appropriate to enable the auditor to meet the objectives of paragraph 17 with respect to risks at the assertion level, based on the auditor's professional judgment. This has been further clarified with enhanced application material in Para.A177a to clarify.
- f) A new heading has been inserted above paragraph 45 to make it clearer that paragraphs 45 and 46 relate to the identification of the risks of material misstatement.
- g) Paragraph 51—the requirement to assess control risk has been rearticulated to explain more directly how control risk is assessed when the auditor does not plan to test the operating effectiveness of controls. This change better facilitates the statements made in ISA 200 and ISA 540 (Revised) that the auditor separately assesses inherent risk and control risk, but it also makes clear that that the assessment of control risk would only change the auditor's assessment of the risk of material misstatement if the auditor plans to test the operating effectiveness of controls.
- h) Paragraph 54(c)—in further considering the specific documentation requirements, the IAASB believed there may be merit in explicitly requiring the design and implementation (D&I) of controls in the control activities component to be documented because of the importance of these procedures in determining further audit procedures.
- i) Paragraph 54(d)—the Task Force has also enhanced the requirement relating to the documentation of assessed risks of material misstatement to include documentation for risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence for completeness of the requirements.

Also, specific requirements are now presented in tables, to further clarify the nature and extent required for understanding the entity and its environment, and the applicable financial reporting framework, and the components of the entity's system of internal control. Changes are made to:

- a) Revise the lead-in, as appropriate, to ringfence the required understanding to the information "relevant to the preparation of the financial statements" (as this concept had been lost and concern had been raised that an understanding broader than intended may be interpreted to be required). The Task Force also considered whether to include the 'boundary' within the definition of the system of internal control but had the view that this boundary was better placed within the requirements themselves;
- b) Clarify that the understanding is to be obtained by 'performing risk assessment procedures;' and
- c) Explain in the application material that the various 'evaluations' of the components of the system of internal control are in the context of the 'understanding' of the specific matters required to be understood for each component, and not to the extent that would be required to support a 'separate opinion' on the component of the system of internal control. In addition, various changes have been made to the text of the requirements relating to obtaining an understanding of each component, for consistency between the requirements for each component, where appropriate. For example, to ensure that scalability is explicitly addressed in the requirements to evaluate each of the indirect components of internal control, "appropriate in the circumstances considering the nature and circumstances of the entity" has been added to the requirements for those components where it had not yet been made explicit.

The NZAuASB in its submission to the IAASB on ED-315 noted that the term 'risk of material misstatement' can be confusing because it refers to both

- Risk of material misstatement at the assertion level for classes of transactions, account balances, and disclosures (i.e. before considering controls) and
- The risk of material misstatement after considering control risk.

Many other respondents, as well as some of the IAASB members raised a similar concern in this regard.

The Board suggested to describe the first type of risk of material misstatement as "preliminary risk of material misstatement" to distinguish it from its latter use. However, the IAASB has decided to not change the standard because:

- a) Explanation of the identification of risks of material misstatement has been included in the proposed conforming amendments to ISA 200 and reiterated in paragraph A202 of ISA 315 (Revised) (i.e., in identifying risks of material misstatement, the auditor considers those misstatements that could (i.e., have a reasonable possibility to: (a) occur (i.e., its likelihood), and (b) be material if they were to occur (i.e., its magnitude). The IAASB intends to develop a FAQ to provide further supporting explanation.
- b) The risks identified are representative of 'what can go wrong,' and are not actual risks of material misstatement until they are assessed in paragraphs 48 and 51. However, they are referred to as risks of material misstatement in paragraph 45 as this is part of the process for which the outcome will be assessed risks of material misstatement.
- c) The auditor is required to separately assess inherent risk and control risk (control risk is not identified), which together comprise the assessed risk of material misstatement.

Changes to application material of ED-315

In light of the changes that have been made to the requirements and the need to further consider how the application material could be made more understandable and clearer, the IAASB has made substantial changes to the application material, in particular moving paragraphs within the application material to reflect the revised flow of the requirements.

Very few new application material paragraphs are added to the ED but also very few have been taken out. Examples of new 'why' paragraphs include; paragraph A135a relating to why the auditor obtains an understanding of the sources of information used in the entity's process to monitor the system of internal control and paragraph A239a about why the auditor needs to evaluate audit evidence from risk assessment procedures.

Changes made to specific aspects of the application material that are more substantial include:

- a) Paragraph A10—has been updated to conform to the articulation of how likelihood and magnitude are considered.
- b) Paragraph A35—clarified that "inquiry alone is not enough" as a risk assessment procedure to address concerns that this was still unclear in the standard.
- c) Paragraph A89—the broad requirement for the auditor to obtain an understanding of the entity's system of internal control has been removed in the new approach to presenting the understanding for each of the components of the entity's system of internal control (previously was an explicit requirement). However, even under the new proposed approach the requirement is still implicitly there, and paragraph A89 has been added to make clear that the understanding of the system of internal control is obtained by understanding each of the components.
- d) Paragraph A200c—the requirement to determine whether one or more control deficiencies have been identified (paragraph 43) no longer makes the link to determining whether these are significant deficiencies. The determination of significant deficiencies is already covered by ISA 265, however, application material has been added to remind auditors of this requirement.
- e) With regards to IT
 - i. Changes have been made in paragraph A144b and A179a to also include considerations about direct access to data.
 - ii. Clarifying in paragraph A235a that the auditor's further audit procedures may need to include substantive procedures to address risks arising from the use of IT when such risks are not effectively addressed through planned tests of operating effectiveness of controls.
- f) With regard to documentation, similar to application material within ISA 540 (Revised), guidance is added as to more specific matters that the auditor may consider when considering what to document in relation to professional scepticism (see paragraph A248).

Furthermore, the revised tabular presentation of the requirements to obtain an understanding of each of the components of the entity's system of internal control has highlighted the two aspects of the requirement, the specific matters required to be understood and the required evaluation(s) of aspects of the component, in the context of the nature and circumstance of the entity. Supporting application material to further explain the nature of the evaluations has been added (see paragraphs A110a, A119a and A135c).

Changes to Appendices

Changes have been made in the Appendices, as needed for consistency with changes that have been made to terms and how they are described or explained in the requirements, definitions and application material (for example, changes have been made in Appendix 2 relating to the inherent risk factors and the way that fraud has been incorporated therein). In addition, other more substantial changes include:

- a) Cybersecurity—Paragraph 19 of Appendix 5 now expands on the concept of cybersecurity.
- b) Emerging Technologies—Appendix 5 has been enhanced to recognise the emerging technologies
- c) The examples of general IT controls in Appendix 6 have been enhanced and presented in a table to help with understanding when they may, or may not, apply in different circumstances

Agenda Item 2-E (Updated)

Proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements

Key Concepts in this ISA

2. ISA 200 deals with the overall objectives of the auditor in conducting an audit of the financial statements,¹ including to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.² Audit risk is a function of the risks of material misstatement and detection risk.³ ISA 200 explains that the risks of material misstatement may exist at two levels:⁴ the overall financial statement level; and the assertion level for classes of transactions, account balances and disclosures.
3. ISA 200 requires the auditor to exercise professional judgment in planning and performing an audit, and to plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.⁵
4. Risks at the financial statement level relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of material misstatement at the assertion level consist of two components, inherent and control risk:
 - Inherent risk is described as the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.
 - Control risk is described as the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's system of internal control.
5. ISA 200 explains that risks of material misstatement are assessed at the assertion level in order to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence.⁶ For the identified risks of material misstatement at the assertion level, a

¹ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

² ISA 200, paragraph 17

³ ISA 200, paragraphs 13(c)

⁴ ISA 200, paragraph A36

⁵ ISA 200, paragraphs 15–16

⁶ ISA 200, paragraph A43a and ISA 330, paragraph 6

separate assessment of inherent risk and control risk is required by this ISA. As explained in ISA 200, inherent risk is higher for some assertions and related classes of transactions, account balances and disclosures than for others. The degree to which inherent risk varies, is referred to in this ISA as the 'spectrum of inherent risk.'

~~6 ISA 330 requires the auditor to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.⁷ ISA 330 further explains that the auditor's assessment of the risks of material misstatement at the financial statement level, and the auditor's overall responses, is affected by the auditor's understanding of the control environment. ISA 330 also requires the auditor to design and perform further audit procedures whose nature, timing and extent are based on and responsive to the assessed risks of material misstatement at the assertion level.⁸~~

6. Risks of material misstatement identified and assessed by the auditor include both those due to error and those due to fraud. Although both are addressed by this ISA, the significance of fraud is such that further requirements and guidance are included in ISA 240⁹ in relation to risk assessment procedures and related activities to obtain information that is used to identify, assess and respond to the risks of material misstatement due to fraud.

~~7. ISA 200 explains that risks of material misstatement are assessed at the assertion level in order to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence.¹⁰ For the identified risks of material misstatement at the assertion level, a separate assessment of inherent risk and control risk is required by this ISA. As explained in ISA 200, inherent risk is higher for some assertions and related classes of transactions, account balances and disclosures than for others. The degree to which inherent risk varies, is referred to in this ISA as the 'spectrum of inherent risk.'~~

~~7~~8. The auditor's risk identification and assessment process is iterative and dynamic. The auditor's understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control are interdependent with concepts within the requirements to identify and assess the risks of material misstatement. In obtaining the understanding required by this ISA, initial expectations of risks may be developed, which may be further refined as the auditor progresses through the risk identification and assessment process. In addition, this ISA and ISA 330 requires the auditor to revise the risk assessments and modify further overall responses, and further audit procedures, based on audit evidence obtained from performing further audit procedures in accordance with ISA 330, or if new information is obtained.

~~8. ISA 330 requires the auditor to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.¹¹ ISA 330 further explains that the auditor's assessment of the risks of material misstatement at the financial statement level, and the auditor's overall responses, is affected by the auditor's understanding of the control environment. ISA~~

⁷—ISA 330, *The Auditor's Responses to Assessed Risks*, paragraph 5

⁸—ISA 330, paragraph 6

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

¹⁰—ISA 200, [paragraph A43a] (conforming amendment) and ISA 330, paragraph 6

¹¹ ISA 330, *The Auditor's Responses to Assessed Risks*, paragraph 5

330 also requires the auditor to design and perform further audit procedures whose nature, timing and extent are based on and responsive to the assessed risks of material misstatement at the assertion level.¹²

Scalability

10. ISA 200 states that some ISAs include scalability considerations which illustrate the application of the requirements to entities whose nature and circumstances are less complex, as well as those that are more complex.¹³ This ISA is intended for audits of all entities, regardless of size or complexity and the application material therefore incorporates specific considerations specific to both less and more complex entities where appropriate. While the size of an entity may be an indicator of its complexity, some smaller entities may be complex and some larger entities may be less complex.

Effective Date

14. This ISA is effective for audits of financial statements for periods beginning on or after [December 15, 2021].

Objective

15. The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.

Definitions

16. For purposes of the ISAs, the following terms have the meanings attributed below:
- (b) *Assertions* – Representations, explicit or otherwise, with respect to the recognition, measurement, presentation and disclosure of information in the financial statements which are inherent in management representing that the financial statements are prepared in accordance with the applicable financial reporting framework. Assertions are used by the auditor to consider the different types of potential misstatements that may occur when identifying, assessing and in responding to the risks of material misstatement. (Ref. Para: A1–A2)
 - (c) *Business risk* – A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.
 - (d) *Controls* – Policies or procedures that an entity establishes to achieve the control objectives of ~~the~~ management or those charged with governance. In this context: (Ref: Para. A2a–A4a)
 - (i) Policies are statements of what should, or should not, be done within the entity to effect control. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.
 - (ii) Procedures are actions to implement policies.

¹² [ISA 330, paragraph 6](#)

¹³ ISA 200, paragraph A65a–~~A66~~

- (e) *General information technology (IT) controls* – Controls over the entity's IT processes that support the continued proper operation of the IT environment, including the continued effective functioning of information processing controls and the integrity of information (i.e. the completeness, accuracy and validity of information) in the entity's information system. Also see the definition of *IT environment*.
- (ea) *Information processing controls* – Controls relating to the processing of information in IT applications or manual information processes in the entity's information system ~~in the control activities component~~ that directly address risks to the integrity of information (i.e., the completeness, accuracy and validity of transactions and other information) ~~throughout processing in IT applications or manual information processes in the entity's information system~~. (Ref: Para. A4b)
- (f) *Inherent risk factors* – Characteristics of events or conditions that affect susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or other fraud risk factors¹⁴ insofar as they affect inherent risk. (Ref: Para. A5–A6)
- (g) *IT environment* – The IT applications and supporting IT infrastructure, as well as the IT processes and personnel involved in those processes, that an entity uses to support business operations and achieve business strategies. For the purposes of this ISA:
 - (i) An IT application is a program or a set of programs that is used in the initiation, processing, recording and reporting of transactions or information. IT applications include data warehouses and report writers.
 - (ii) The IT infrastructure comprises the network, operating systems, and databases and their related hardware and software.
 - (iii) The IT processes are the entity's processes to manage access to the IT environment, manage program changes or changes to the IT environment and manage IT operations.
- (h) *Relevant assertions* – An assertion about a class of transactions, account balance or disclosure is relevant when it has an identified risk of material misstatement. The determination of whether an assertion is a relevant assertion is made ~~without taking into account any plans by the auditor to test the operating effectiveness of controls before consideration of any related controls (i.e., the inherent risk)~~. (Ref: Para. A9)
- (ha) *Risks arising from the use of IT* – Susceptibility of information processing controls to ineffective design or operation, or risks to the integrity of information (i.e., the completeness, accuracy and validity of transactions and other information) in the entity's information system, due to ineffective design or operation of controls in the entity's IT processes (see IT environment).

¹⁴ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraphs A24–A27

- (i) *Risk assessment procedures* – The audit procedures designed and performed to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.
- (j) *Significant class of transactions, account balance or disclosure* – A class of transactions, account balance or disclosure for which there is one or more relevant assertions.
- (k) *Significant risk* – An identified risk of material misstatement: (Ref: Para. A10)
 - (i) For which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which ~~the~~ inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur; or
 - (ii) That is to be treated as a significant risk in accordance with the requirements of other ISAs.¹⁵
- (l) *System of Internal Control* – The system designed, implemented and maintained by those charged with governance, management and other personnel, to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. For the purposes of the ISAs, the system of internal control consists of five inter-related components:
 - (i) Control environment.
 - (ii) The entity's risk assessment process.~~eee~~
 - (iii) The entity's process to monitor the system of internal control.
 - (iv) The information system and communication.
 - (v) Control activities.

Requirements

Risk Assessment Procedures and Related Activities

17. The auditor shall design and perform risk assessment procedures to obtain audit evidence that provides an appropriate basis for: (Ref: Para.A13–A16b)
- (a) The identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels; and
 - (b) The design of further audit procedures in accordance with ISA 330.

The auditor shall design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory. to obtain audit evidence in an unbiased in a manner that is not biased towards obtaining audit evidence that may corroborate assertions the existence of risks or made by

¹⁵ ISA 240, paragraph 27 and ISA 550, *Related Parties*, paragraph 18

~~management or towards excluding audit evidence that may be contradictory to the existence of such assertions risks.~~

18. The risk assessment procedures shall include the following: (Ref: Para. A17–A20a)
- (a) Inquiries of management and of other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists). (Ref: Para. A21–A29)
 - (b) Analytical procedures. (Ref: Para. A30–A34a)
 - (c) Observation and inspection. (Ref: Para. A35–A36)

Information from Other Sources

19. In obtaining audit evidence in accordance with paragraph 17, the auditor shall consider information from: (Ref: Para. A37–A38)
- (a) The ~~results of the~~ auditor's procedures regarding acceptance or continuance of the client relationship or the audit engagement; and
 - (b) When applicable, other engagements performed by the engagement partner for the entity.
21. ~~When~~ the auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor shall evaluate whether such information remains relevant and reliable as audit evidence for the current audit. (Ref: Para. A39–A40)

Engagement Team Discussion

22. The engagement partner and other key engagement team members shall discuss the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement. (Ref: Para. A40a–A46)
- 22A. When there are engagement team members not involved in the engagement team discussion, the engagement partner shall determine which matters are to be communicated to those members.

Obtaining an Understanding of the Entity and its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control (Ref: Para. A46a)

Understanding the Entity and Its Environment, and the Applicable Financial Reporting Framework (Ref: Para. A47–A47~~ebh~~)

23. The auditor shall perform risk assessment procedures to obtain an understanding of:
- a) The following aspects of the entity and its environment:
 - (i) The entity's organizational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT; (Ref: Para. A49–A63)
 - (ii) Industry, regulatory and other external factors; (Ref: Para. A64–A69) and

- (iii) The measures used, internally and externally, to assess the entity's financial performance; (Ref: Para. A70a–A82)
 - b) The applicable financial reporting framework, and the entity's accounting policies and the reasons for any changes thereto; (Ref: Para. A79–A82) and
 - (c) ~~Based on (a) and (b), How the~~ inherent risk factors ~~that~~ affect susceptibility ~~of assertions to~~ misstatement ~~of assertions, and how they do so and the degree to which they do so~~ in the preparation of the financial statements in accordance with the applicable financial reporting framework, based on the understanding obtained in (a) and (b). (Ref: Para. A88a–A88d)
24. The auditor shall evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework.

Understanding the Components of the Entity's System of Internal Control (Ref: Para. A89 – A102)

Control Environment, the Entity's Risk Assessment Process and the Entity's Process to Monitor the System of Internal Control (Ref: Para. A104a–A104d)

Control environment

28. The auditor shall obtain an understanding of the control environment relevant to the preparation of the financial statements, <u>by through</u> performing risk assessment procedures, to by . (Ref: Para. A106 – A107)	
<p>(a) Understanding the set of controls, processes and structures that address: (Ref: Para. A108–A108a)</p> <ul style="list-style-type: none"> (i) How management's oversight responsibilities are carried out, such as the entity's culture and management's commitment to integrity and ethical values; (ii) When those charged with governance are separate from management, the independence of, and oversight over the entity's system of internal control by, those charged with governance; (iii) The entity's assignment of authority and responsibility; (iv) How the entity attracts, develops, and retains competent individuals; and (v) How the entity holds individuals accountable for their responsibilities in the pursuit of the objectives of the system of internal control; 	<p>and</p> <p>(b) Evaluating whether: (Ref: Para. A110a–A114b)</p> <ul style="list-style-type: none"> (i) Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior; (ii) The control environment provides an appropriate foundation for the other components of the <u>entity's</u> system of internal control considering the nature and <u>size complexity</u> of the entity; and (iii) Control deficiencies identified in the control environment undermine the other components of the <u>entity's</u> system of internal control.

The entity's risk assessment process

30. The auditor shall obtain an understanding of the entity's risk assessment process relevant to the preparation of the financial statements, by performing risk assessment procedures, by :	
(a) Understanding the entity's process for: (Ref: Para. A117–A117a)	and
(i) Identifying business risks relevant to financial reporting objectives;	(b) Evaluating whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature and size-complexity of the entity. (Ref: Para. A119a–A120)
(ii) Assessing the significance of those risks, including the likelihood of their occurrence; and	
(iii) Addressing those risks;	

31. If the auditor identifies risks of material misstatement that management failed to identify, the auditor shall:
- (a) Determine whether any such risks are of a kind that the auditor expects would have been identified by the entity's risk assessment process and, if so, obtain an understanding of why the entity's risk assessment process failed to identify such risks of material misstatement; and
 - (b) Consider the implications for the auditor's evaluation in paragraph 30(b).

The entity's process for monitoring the system of internal control

31A. The auditor shall obtain an understanding of the entity's process for monitoring the system of internal control relevant to the preparation of the financial statements, by performing risk assessment procedures, to by : (Ref: Para. A123–A124)	
(a) Understanding those aspects of the entity's process that address:	and
(i) Ongoing and separate evaluations for monitoring the effectiveness of controls, and the identification and remediation of control deficiencies identified; (Ref: Para. A126a–A127) and	(c) Evaluating whether the entity's process for monitoring the system of internal control is appropriate to the entity's circumstances considering the nature and size-complexity of the entity. (Ref: Para. A135c)
(ii) The entity's internal audit function, if any, including its nature, responsibilities and activities; (Ref: Para. A131)	
(b) Understanding the sources of the information used in the entity's process to monitor the system of internal control, and the basis upon which management considers the information to be sufficiently reliable for the purpose; (Ref: Para. A135a–A135b)	

Information System and Communication, and Control Activities (Ref: Para. A135d–A135m~~l~~)

The information system and communication

<p>36. The auditor shall obtain an understanding of the entity's information system and communication relevant to the preparation of the financial statements₁ by performing risk assessment procedures₁ by_{to}: (Ref: Para. A135nm)</p>	
<p>(a) Understandinging the entity's information processing activities, including its data and information, the resources to be used in such activities and the policies that define, for significant classes of transactions, account balances and disclosures: (Ref: Para. A136a–A146)</p> <p>(i) How information flows through the entity's information system, including how:</p> <p>a. Transactions are initiated, and how information about them is recorded, processed, corrected as necessary, incorporated in the general ledger and reported in the financial statements; and</p> <p>b. Information about events and conditions, other than transactions, is captured, processed and disclosed in the financial statements;</p> <p>(ii) The accounting records, specific accounts in the financial statements and other supporting records relating to the flows of information in the information system;</p> <p>(iii) The financial reporting process used to prepare the entity's financial statements, including disclosures; and</p> <p>(iv) The entity's resources, including the IT environment, relevant to (a)(i) to (a)(iii) above;</p> <p>(b) Understandinging how the entity communicates significant matters that support the preparation of the financial statements and related reporting responsibilities in the information system and other components of the system of internal control: (Ref: Para. A158a–A159)</p> <p>(i) Between people within the entity, including how financial reporting roles and responsibilities are communicated;</p> <p>(ii) Between management and those charged with governance; and</p> <p>(iii) With external parties, such as those with regulatory authorities;</p>	<p>and</p> <p>(c) Evaluating_e whether the entity's information system and communication appropriately support the preparation of the entity's financial statements in accordance with the applicable financial reporting framework. (Ref: Para. A159(a))</p>

Control activities

<p>39.--The auditor shall obtain an understanding of the control activities component, by performing risk assessment procedures, <u>by</u> to: (Ref: Para. A160–A161a)</p>	
<p>(a) Identifying controls that address risks of material misstatement at the assertion level in the control activities component, as follows:</p> <p>(i) Controls that address risks that are determined to be a significant risk; (Ref: Para. A170–A172)</p> <p>—Controls that address assessed risks for which the effect of the inherent risk factors on the assessment of inherent risk indicates that there is a reasonable possibility that the assessed risks could be significant risks but that the auditor determines are not significant risks, based on the auditor's professional judgment; (Ref: Para. A173a–A173b)</p> <p>(ii) Controls over journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments; (Ref: Para. A175–A175a) and</p> <p>(iii) Controls for which the auditor plans to test operating effectiveness in determining the nature, timing and extent of substantive testing, which shall include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; and (Ref: Para. A175d–A1778)</p> <p>(iii)(iv) Other controls that the auditor considers are appropriate to enable the auditor to meet the objectives of paragraph 17(a) and (b) with respect to risks at the assertion level, based on the auditor's professional judgment; (Ref: Para. A177a)</p> <p>(b) Based on controls identified in (a), identifying the IT applications and the other aspects of the entity's IT environment that are subject to risks arising from the use of IT; (Ref: Para. A179a–A188)</p> <p>(c) For such IT applications and other aspects of the IT environment identified in (b), identifying: (Ref: Para. A188a–A189)</p> <p>(i) The applicable-related risks arising from the use of IT; and</p> <p>(ii) The entity's general IT controls that address such risks;</p>	<p>and</p> <p>(d) For each control identified in (a) or (c)(ii): (Ref: Para. A194–A200)</p> <p>(i) Evaluating whether the control is designed effectively to address the risk of material misstatement at the assertion level, or effectively designed to support the operation of other controls; and</p> <p>(ii) Determining whether the control has been implemented by performing procedures in addition to inquiry of the entity's personnel.</p>

Control Deficiencies Within the Entity's System of Internal Control

43. Based on the auditor's evaluation of each of the components of the entity's system of internal control, the auditor shall determine whether one or more control deficiencies have been identified. (Ref: Para. A200a–A200c)

Identifying and Assessing the Risks of Material Misstatement

Identifying Risks of Material Misstatement

45. The auditor shall identify the risks of material misstatement and determine whether they exist at: (Ref: Para. A201–A206)
- (a) The financial statement level; (Ref: Para. A206a–A207e) or
 - (b) The assertion level for classes of transactions, account balances, and disclosures. (Ref: Para. A208–A208a)
46. The auditor shall determine the relevant assertions and the related significant classes of transactions, account balances and disclosures. (Ref: Para. A211–A214)

Assessing Risks of Material Misstatement at the Financial Statement Level

47. ~~The auditor shall assess the identified risks of material misstatement at the financial statement level.~~ For ~~each risk~~ identified risks at the financial statement level, the auditor shall assess the risk and: (Ref: Para. A206a–A207e)
- (a) Determine whether such risks affect the assessment of risks at the assertion level; and
 - (b) Evaluate the nature and extent of their pervasive effect on the financial statements.

Assessing Risks of Material Misstatement at the Assertion Level

Assessing Inherent Risk

48. For identified ~~each~~ risks of material misstatement at the assertion level, ~~in accordance with paragraph 45(b),~~ the auditor shall assess inherent risk by assessing the likelihood and magnitude of misstatement. In doing so, the auditor shall take into account how, and the degree to which: (Ref: Para. A220a–A228)
- (a) Inherent risk factors affect the susceptibility ~~to misstatement~~ of relevant assertions to misstatement; and
 - (b) The risks of material misstatement at the financial statement level affect the assessment of inherent risk ~~for risks of material misstatement at the assertion level~~ for risks of material misstatement at the assertion level.
49. The auditor shall determine whether any of the assessed risks of material misstatement are significant risks. (Ref: Para. A228a–A229b234b)

50. The auditor shall determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the risks of material misstatement at the assertion level. (Ref: Para. A231~~ae~~–A231e)

Assessing Control Risk

51. If the auditor plans to test the operating effectiveness of controls, the auditor shall assess control risk. If the auditor does not plan to test the operating effectiveness of controls, the auditor's assessment of control risk shall be such that the assessment of the risk of material misstatement is the same as the assessment of inherent risk. (Ref: Para. A232–A235a)

Evaluating the Audit Evidence Obtained from the Risk Assessment Procedures

- 51A. The auditor shall evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement. If not, the auditor shall perform additional risk assessment procedures ~~until audit evidence has been~~ obtained to provide such a basis. In identifying and assessing the risks of material misstatement, the auditor shall take into account all audit evidence obtained from the risk assessment procedures, whether corroborative or contradictory to assertions made by management. (Ref: Para. A239a–A239c)

Classes of Transactions, Account Balances and Disclosures that are Not Significant, but Which Are Material

52. For material classes of transactions, account balances or disclosures that have not been determined to be significant classes of transactions, account balances or disclosures, the auditor shall evaluate whether the auditor's determination remains appropriate. (Ref: Para. A240–A242)

Revision of Risk Assessment

53. If the auditor obtains new information which is inconsistent with the audit evidence on which the auditor originally based the identification ~~and~~ assessments of the risks of material misstatement, the auditor shall revise the identification ~~and~~ assessment. (Ref: Para. A243)

Documentation

54. The auditor shall include in the audit documentation:¹⁶ (Ref: Para. A244–A248)
- (a) The discussion among the engagement team and the significant decisions reached;
 - (b) Key elements of the auditor's understanding in accordance with paragraphs 23, 28, 30, 31A and 36; the sources of information from which the auditor's understanding was obtained; and the risk assessment procedures performed;
 - (c) The evaluation of the design of identified controls, and determination whether such controls have been implemented, in accordance with the requirements in paragraph 39.

¹⁶ ISA 230, *Audit Documentation*, paragraphs 8–11, and A6–A7

- (d) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level, including significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made.

Application and Other Explanatory Material

Definitions (Ref: Para. 16)

Assertions (Ref: Para. 16(b))

A1. ~~Categories of assertions are used by auditors to consider the different types of potential misstatements that may occur when identifying, assessing and responding to the risks of material misstatement. Examples of these categories of assertions are described in paragraph A204. Representations by management with respect to the recognition, measurement, presentation and disclosure of information in the financial statements for classes of transactions, account balances and disclosures, which are inherent in management representing that the financial statements are prepared in accordance with the applicable financial reporting framework. The assertions by management in the financial statements~~ differ from the written representations ~~provided to the auditor by management, as~~ required by ISA 580,¹⁷ to confirm certain matters or support other audit evidence.

- A2. Assertions that the auditor may use in addressing the requirements of this ISA are further described in paragraph A204.

Controls (Ref: Para. 16(d))

A2a. Controls are embedded within the components of the entity's system of internal control.

- A3. Policies are implemented through the actions of personnel within the entity, or through the ~~restraint of personnel~~ from taking actions that would conflict with such policies.
- A4. Procedures may be mandated, through formal documentation or other communication by management or those charged with governance, or may result from behaviors that are not mandated but are rather conditioned by the entity's culture. Procedures may be enforced through the actions permitted by the IT applications used by the entity or other aspects of the entity's IT environment.
- A4a. Controls may be direct or indirect ~~controls~~. Direct controls are controls that are precise enough to address risks of material misstatement at the assertion level. Indirect controls are controls that support direct controls.

Information Processing Controls (Ref: Para. 16(ea))

- A4b. Risks to the integrity of information arise from susceptibility to ineffective implementation of the entity's information policies, which are policies that define the information flows, records and reporting processes in the entity's information system. Information processing controls are procedures that support effective implementation of the entity's information policies. Information processing controls

¹⁷ ISA 580, *Written Representations*

may be automated (i.e., embedded in IT applications) or manual (e.g., input or output controls) and may rely on other controls, including other information processing controls or general IT controls.

Inherent Risk Factors (Ref: Para. 16(f))

Appendix 2 sets out further considerations relating to understanding ~~the~~ inherent risk factors.

- A5. Inherent risk factors may be qualitative or quantitative and affect the susceptibility to misstatement of assertions. Qualitative inherent risk factors relating to the preparation of information required by the applicable financial reporting framework include:
- Complexity;
 - Subjectivity;
 - Change;
 - Uncertainty; and
 - Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk.
- A6. Other inherent risk factors, that affect susceptibility to misstatement of an assertion about a class of transactions, account balance or disclosure may include:
- The quantitative or qualitative significance of the class of transactions, account balance or disclosure, ~~and of the items in relation to performance materiality~~; or
 - The volume or a lack of uniformity in the composition of the items to be processed through the class of transactions or account balance, or to be reflected in the disclosure.

Relevant Assertions (Ref: Para. 16(h))

- A9. A risk of material misstatement may relate to more than one assertion, in which case all the assertions to which such a risk relates are relevant assertions. If an assertion does not have an identified risk of material misstatement, then it is not a relevant assertion.

Significant Risk (Ref: Para. 16(k))

- A10. Significance can be described as the relative importance of a matter, and is judged by the auditor in the context in which the matter is being considered. ~~In the context of~~ For inherent risk, significance may be considered in the context of how, and the degree to which, ~~the~~ inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur.

Risk Assessment Procedures and Related Activities (Ref: Para. 17–22A)

- A13. The risks of material misstatement to be identified and assessed include both those due to fraud and those due to error, and both are covered by this ISA. However, the significance of fraud is such that further requirements and guidance are included in ISA 240 in relation to risk assessment procedures and related activities to obtain information that is used to identify and assess the risks of material

misstatement due to fraud.¹⁸ In addition, the following ISAs provide further requirements and guidance on identifying and assessing risks of material misstatement regarding specific matters or circumstances:

- ISA 540 (Revised)¹⁹ in regard to accounting estimates;
- ISA 550²⁰ in regard to related party relationships and transactions;
- ISA 570 (Revised)²¹ in regard to going concern; and
- ISA 600²² in regard to group financial statements.

A15a. Professional skepticism is necessary for the critical assessment of audit evidence gathered when performing risk assessment procedures, and assists the auditor in remaining alert for possible indications of management bias. Professional skepticism is an attitude that is applied by the auditor when making professional judgments that then provides the basis for the auditor's actions. The auditor applies their professional judgment in determining when they have audit evidence that provides an appropriate basis for risk assessment, ~~and also in designing the auditor's responses to assessed risks of material misstatement.~~

A15c. The application of professional skepticism by the auditor may include:

- Questioning contradictory information and the reliability of documents;
- Considering responses to inquiries and other information obtained from management and those charged with governance;
- Being alert to conditions that may indicate possible misstatement due to fraud or error ~~or fraud~~; and
- Considering whether audit evidence obtained supports the auditor's identification and assessment of the risks of material misstatement in light of the entity's nature and circumstances.

Why Obtaining Information-Audit Evidence in an Unbiased Manner is Important (Ref: Para. 17)

A15d. ~~Designing and performing risk assessment procedures to obtain audit evidence in~~ Obtaining information in an unbiased manner may ~~provide-identify~~ potentially contradictory information, which may assist the auditor in exercising professional skepticism in identifying and assessing the risks of material misstatement.

¹⁸ ISA 240, paragraphs 12–25

¹⁹ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

²⁰ ~~ISA 550, *Related Parties*~~

²¹ ISA 570 (Revised), *Going Concern*

²² ISA 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*

Sources of ~~Information-Audit Evidence~~ (Ref: Para. 17)

A15e ~~Designing and performing risk assessment procedures to o~~Obtaining audit evidence ~~from risk assessment procedures~~ in an unbiased manner may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence. ~~In addition to information from other sources~~²³, ~~s~~Sources of information for risk assessment procedures may include:

- Interactions with management, those charged with governance, and other key entity personnel, such as internal auditors.
- Certain external parties such as regulators, whether obtained directly or indirectly.
- ~~The auditor's acceptance and continuance procedures and other engagements performed by the engagement partner for the entity.~~
- ~~The auditor's previous experience with the entity and from audit procedures performed in previous audits, updated as appropriate.~~
- Publicly available information about the entity, for example entity-issued press releases, ~~and~~ materials for analysts or investor group meetings, analysts' reports or information about trading activity.

Regardless of the source of information, the auditor considers the relevance and reliability of the information to be used as audit evidence in accordance with ISA 500.²⁴

Scalability (Ref: Para. 17)

A16. The nature and extent of risk assessment procedures will vary based on the nature ~~(e.g., size and complexity)~~ and circumstances of the entity (e.g., the formality of the entity's policies and procedures, and processes and systems). The auditor uses professional judgment to determine the nature and extent of the risk assessment procedures to be performed to meet the ~~requirements of objective stated in~~ this ISA.

A16a. Although the extent to which an entity's policies and procedures, and processes and systems are formalized may vary, the auditor is still required to obtain the understanding in accordance with paragraphs 23, 28, 30, 31A, 36 and 39.

Examples:

Some entities, including less complex entities, and particularly owner-managed entities, may not have established structured processes and systems ~~(e.g., such as a risk assessment process or a process to monitor the system of internal control)~~, or may have established ~~such~~ processes or systems with limited documentation or a lack of consistency in how they are undertaken. When such systems and processes lack formality, the auditor may still be able to perform risk assessment procedures through observation and inquiry.

²³ See Paragraph A37 and A38.

²⁴ ISA 500, *Audit Evidence*, paragraph 7

Other entities, typically more complex entities, are expected to have more formalized and documented policies and procedures. The auditor may use such documentation in performing risk assessment procedures.

A16b. The nature and extent of risk assessment procedures to be performed the first time an engagement is undertaken may be more extensive than procedures for a recurring engagement. In subsequent periods, the auditor may focus on changes that have occurred since the preceding period.

Types of Risk Assessment Procedures (Ref: Para. 18)

A17. ISA 500²⁵ explains the types of audit procedures that may be performed in obtaining audit evidence from risk assessment procedures and further audit procedures. The nature, timing and extent of the audit procedures may be affected by the fact that some of the accounting data and other evidence may only be available in electronic form or only at certain points in time.²⁶ The auditor may perform substantive procedures or tests of controls, in accordance with ISA 330, concurrently with risk assessment procedures, when it is efficient to do so. ~~Some of the a~~Audit evidence obtained ~~in doing so~~, which supports the identification and assessment of risks of material misstatement, may also support the detection of misstatements at the assertion level or the evaluation of the operating effectiveness of controls.

A18. Although the auditor is required to perform all the risk assessment procedures described in paragraph 18 in the course of obtaining the required understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control (see paragraphs 23–39), the auditor is not required to perform all of them for each aspect of that understanding requirement. Other procedures may be performed when the information to be obtained ~~there from~~ may be helpful in identifying risks of material misstatement. Examples of such procedures may include making inquiries of the entity's external legal counsel or external supervisors, or of valuation experts that the entity has used.

Automated Tools and Techniques (Ref: Para. 18)

A20a. Using automated tools and techniques, the auditor may perform risk assessment procedures on large volumes of data (from the general ledger, sub-ledgers or other operational data) including for analysis, recalculations, reperformance or reconciliations.

Inquiries of Management and Others within the Entity (Ref: Para. 18(a))

Why Inquiries are Made of Management and Others Within the Entity

A21. ~~Much of the i~~Information obtained by the auditor to support an appropriate basis for the identification and assessment of risks, and the design of further audit procedures, may be obtained through inquiries of management and those responsible for financial reporting.

²⁵ ISA 500, paragraphs A14–A17 and A21–A25.

²⁶ ISA 500, paragraph A12

- A22. Inquiries of management and those responsible for financial reporting and of other appropriate individuals within the entity and other employees with different levels of authority may offer the auditor ~~a~~-varying perspectives when identifying and assessing risks of material misstatement.

Examples:

- Inquiries directed towards those charged with governance may help the auditor understand the extent of oversight by those charged with governance over the preparation of the financial statements by management. ISA 260 (Revised)²⁷ identifies the importance of effective two-way communication in assisting the auditor to obtain information from those charged with governance in this regard.
- Inquiries of employees responsible for initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.
- Inquiries directed towards in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures) with business partners, and the meaning of contractual terms.
- Inquiries directed towards marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.
- Inquiries directed towards the risk management function (or inquiries of those performing such roles) may provide information about operational and regulatory risks that may affect financial reporting.
- Inquiries directed towards IT personnel may provide information about system changes, system or control failures, or other IT-related risks.

Considerations Specific to Public Sector Entities

- A24. When making inquiries of those who may have information that is likely to assist in identifying risks of material misstatement, auditors of public sector entities may obtain information from additional sources such as from the auditors that are involved in performance or other audits related to the entity.

Inquiries of the Internal Audit Function (Ref: Para 18(a))

Appendix 4 sets out considerations for understanding an entity's internal audit function.

²⁷ ISA 260 (Revised), *Communication with Those Charged with Governance*, paragraph 4(b)

Why inquiries are made of the internal audit function (if the function exists)

- A25. If an entity has an internal audit function, inquiries of the appropriate individuals within the function may assist the auditor in understanding the entity and its environment, and the entity's system of internal control, in the identification and assessment of risks.

Considerations specific to public sector entities

- A29. Auditors of public sector entities often have additional responsibilities with regard to internal control and compliance with applicable laws and regulations. Inquiries of appropriate individuals in the internal audit function may assist the auditors in identifying the risk of material non-compliance with applicable laws and regulations, and the risk of control deficiencies related to financial reporting.

Analytical Procedures (Ref: Para. 18(b))

Why Analytical Procedures are Performed as a Risk Assessment Procedure

- A30. Analytical procedures also help identify inconsistencies, unusual transactions or events, and amounts, ratios, and trends that indicate matters that may have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.
- A31. Analytical procedures performed as risk assessment procedures may therefore assist in identifying and assessing the risks of material misstatement by identifying aspects of the entity of which the auditor was unaware or ~~identifying characteristics of events or conditions relevant to the auditor's consideration of the understanding how~~ inherent risk factors, such as change, affect susceptibility of assertions to misstatement.

Types of Analytical Procedures

- A32. Analytical procedures performed as risk assessment procedures may:
- Include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold (non-financial).
 - Use data aggregated at a high level. Accordingly, the results of those analytical procedures may provide a broad initial indication about the likelihood of a material misstatement.

Example:

In the audit of many entities, including those with less complex business models and processes, and a less complex information system, the auditor may perform a simple comparison of information, such as the change in interim or monthly account balances from balances in prior periods, to obtain an indication of potentially higher risk areas.

- A34. This ISA deals with the auditor's use of analytical procedures as risk assessment procedures. ISA 520²⁸ deals with the auditor's use of analytical procedures as substantive procedures ("substantive

²⁸ ISA 520, *Analytical Procedures*

analytical procedures”) and the auditor’s responsibility to perform analytical procedures near the end of the audit. Accordingly, analytical procedures performed as risk assessment procedures are not required to be performed in accordance with the requirements of ISA 520. However, the requirements and application material in ISA 520 may provide useful guidance to the auditor when performing analytical procedures as part of the risk assessment procedures.

Automated tools and techniques

A34a. Analytical procedures can be performed using a number of tools or techniques, which may be automated. Applying automated analytical procedures to the data may be referred to as data analytics.

Example:

The auditor may use a spreadsheet to perform a comparison of actual recorded amounts to budgeted amounts, or may perform a more advanced procedure by extracting data from the entity’s information system, and further analyzing this data using visualization techniques to identify classes of transactions, account balances or disclosures for which further specific risk assessment procedures may be warranted.

Observation and Inspection (Ref: Para. 18(c))

Why Observation and Inspection are Performed as Risk Assessment Procedures

A35. ~~Because inquiry alone is not enough,~~²⁹ Observation and inspection may support or corroborate or contradict inquiries of management and others, and may also provide information about the entity and its environment.

Scalability (Ref: Para. 18(c))

A35a. Where policies or procedures are not documented, or the entity has less formalized controls, the auditor may still be able to obtain some audit evidence to support the identification and assessment of the risks of material misstatement through observation or inspection of the performance of the control.

Examples:

- The auditor may obtain an understanding of controls over an inventory count, even if they have not been documented by the entity, through direct observation.
- The auditor may be able to observe segregation of duties.
- The auditor may be able to observe passwords being entered.

²⁹ —ISA 500, paragraph A2

Observation and Inspection as Risk Assessment Procedures

A35b. Risk assessment procedures may include observation or inspection of the following:

- The entity's operations.
- Internal documents (such as business plans and strategies), records, and internal control manuals.
- Reports prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of directors' meetings).
- The entity's premises and plant facilities.
- Information obtained from external sources such as trade and economic journals; reports by analysts, banks, or rating agencies; or regulatory or financial publications; or other external documents about the entity's financial performance (such as those referred to in paragraph A74).
- The behaviors and actions of management or those charged with governance (such as the observation of an audit committee meeting).

Automated Tools or Techniques

A35c. Automated tools or techniques may also be used to observe or inspect, in particular assets, for example through the use of remote observation tools (e.g., a drone).

Considerations Specific to Public Sector Entities

A36. Risk assessment procedures performed by auditors of public sector entities may also include observation and inspection of documents prepared by management for the legislature, for example documents related to mandatory performance reporting.

Information from Other Sources (Ref: Para. 19)

Why the Auditor Considers Information from Other Sources

A37. Information obtained from other sources may be relevant to the identification and assessment of the risks of material misstatement by providing information and insights about:

- The nature of the entity and its business risks, and what may have changed from previous periods.
- The integrity and ethical values of management and those charged with governance, which may also be relevant to the auditor's understanding of the control environment.
- The applicable financial reporting framework and its application to the nature and circumstances of the entity.

Other Relevant Sources

A38. Other relevant sources of information include:

- The results of the auditor's procedures regarding acceptance or continuance of the client relationship or the audit engagement in accordance with ISA 220, including ~~from procedures regarding the acceptance and continuance of client relationships and audit engagements, and~~ the conclusions reached thereon.³⁰
- Other engagements performed for the entity by the engagement partner. The engagement partner may have obtained knowledge relevant to the audit, including about the entity and its environment, when performing other engagements for the entity. Such engagements may include agreed-upon procedures engagements or other audit or assurance engagements, including engagements to address incremental reporting requirements in the jurisdiction.

Information from the Auditor's Previous Experience with the Entity and Previous Audits (Ref: Para. 21)

Why Information from Previous Audits is Important to the Current Audit

A39. The auditor's previous experience with the entity and from audit procedures performed in previous audits may provide the auditor with information that is relevant to the auditor's determination of the nature and extent of risk assessment procedures, and the identification and assessment of risks of material misstatement.

Nature of the Information from Previous Audits

A39a. The auditor's previous experience with the entity and audit procedures performed in previous audits may provide the auditor with information about such matters as:~~Information from previous audits that may be important to the current audit may include:~~

- Past misstatements and whether they were corrected on a timely basis.
- The nature of the entity and its environment, and the entity's system of internal control (including control deficiencies).
- Significant changes that the entity or its operations may have undergone since the prior financial period.
- Those particular types of transactions and other events or account balances (and related disclosures) where the auditor experienced difficulty in performing the necessary audit procedures, for example, due to their complexity.

A40- The auditor is required to determine whether information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits remains relevant and reliable, if the auditor intends to use that information for the purposes of the current audit. If the nature or circumstances of the entity ~~may~~ have changed, or new information ~~may have~~ been obtained, the information from prior periods may no longer be relevant or reliable for the current audit. To determine whether changes have occurred that may affect the relevance or reliability of such information, the auditor may make inquiries and perform other appropriate audit procedures, such as

³⁰ ISA 220, *Quality Control for an Audit of Financial Statements*, paragraph 12

walk-throughs of relevant systems. If the information is not reliable, the auditor may consider performing additional procedures that are appropriate in the circumstances.

Example:

~~The auditor may make inquiries and perform other appropriate risk assessment procedures such as a walkthrough of relevant systems, to determine whether the information from the prior period remains relevant.~~

Engagement Team Discussion (Ref: Para. 22–22A)

Why the Engagement Team is Required to Discuss the Application of the Applicable Financial Reporting Framework and the Susceptibility of the Entity's Financial Statements to Material Misstatement

A40a. The discussion among the engagement team about the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement:

- Provides an opportunity for more experienced engagement team members, including the engagement partner, to share their insights based on their knowledge of the entity. Sharing information contributes to an enhanced understanding by all engagement team members.
- Allows the engagement team members to exchange information about the business risks to which the entity is subject, how ~~the~~ inherent risk factors may affect the susceptibility to misstatement of classes of transactions, account balances and disclosures, and about how and where the financial statements might be susceptible to material misstatement due to fraud or error.
- Assists the engagement team members to gain a better understanding of the potential for material misstatement of the financial statements in the specific areas assigned to them, and to understand how the results of the audit procedures that they perform may affect other aspects of the audit, including the decisions about the nature, timing and extent of further audit procedures. In particular, the discussion assists engagement team members in further considering contradictory information based on each member's own understanding of the nature and circumstances of the entity.
- Provides a basis upon which engagement team members communicate and share new information obtained throughout the audit that may affect the assessment of risks of material misstatement or the audit procedures performed to address these risks.

ISA 240 requires the engagement team discussion to place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur.³¹

A40b. Professional skepticism is necessary for the critical assessment of audit evidence, and a robust and open engagement team discussion, including for recurring audits, may lead to improved identification and assessment of the risks of material misstatement. Another outcome from the discussion may be that the

³¹ ISA 240, paragraph 16

auditor identifies specific areas of the audit for which exercising professional skepticism may be particularly important, and may lead to the involvement of more experienced members of the engagement team who are appropriately skilled to be involved in the performance of audit procedures related to those areas.

Scalability ([Ref: Para. 22–22A](#))

A41. When the engagement is carried out by a single individual, such as a sole practitioner, (i.e., where an engagement team discussion would not be possible), consideration of the matters referred to in paragraphs A40a and A43 nonetheless may assist the auditor in identifying where there may be risks of material misstatement.

A41a. When an engagement is carried out by a large engagement team, such as for an audit of group financial statements, it is not always necessary or practical for the discussion to include all members in a single discussion (for example, in a multi-location audit), nor is it necessary for all the members of the engagement team to be informed of all the decisions reached in the discussion. The engagement partner may discuss matters with key members of the engagement team including, if considered appropriate, those with specific skills or knowledge, and those responsible for the audits of components, while delegating discussion with others, taking into account ~~of~~ the extent of communication considered necessary throughout the engagement team. A communications plan, agreed by the engagement partner, may be useful.

Discussion of Disclosures in the Applicable Financial Reporting Framework

A43. As part of the discussion among the engagement team, consideration of the disclosure requirements of the applicable financial reporting framework assists in identifying early in the audit where there may be risks of material misstatement in relation to disclosures, even in circumstances where the applicable financial reporting framework only requires simplified disclosures. Matters the engagement team may discuss include:

- Changes in financial reporting requirements that may result in significant new or revised disclosures;
- Changes in the entity's environment, financial condition or activities that may result in significant new or revised disclosures, for example, a significant business combination in the period under audit;
- Disclosures for which obtaining sufficient appropriate audit evidence may have been difficult in the past; and
- Disclosures about complex matters, including those involving significant management judgment as to what information to disclose.

Considerations Specific to Public Sector Entities

A46. As part of the discussion among the engagement team by auditors of public sector entities, consideration may also be given to any additional broader objectives, and related risks, arising from the audit mandate or obligations for public sector entities.

Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control (Ref: Para. 23–43)

Appendices 1 through 6 set out further considerations relating to obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control.

Obtaining the Required Understanding (Ref: Para. 23–43)

A46a. Obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control is a dynamic and iterative process of gathering, updating and analyzing information and continues throughout the audit. Therefore, the auditor's expectations may change as new information is obtained.

A46b. The auditor's understanding of the entity and its environment and the applicable financial reporting framework may also assist the auditor in developing initial expectations about the classes of transactions, account balances and disclosures that may be significant classes of transactions, account balances and disclosures. This—which forms the basis for the scope of the auditor's understanding of the entity's information system.

Why an Understanding of the Entity and Its Environment, and the Applicable Financial Reporting Framework is Required (Ref: Para. 23–24)

A47. The auditor's understanding of the entity and its environment, and the applicable financial reporting framework, assists the auditor in understanding the events and conditions that are relevant to the entity, and in identifying how inherent risk factors affect the susceptibility to misstatement of assertions in the preparation of the financial statements, in accordance with the applicable financial reporting framework, and the degree to which they do so. Such information establishes a frame of reference within which the auditor identifies and assesses risks of material misstatement. This frame of reference also assists the auditor in planning the audit and exercising professional judgment and professional skepticism throughout the audit, for example, when:

- Identifying and assessing risks of material misstatement of the financial statements in accordance with ISA 315 (Revised) or other relevant standards (e.g., relating to risks of fraud in accordance with ISA 240 or when identifying or assessing risks related to accounting estimates in accordance with ISA 540 (Revised));
- Performing procedures to help identify instances of non-compliance with laws and regulations that may have a material effect on the financial statements in accordance with ISA 2540³²;
- Evaluating whether the financial statements provide adequate disclosures in accordance with ISA 700 (Revised)³³;
- Determining materiality or performance materiality in accordance with ISA 320;³⁴ or

³² ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraph 14.

³³ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 13.

³⁴ ISA 320, *Materiality in Planning and Performing an Audit*, paragraphs 10–11

- Considering the appropriateness of the selection and application of accounting policies, and the adequacy of financial statement disclosures.

~~This understanding assists the auditor in identifying areas in the financial statements where material misstatements may be more likely to arise exist.~~

A47a. The auditor's understanding of the entity and its environment, and the applicable financial reporting framework, also informs how the auditor plans and performs further audit procedures, for example, when:

- Developing expectations for use when performing analytical procedures in accordance with ISA 520;³⁵
- Designing and performing further audit procedures to obtain sufficient appropriate audit evidence in accordance with ISA 330;³⁶ and
- Evaluating the sufficiency and appropriateness of audit evidence obtained (e.g., relating to assumptions or management's oral and written representations).

~~A47b. The auditor's understanding of the entity and its environment and the applicable financial framework may also assist the auditor in developing initial expectations about the classes of transactions, account balances and disclosures that may be significant classes of transactions, account balances and disclosures, which form the basis for the scope of the auditor's understanding of the entity's information system.~~

Scalability (Ref: Para. 23–24)

A47c. The nature and extent of the required understanding ~~needed~~ is a matter of the auditor's professional judgment and varies from entity to entity based on the nature and circumstances of the entity, including:

- The size and complexity of the entity, including its IT environment;
- The auditor's previous experience with the entity;
- The nature of the entity's systems and processes, including whether they are formalized or not; and
- The nature and form of the entity's documentation.

A47e. The auditor's risk assessment procedures to obtain the ~~overall~~ required understanding may be less extensive in audits of less complex entities and more extensive for entities that are more complex. The depth of the ~~overall~~ understanding that is required by the auditor is expected to be less than that possessed by management in managing the entity.

A47ea. Some financial reporting frameworks allow smaller entities to provide simpler and less detailed disclosures in the financial statements. However, this does not relieve the auditor of the responsibility to obtain an understanding of the entity and its environment and; the applicable financial reporting ~~and the~~ framework as it applies to the entity.

³⁵ ISA 520, *Analytical Procedures*, paragraph 5

³⁶ ~~ISA 330, The Auditor's Responses to Assessed Risks~~

A47eb. The entity's use of IT and the nature and extent of changes in the IT environment may also affect the specialized skills that are needed to assist with obtaining the required understanding.

The Entity and Its Environment (Ref: Para. 23)

The Entity's Organizational Structure, Ownership and Governance, and Business Model (Ref: Para. 23(a)(i))

The entity's organizational structure and ownership (Ref: Para. 23(a)(i))

A49. An understanding of the entity's organizational structure and ownership may enable the auditor to understand such matters as:

- The complexity of the entity's structure.

Example:

The entity may be a single entity or the entity's structure may include subsidiaries, divisions or other components in multiple locations. Further, the legal structure may be different from the operating structure. Complex structures often introduce factors that may give rise to increased susceptibility to risks of material misstatement. Such issues may include whether goodwill, joint ventures, investments, or special-purpose entities are accounted for appropriately and whether adequate disclosure of such issues in the financial statements has been made.

- The ownership, and relationships between owners and other people or entities, including related parties. This understanding may assist in determining whether related party transactions have been appropriately identified, accounted for, and adequately disclosed in the financial statements.³⁷
- The distinction between the owners, those charged with governance and management.

Example:

In less complex entities, owners of the entity may be involved in managing the entity, therefore there is little or no distinction. In contrast, such as in some listed entities, there may be a clear distinction between management, the owners of the entity, and those charged with governance.³⁸

³⁷ ISA 550 establishes requirements and provide guidance on the auditor's considerations relevant to related parties.

³⁸ ISA 260 (Revised), paragraphs A1 and A2, provide guidance on the identification of those charged with governance and explains that in some cases, some or all of those charged with governance may be involved in managing the entity.

- The structure and complexity of the entity's IT environment.

Examples:

~~An entity's IT environment may be relatively simple because it consists only of commercial software for which the entity does not have access to the underlying source code to which no changes can be made.~~

~~Alternatively, a~~An entity may:

- Have multiple legacy IT systems in diverse businesses that are not well integrated resulting in a complex IT environment.
- Be using external or internal service providers for aspects of its IT environment (e.g., outsourcing the hosting of its IT environment to a third party or using a shared service centre for central management of IT processes in a group).

Automated tools and techniques

A49a. The auditor may use automated tools and techniques to understand flows of transactions and processing as part of the auditor's procedures to understand the information system. An outcome of these procedures may be that the auditor obtains information about the entity's organizational structure or those with whom the entity conducts business (e.g., vendors, customers, related parties).

Considerations specific to public sector entities

A50. Ownership of a public sector entity may not have the same relevance as in the private sector because decisions related to the entity may be initiated-made outside of the entity as a result of political processes. Therefore, management may not have control over certain decisions that are made. Matters that may be relevant include understanding the ability of the entity to make unilateral decisions, and the ability of other public sector entities to control or influence the entity's mandate and strategic direction.

Example:

A public sector entity may be subject to laws or other directives from authorities that require it to obtain approval from parties external to the entity of its strategy and objectives prior to it implementing them. Therefore, matters related to understanding the legal structure of the entity may include applicable laws and regulations, and the classification of the entity (i.e., whether the entity is a ministry, department, agency or other type of entity).

Governance (Ref: Para. 23(a)(i))

Why the auditor obtains an understanding of governance

A51. Understanding the entity's governance may assist the auditor with understanding the entity's ability to provide appropriate oversight of its system of internal control. However, this understanding may also provide evidence of deficiencies, which may indicate an increase in the susceptibility of the entity's financial statements to risks of material misstatement.

Understanding the entity's governance

A51a. Matters that may be relevant for the auditor to consider in obtaining an understanding of the governance of the entity include:

- Whether any or all of those charged with governance are involved in managing the entity.
- The existence (and separation) of a non-executive Board, if any, from executive management.
- Whether those charged with governance hold positions that are an integral part of the entity's legal structure, for example as directors.
- The existence of sub-groups of those charged with governance such as an audit committee, and the responsibilities of such a group.
- The responsibilities of those charged with governance for oversight of financial reporting, including approval of the financial statements.

The Entity's Business Model (Ref: Para. 23(a)(i))

Appendix 1 sets out additional considerations for obtaining an understanding of the entity and its business model, as well as additional considerations for auditing special purpose entities.

Why the auditor obtains an understanding of the entity's business model ~~and its related risks~~

A52. Understanding the entity's objectives, strategy and business model helps the auditor to understand the entity at a strategic level, and to understand the business risks the entity takes and faces. An understanding of the business risks that have an effect on the financial statements assists the auditor in identifying risks of material misstatement, since most business risks will eventually have financial consequences and, therefore, an effect on the financial statements.

Examples:

An entity's business model may rely on the use of IT in different ways:

- The entity sells shoes from a physical store, and uses an advanced stock and point of sale system to record the selling of shoes; or
- The entity sells shoes online so that all sales transactions are processed in an IT environment, including initiation of the transactions through a website.

For both of these entities the business risks arising from a significantly different business model would be substantially different, notwithstanding both entities sell shoes.

Understanding the entity's business model

A59. Not all aspects of the business model are relevant ~~to~~for the auditor's understanding. Business risks are broader than the risks of material misstatement of the financial statements, although business risks include the latter. The auditor does not have a responsibility to understand or identify ~~or assess~~ all business risks because not all business risks give rise to risks of material misstatement.

A59a. Business risks increasing the susceptibility to risks of material misstatement may arise from:

- Inappropriate objectives or strategies, ineffective execution of strategies, or change or complexity.
- A failure to recognize the need for change may also give rise to business risk, for example, from:
 - The development of new products or services that may fail;
 - A market which, even if successfully developed, is inadequate to support a product or service; or
 - Flaws in a product or service that may result in legal liability and reputational risk.
- Incentives and pressures on management, which may result in intentional or unintentional management bias, and therefore affect the reasonableness of significant assumptions and the expectations of management or those charged with governance.

A61. Examples of matters that the auditor may consider when obtaining an understanding of the entity's business model, objectives, strategies and related business risks that may result in a risk of material misstatement of the financial statements include ~~possible risks arising from~~:

- Industry developments, such as the lack of personnel or expertise to deal with the changes in the industry;
- New products and services that may lead to increased product liability;
- Expansion of the entity's business, and demand has not been accurately estimated;
- New accounting requirements where there has been incomplete or improper implementation;
- Regulatory requirements resulting in increased legal exposure;
- Current and prospective financing requirements, such as loss of financing due to the entity's inability to meet requirements;
- Use of IT, such as the implementation of a new IT system that will affect both operations and financial reporting; or
- The effects of implementing a strategy, particularly any effects that will lead to new accounting requirements.

A62. Ordinarily, management identifies business risks and develops approaches to address them. Such a risk assessment process is part of the entity's system of internal control and is discussed in paragraph 30, and paragraphs A117–A120.

Considerations specific to public sector entities

A62a Entities operating in the public sector may create and deliver value in different ways to those creating wealth for owners but will still have a 'business model' with a specific objective. Matters public sector auditors may obtain an understanding of that are relevant to the business model of the entity, include:

- Knowledge of relevant government activities, including related programs.

- Program objectives and strategies, including public policy elements.

A63. For the audits of public sector entities, “management objectives” may be influenced by requirements to demonstrate public accountability and may include objectives which have their source in law, regulation or other authority.

Industry, Regulatory and Other External Factors (Ref: Para. 23(a)(ii))

Industry factors (Ref: Para. 23(a)(ii))

A64. Relevant industry factors include industry conditions such as the competitive environment, supplier and customer relationships, and technological developments. Matters the auditor may consider include:

- The market and competition, including demand, capacity, and price competition.
- Cyclical or seasonal activity.
- Product technology relating to the entity’s products.
- Energy supply and cost.

A65. The industry in which the entity operates may give rise to specific risks of material misstatement arising from the nature of the business or the degree of regulation.

Example:

In the construction industry, long-term contracts may involve significant estimates of revenues and expenses that give rise to risks of material misstatement. In such cases, it is important that the engagement team include members with sufficient relevant knowledge and experience.³⁹

Regulatory factors (Ref: Para. 23(a)(ii))

A66. Relevant regulatory factors include the regulatory environment. The regulatory environment encompasses, among other matters, the applicable financial reporting framework and the legal and political environment and any changes thereto. Matters the auditor may consider include:

- Regulatory framework for a regulated industry, for example, prudential requirements, including related disclosures.
- Legislation and regulation that significantly affect the entity’s operations, for example, labor laws and regulations.
- Taxation legislation and regulations.
- Government policies currently affecting the conduct of the entity’s business, such as monetary, including foreign exchange controls, fiscal, financial incentives (for example, government aid programs), and tariffs or trade restriction policies.

³⁹ ISA 220, paragraph 14

- Environmental requirements affecting the industry and the entity's business.

A67. ISA 250 (Revised) includes some specific requirements related to the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates.⁴⁰

Considerations specific to public sector entities

A68. For the audits of public sector entities, there may be particular laws or regulations that affect the entity's operations. Such elements may be an essential consideration when obtaining an understanding of the entity and its environment.

Other external factors (Ref: Para. 23(a)(ii))

A69. Other external factors affecting the entity that the auditor may consider include the general economic conditions, interest rates and availability of financing, and inflation or currency revaluation.

Measures Used by Management to Assess the Entity's Financial Performance (Ref: Para. 23(a)(iii))

Why the auditor understands measures used by management

A70a. An understanding of the entity's measures assists the auditor in considering whether such measures, whether used externally or internally, create pressures on the entity to achieve performance targets. These pressures may motivate management to take actions that increase the susceptibility to misstatement due to management bias or fraud (e.g., to improve the business performance or to intentionally misstate the financial statements) (see ISA 240 for requirements and guidance in relation to the risks of fraud).

A70b Measures may also indicate to the auditor the likelihood ~~with which~~ of risks of material misstatement of related financial statement information ~~exist~~. For example, performance measures may indicate that the entity has unusually rapid growth or profitability when compared to that of other entities in the same industry.

Measures used by management

A70c. Management and others ordinarily measure and review those matters they regard as important. Inquiries of management may reveal that it relies on certain key indicators, whether publicly available or not, for evaluating financial performance and taking action. In such cases, the auditor may identify relevant performance measures, whether internal or external, by considering the information that the entity uses to manage its business. If such inquiry indicates an absence of performance measurement or review, there may be an increased risk of misstatements not being detected and corrected.

A70d. Key indicators used for evaluating financial performance may include:

- Key performance indicators (financial and non-financial) and key ratios, trends and operating statistics.
- Period-on-period financial performance analyses.

⁴⁰ ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraph 13

- Budgets, forecasts, variance analyses, segment information and divisional, departmental or other level performance reports.
- Employee performance measures and incentive compensation policies.
- Comparisons of an entity's performance with that of competitors.

Scalability [\(Ref: Para. 23\(a\)\(iii\)\)](#)

A73a. The procedures undertaken to understand the entity's measures may vary depending on the size or complexity of the entity, as well as the involvement of owners or those charged with governance in the management of the entity.

Examples:

- For some less complex entities, the terms of the entity's bank borrowings (i.e., bank covenants) may be linked to specific performance measures related to the entity's performance or financial position (e.g., a maximum working capital amount). The auditor's understanding of the performance measures used by the ~~bank~~~~bank lender~~ may help identify areas where there is increased susceptibility to the risk of material misstatement.
- For some entities whose nature and circumstances are more complex, such as those operating in the insurance or banking industries, performance or financial position may be measured against regulatory requirements (e.g., regulatory ratio requirements such as capital adequacy and liquidity ratios performance hurdles). The auditor's understanding of these performance measures may help identify areas where there is increased susceptibility to the risk of material misstatement.

Other considerations

A74. External parties may also review and analyze the entity's financial performance, in particular for entities where financial information is publicly available. The auditor may also consider publicly available information to help the auditor further understand the business or identify contradictory information such as information from:

- Analysts or credit agencies.
- News, other media including social media, newspapers and the media.
- Taxation authorities.
- Regulators.
- Trade unions.
- Providers of finance.

Such financial information can often be obtained from the entity being audited.

A77a. The measurement and review of financial performance is not the same as the monitoring of the system of internal control (discussed as a component of the system of internal control in paragraphs A123–A135c), though their purposes may overlap:

- The measurement and review of performance is directed at whether business performance is meeting the objectives set by management (or third parties).
- In contrast, monitoring of the system of internal control is concerned with monitoring the effectiveness of controls including those related to management's measurement and review of financial performance.

In some cases, however, performance indicators also provide information that enables management to identify control deficiencies.

Considerations specific to public sector entities

A78. In addition to considering relevant measures used by a public sector entity to assess the entity's financial performance, auditors of public sector entities may also consider non-financial information such as achievement of public benefit outcomes (for example, the number of people assisted by a specific program).

The Applicable Financial Reporting Framework (Ref: Para. 23(b))

Understanding the Applicable Financial Reporting Framework and the Entity's Accounting Policies

A79. Matters that the auditor may consider when obtaining an understanding of the entity's applicable financial reporting framework, and how it applies in the context of the nature and circumstances of the entity and its environment include:

- The entity's financial reporting practices in terms of the applicable financial reporting framework, such as:
 - Accounting principles and industry-specific practices, including for industry-specific significant classes of transactions, account balances and related disclosures in the financial statements (for example, loans and investments for banks, or research and development for pharmaceuticals).
 - Revenue recognition.
 - Accounting for financial instruments, including related credit losses.
 - Foreign currency assets, liabilities and transactions.
 - Accounting for unusual or complex transactions including those in controversial or emerging areas (for example, accounting for cryptocurrency).
- An understanding of the entity's selection and application of accounting policies, including any changes thereto as well as the reasons therefore, may encompass such matters as:
 - The methods the entity uses to recognize, measure, present and disclose significant and unusual transactions.
 - The effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

- Changes in the environment, such as changes in the applicable financial reporting framework or tax reforms that may necessitate a change in the entity's accounting policies.
- Financial reporting standards and laws and regulations that are new to the entity and when and how the entity will adopt, or comply with, such requirements.

A80. Obtaining an understanding of the entity and its environment may assist the auditor in considering where changes in the entity's financial reporting (e.g., from prior periods) ~~should~~ may be expected.

Example:

If the entity has had a significant business combination during the period, the auditor would likely expect changes in classes of transactions, account balances and disclosures associated with that business combination. Alternatively, if there were no significant changes in the financial reporting framework during the period the auditor's understanding may help confirm that the understanding obtained in the prior period remains applicable.

Considerations specific to public sector entities

A82. The applicable financial reporting framework in a public sector entity is determined by the legislative and regulatory frameworks relevant to each jurisdiction or within each geographical area. Matters that may be considered in the entity's application of the applicable financial reporting requirements, and how it applies in the context of the nature and circumstances of the entity and its environment, include whether the entity applies a full accrual-basis of accounting or a cash-basis of accounting (such as in accordance with the International Public Sector Accounting Standards), ~~a cash-basis of accounting~~, or a hybrid.

How ~~the~~ Inherent Risk Factors Affect Susceptibility to Misstatement of Assertions (Ref: Para. 23(c))

Appendix 2 provides examples of events and conditions that may indicate ~~susceptibility to the existence of~~ risks of material misstatement, categorized by inherent risk factor.

Why the auditor ~~understand~~ considers the inherent risk factors when understanding the entity and its environment and the applicable financial reporting framework

A88a. Understanding the entity and its environment, and the applicable financial reporting framework, assists the auditor in identifying events ~~and or~~ conditions, the characteristics of which may affect the susceptibility of assertions about classes of transactions, account balances or disclosures to misstatement. These characteristics are inherent risk factors. Inherent risk factors may affect susceptibility of assertions to misstatement by influencing the likelihood of occurrence of a misstatement or the magnitude of the misstatement if it were to occur. Accordingly, uUnderstanding ~~the how~~ -inherent risk factors (i.e., that affect the susceptibility of assertions to misstatement, and how they do so) assists may assist the auditor with a preliminary understanding of the likelihood or magnitude of misstatements, which assists the auditor in identifying ~~and assessing the risks~~ of material misstatement at the assertion level in accordance with paragraph 45(b). Understanding the

degree to which inherent risk factors affect susceptibility of assertions to misstatement also assists the auditor in assessing the likelihood and magnitude of a possible misstatement when assessing inherent risk in accordance with paragraph 48(b). Accordingly, understanding the inherent risk factors may also assist the auditor in designing and performing further audit procedures in accordance with ISA 330.

A88aa. The auditor's identification of risks of material misstatement at the assertion level and assessment of inherent risk may also be influenced by audit evidence obtained by the auditor in performing other risk assessment procedures, further audit procedures or in fulfilling other requirements on the ISAs (see paragraph A102), and in performing further audit procedures in accordance with ISA 330. The ~~inherent risk factors may also be used by~~ assist the auditor in assessing the likelihood and magnitude of a possible misstatement when assessing inherent risk.

The effect of ~~the~~ inherent risk factors on a class of transactions, account balance or disclosure

A88b. The extent of susceptibility to misstatement of a class of transactions, account balance or disclosure arising from complexity or subjectivity, is often closely related to the extent to which it is subject to change or uncertainty.

Example:

If the entity has an accounting estimate ~~that is~~ based on assumptions, the selection of which are that are subject to significant inherent uncertainty/judgment, the measurement of the accounting estimate is likely to be affected by both subjectivity and uncertainty.

A88c. The greater the extent to which a class of transactions, account balance or disclosure is susceptible to misstatement because of complexity or subjectivity, the greater the need for the auditor to apply professional skepticism. Further, when a class of transactions, account balance or disclosure is susceptible to misstatement because of complexity, subjectivity, change or uncertainty, these inherent risk factors may create opportunity for management bias, whether unintentional or intentional, and affect susceptibility to misstatement due to management bias. The auditor's identification of risks of material misstatement, and assessment of inherent risk at the assertion level, are also affected by the interrelationships among ~~the~~ inherent risk factors.

A88d. Events or conditions that may affect susceptibility to misstatement due to management bias may also affect susceptibility to misstatement due to other fraud risk factors. Accordingly, this may be relevant information for use in accordance with paragraph 24 of ISA 240, which requires the auditor to evaluate whether the information obtained from the other risk assessment procedures and related activities indicates that one or more fraud risk factors are present.

Obtaining an Understanding of the Entity's System of Internal Control (Ref: Para. 28–43)

Appendix 3 further describes the nature of the entity's system of internal control and inherent limitations of internal control, respectively. Appendix 3 also provides further explanation of the components of a system of internal control for the purposes of the ISAs.

A89. The auditor's understanding of the entity's system of internal control is obtained through risk assessment procedures performed to understand and evaluate each of the components of the system of internal control as set out in paragraphs 28 to 39 of this ISA.

A89a. The components of the entity's system of internal control for the purpose of this ISA may not necessarily reflect how an entity designs, implements and maintains its system of internal control, or how it may classify any particular component. Entities may use different terminology or frameworks to describe the various aspects of the system of internal control. For the purpose of an audit, auditors may also use different terminology or frameworks provided all the components described in this ISA are addressed.

Scalability

A95a. The way in which the entity's system of internal control is designed, implemented and maintained varies with an entity's size and complexity. For example, less complex entities may use less structured or simpler controls (i.e., policies and procedures) to achieve their objectives.

Considerations Specific to Public Sector Entities

A96. Auditors of public sector entities often have additional responsibilities with respect to internal control, for example, to report on compliance with an established code of practice or reporting on spending against budget. Auditors of public sector entities may also have responsibilities to report on compliance with law, regulation or other authority. As a result, their considerations about the system of internal control may be broader and more detailed.

Information Technology in the Components of the Entity's System of Internal Control

Appendix 5 provides further guidance on understanding the entity's use of IT in the components of the system of internal control.

A97. The overall objective and scope of an audit does not differ whether an entity operates in a mainly manual environment, a completely automated environment, or an environment involving some combination of manual and automated elements (i.e., manual and automated controls and other resources used in the entity's system of internal control).

Understanding the Nature of the Components of the Entity's System of Internal Control

A102. The auditor's understanding of each of the components of the entity's system of internal control provides the auditor with a preliminary understanding of how the entity identifies business risks and how it responds to them. This assists the auditor in designing and performing further audit procedures, including any plans to test the operating effectiveness of controls. It may also influence the auditor's identification and assessment of the risks of material misstatement in different ways (see paragraph A88).~~The auditor's understanding of each of the components of the entity's system of internal control provides the auditor with a preliminary understanding of how the entity identifies business risks and how it responds to them. It may also influence the auditor's identification and assessment of the risks of material misstatement in different ways (see paragraph A88).~~ This assists the auditor in designing and performing further audit procedures, including any plans to test the operating effectiveness of controls and, if so, in evaluating the effectiveness of design of those controls and whether they have been implemented (see paragraph A135h).~~– assists the~~

auditor in designing and performing further audit procedures, including any plans to test the operating effectiveness of controls. It may affect also influence the auditor's identification and assessment of the risks of material misstatement in different ways (see paragraph A88a). For example:

- The auditor's understanding of the entity's control environment, the entity's risk assessment process, and the entity's process to monitor controls components are more likely to affect the identification and assessment of risks of material misstatement at the financial statement level.
- The auditor's understanding of the entity's information system and communication, and the entity's control activities component, are more likely to affect the identification and assessment of risks of material misstatement at the assertion level.

Examples

~~The auditor's understanding of the entity's control environment, the entity's risk assessment process, and the entity's process to monitor controls components are more likely to affect the identification and assessment of risks of material misstatement at the financial statement level.~~

- ~~The auditor's understanding of the entity's information system and communication, and the entity's control activities component, are more likely to affect the identification and assessment of risks of material misstatement at the assertion level.~~

~~The auditor's understanding of the entity's control environment, the entity's risk assessment process, and the entity's process to monitor controls components are more likely to affect the identification and assessment of risks of material misstatement at the financial statement level.~~

- ~~The auditor's understanding of the entity's information system and communication, and the entity's control activities component, are more likely to affect the identification and assessment of risks of material misstatement at the assertion level.~~

Control Environment, The Entity's Risk Assessment Process and the Entity's Process to Monitor the System of Internal Control (Ref: Para. 28–31A)

A104a. The controls in the control environment, the entity's risk assessment process and the entity's process to monitor the system of internal control are primarily indirect controls (i.e., controls that are not sufficiently precise to prevent, detect or correct misstatements at the assertion level but which support other controls and may therefore have an indirect effect on the likelihood that a misstatement will be detected or prevented on a timely basis). However, some controls within these components may also be direct controls.

Why the Auditor is Required to Understand the Control Environment, The Entity's Risk Assessment Process and the Entity's Process to Monitor the System of Internal Control

A104b. The control environment provides an overall foundation for the operation of the other components of the system of internal control. The control environment does not directly prevent, or detect and correct, misstatements. It may, however, influence the effectiveness of controls in the other components of the system of internal control. Similarly, the entity's risk assessment process and its

process for monitoring the system of internal control are designed to operate in a manner that also supports the entire system of internal control.

A104c. Because these components are foundational to the entity's system of internal control, any deficiencies in their operation could have pervasive effects ~~to-on~~ the preparation of the financial statements. Therefore, the auditor's understanding and evaluations of these components affect the auditor's identification and assessment of risks of material misstatement at the financial statement level, and may also affect the identification and assessment of risks of material misstatement at the assertion level. ~~Identified-r~~Risks of material misstatement at the financial statement level affect the auditor's design of overall responses, including, as explained in ISA 330, an influence on the nature, timing and extent of the auditor's further procedures.⁴¹

~~A104d. The auditor's intention to test the operating effectiveness of controls may also be influenced by the identified risks of material misstatement at the financial statement level because they may influence the auditor's expectations about the operating effectiveness of controls.~~

Obtaining an Understanding of the Control Environment (Ref: Para. 28)

Scalability

A106. The nature of the control environment in a less complex entity is likely to be different from the control environment in a more complex entity. ~~A106a.~~ For example, those charged with governance in less complex entities may not include an independent or outside member, and the role of governance may be undertaken directly by the owner-manager where there are no other owners. Accordingly, some considerations about the entity's control environment may be less relevant or may not be applicable.

A107. In addition, audit evidence about elements of the control environment in less complex entities may not be available in documentary form, in particular where communication between management and other personnel is informal, but the evidence may still be appropriately relevant and reliable in the circumstances.

Examples:

- The organizational structure in a less complex entity will likely be simpler and may include a small number of employees involved in roles related to financial reporting.
- If the role of governance is undertaken directly by the owner-manager, the auditor may determine that the independence of those charged with governance is not relevant.
- Less complex entities may not have a written code of conduct but, instead, develop a culture that emphasizes the importance of integrity and ethical behaviour through oral communication and by management example. Consequently, the attitudes, awareness and actions of management or the owner-manager are of particular importance to the auditor's understanding of a less complex entity's control environment.

⁴¹ ISA 330, paragraphs A1–A3

Understanding the control environment (Ref: Para. 28(a))

A108. Audit evidence for the auditor's understanding of the control environment may be obtained through a combination of inquiries and other risk assessment procedures (i.e., corroborating inquiries through observation or inspection of documents).

A108a. In considering the extent to which management demonstrates a commitment to integrity and ethical values, the auditor may obtain an understanding through inquiries of management and employees and through considering information from external sources, about:

- ~~How management communicates to employees its views on business practices and ethical behavior; and~~
- ~~Inspecting management's written code of conduct and observing whether management acts in a manner that supports that code.~~

Evaluating the control environment (Ref: Para. 28(b))

Why the auditor evaluates the control environment

A108b. The auditor's evaluation of how the entity demonstrates behavior consistent with the entity's commitment to integrity and ethical values; whether the control environment provides an appropriate foundation for the other components of the entity's system of internal control; and whether any identified control deficiencies undermine the other components of the system of internal control, assists the auditor in identifying potential issues in the other components of the system of internal control. This is because the control environment is foundational to the other components of the entity's system of internal control. This evaluation may also assist the auditor in understanding risks faced by the entity and therefore in identifying and assessing the risks of material misstatement at the financial statement and assertion levels (see paragraph A102).

The auditor's evaluation of the control environment

A110a. The auditor's evaluation of the control environment is ~~undertaken using the information from~~ based on the understanding obtained in accordance with paragraph 28(a).

A113. Some entities may be dominated by a single individual who may exercise a great deal of discretion. The actions and attitudes of that individual may have a pervasive effect on the culture of the entity, which in turn may have a pervasive effect on the control environment. Such an effect may be positive or negative.

Example:

Direct involvement by a single individual may be key to enabling the entity to meet its growth and other objectives, and can also contribute significantly to an effective system of internal control. On the other hand, such concentration of knowledge and authority can also lead to an increased susceptibility to misstatement through management override of controls.

A114. The auditor may consider how the different elements of the control environment may be influenced by the philosophy and operating style of senior management taking into account the involvement of independent members of those charged with governance.

A114a. Although the control environment may provide an appropriate foundation for the system of internal control and may help reduce the risk of fraud, an appropriate control environment is not necessarily an effective deterrent to fraud.

Example:

Human resource policies and procedures directed toward hiring competent financial, accounting, and IT personnel may mitigate the risk of errors in processing and recording financial information. However, such policies and procedures may not mitigate the override of controls by senior management (e.g., to overstate earnings).

A114b. The auditor's evaluation of the control environment as it relates to the entity's use of IT may include such matters as:

- Whether governance over IT is commensurate with the nature and size-complexity of the entity and its business operations enabled by IT, including the complexity or maturity of the entity's technology platform or architecture and the extent to which the entity relies on IT applications to support its financial reporting.
- The management organizational structure regarding IT and the resources allocated (for example, whether the entity has invested in an appropriate IT environment and necessary enhancements, or whether a sufficient number of appropriately skilled individuals have been employed including when the entity uses commercial software (with no or limited modifications)).

Obtaining an Understanding of the Entity's Risk Assessment Process (Ref: Para. 30–31)

Understanding the entity's risk assessment process (Ref: Para. 30(a))

A117. As explained in paragraph A59, not all business risks give rise to risks of material misstatement. In understanding how management and those charged with governance have identified business risks relevant to the preparation of the financial statements, and ~~have~~ decided about actions to address those risks, matters the auditor may consider include how management or, as appropriate, those charged with governance, has~~ve~~:

- Specified the entity's objectives with sufficient precision and clarity to enable the identification and assessment of the risks relating to the objectives;
- Identified the risks to achieving the entity's objectives and analyzed the risks as a basis for determining how the risks should be managed; and
- Considered the potential for fraud when considering the risks to achieving the entity's objectives.⁴²

A117a. The auditor may consider the implications of such business risks for the preparation of the entity's financial statements and other aspects of its system of internal control.

⁴² See paragraph 198(a) of ISA 240

Evaluating the entity's risk assessment process (Ref: Para. 30(b))

Why the auditor evaluates whether the entity's risk assessment process is appropriate

A117b. The auditor's evaluation of the entity's risk assessment process may assist the auditor in understanding where the entity has identified risks that may occur, and how the entity has responded to those risks. The auditor's evaluation of how the entity identifies its business risks, and how it assesses and addresses those risks assists the auditor in understanding whether the risks faced by the entity have been identified, assessed and addressed as appropriate to the nature and complexity of the entity. This evaluation may also assist the auditor with identifying and assessing financial statement level and assertion level risks of material misstatement (see paragraph A102).

Evaluating whether the entity's risk assessment process is appropriate (Ref: Para. 30(b))

A119a. The auditor's evaluation of the appropriateness of the entity's risk assessment process is ~~undertaken~~ based on the understanding obtained in accordance with paragraph 30(a).

Scalability

A120. Whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature and ~~size-complexity~~ of the entity is a matter of the auditor's professional judgment.

Example:

In some less complex entities, and particularly owner-managed entities, an appropriate risk assessment may be performed through the direct involvement of management or the owner-manager (e.g., the manager or owner-manager may routinely devote time to monitoring the activities of competitors and other developments in the market place to identify emerging business risks). The evidence of this risk assessment occurring in these types of entities is often not formally documented, but it may be evident from the discussions the auditor has with management that management are in fact performing risk assessment procedures.

Obtaining an Understanding of the Entity's Process to Monitor the Entity's System of Internal Control
(Ref: Para. 31A)

Scalability

A123. In less complex entities, and in particular owner-manager entities, the auditor's understanding of the entity's process to monitor the system of internal control is often focused on how management or the owner-manager's is directly involved in operations, as there may not be any other monitoring activities.

Example:

Management may receive complaints from customers about inaccuracies in their monthly statement that alerts the owner-manager to issues with the timing of when customer payments are being recognized in the accounting records.

A124. For entities where there is no formal process for monitoring the system of internal control, understanding the process to monitor the system of internal control may include understanding periodic reviews of management accounting information that are designed to contribute to how the entity prevents or detects misstatements.

Understanding the entity's process to monitor the system of internal control (Ref: Para. 31A(a))

A126a. Matters that may be relevant for the auditor to consider when understanding how the entity monitors its system of internal control include:

- The design of the monitoring activities, for example whether it is periodic or ongoing monitoring;
- The performance and frequency of the monitoring activities;
- The evaluation of the results of the monitoring activities, on a timely basis, to determine whether the controls have been effective; and
- How identified deficiencies have been addressed through appropriate remedial actions, including timely communication of such deficiencies to those responsible for taking remedial action.

A127. The auditor may also consider how the entity's process to monitor the system of internal control addresses monitoring information processing controls that involve the use of IT. This may include, for example:

- Controls to monitor complex IT environments that:
 - Evaluate the continuing design effectiveness of information processing controls and modify them, as appropriate, for changes in conditions; or
 - Evaluate the operating effectiveness of information processing controls.
- Controls that monitor the permissions applied in automated information processing controls that enforce the segregation of duties.
- Controls that monitor how errors or control deficiencies related to the automation of financial reporting are identified and addressed.

Understanding the entity's internal audit function (Ref: Para. 31A(a)(ii))

Appendix 4 sets out further considerations ~~relating to~~ for understanding the entity's internal audit function.

A131. The auditor's inquiries of appropriate individuals within the internal audit function help the auditor obtain an understanding of the nature of the internal audit function's responsibilities. If the auditor determines that the function's responsibilities are related to the entity's financial reporting, the auditor may obtain further understanding of the activities performed, or to be performed, by the internal audit function by reviewing the internal audit function's audit plan for the period, if any, and discussing that plan with the appropriate individuals within the function. This understanding, together with the information obtained from the auditor's inquiries, may also provide information that is directly relevant to the auditor's identification and assessment of the risks of material misstatement. If, based on the

auditor's preliminary understanding of the internal audit function, the auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed, ISA 610 (Revised 2013) applies.

Other sources of information used in the entity's process to monitor the system of internal control

Understanding the sources of information (Ref: Para. 31A(b))

A135b. Management's monitoring activities may use information in communications from external parties such as customer complaints or regulator comments that may indicate problems or highlight areas in need of improvement.

Why the auditor is required to understand the sources of information used for the entity's monitoring of the system of internal control

A135a. The auditor's understanding of the sources of information used by the entity in monitoring the entity's system of internal control, including whether the information used is relevant and reliable, assists the auditor in evaluating whether the entity's process to monitor the entity's system of internal control is appropriate. If management assumes that information used for monitoring is relevant and reliable without having a basis for that assumption, errors that may exist in the information could potentially lead management to draw incorrect conclusions from its monitoring activities.

~~Other sources of information used in the entity's process to monitor the system of internal control~~

~~A135b. Management's monitoring activities may use information in communications from external parties such as customer complaints or regulator comments that may indicate problems or highlight areas in need of improvement.~~

Evaluating the entity's process to monitor the system of internal control

Why the auditor evaluates whether the entity's process to monitor the system of internal control is appropriate (Ref: Para 31A(c))

A135b. The auditor's evaluation about how the entity undertakes ongoing and separate evaluations for monitoring the effectiveness of controls assists the auditor in understanding whether the other components of the entity's system of internal control are present and functioning, and therefore assists with understanding the other components of the entity's system of internal control. This evaluation may also assist the auditor with identifying and assessing financial statement level and assertion level risks of material misstatement (see paragraph A102).

Evaluating whether the entity's process to monitor the system of internal control is appropriate (Ref: Para. 31A(c))

A135c. The auditor's evaluation of the appropriateness of the entity's process to monitor the system of internal control is based on the auditor's understanding of the entity's process to monitor the system of internal control.

~~The Information System and Communication, and Control Activities~~ (Ref: Para. 36–39)

~~A135ca. The controls in the information system and communication, and control activities components are primarily direct controls (i.e., controls that are sufficiently precise to prevent, detect or correct misstatements at the assertion level).~~

Why the Auditor is Required to Understand the Information System and Communication and Controls in the Control Activities Component

A135d. The auditor is required to understand~~s~~ the entity's information system and communication because understanding the entity's policies that define the flows of transactions and other aspects of the entity's information processing activities relevant to the preparation of the financial statements, and evaluating whether the component appropriately supports the preparation of the entity's financial statements, supports the auditor's identification and assessment of risks of material misstatement at the assertion level. This understanding and evaluation may also result in the identification of risks of material misstatement at the financial statement level when the results of the auditor's procedures are inconsistent with expectations about the entity's system of internal control that may have been set based on information obtained during the engagement acceptance or continuance process (see paragraph A102).

A135h. The auditor is required to identify specific controls in the control activities component, and evaluate the design and determine whether the controls have been implemented, as it assists the auditor's understanding about management's approach to addressing certain risks ~~(in particular those that are higher on the spectrum of inherent risk)~~ and therefore informs-provides a basis for the design and performance of substantive-further audit procedures responsive to these risks as required by ISA 330. The higher on the spectrum of inherent risk a risk is assessed, the more persuasive the audit evidence needs to be. Even when the auditor does not plan to test the operating effectiveness of identified controls, the auditor's understanding may still affect the design of the nature, timing and extent of substantive audit procedures that are responsive to the related risks of material misstatement.

Example:

~~The results of these risk assessment procedures may inform the auditor's consideration of possible deviations in a population when designing audit samples.~~

~~A135i. The higher on the spectrum of inherent risk a risk is assessed, the more persuasive the audit evidence needs to be. As explained in ISA 330,⁴³ obtaining more persuasive evidence may involve obtaining evidence that is more relevant or reliable. The auditor's understanding of controls contributes to~~

⁴³—ISA 330, paragraph A19

~~the audit evidence obtained for these risks and this understanding may further assist the auditor in designing further audit procedures to obtain more relevant and reliable audit evidence.~~

The Iterative Nature of the Auditor's Understanding and Evaluation of the Information System and Communication, and Control Activities

The Iterative Nature of the Auditor's Understanding and Evaluation of the Information System and Communication, and Control Activities

~~A135j. The auditor's identification and assessment of risks of material misstatement at the assertion level is influenced by both the auditor's understanding of the entity's policies for its information processing activities in the information system and communication, and the auditor's identification and evaluation of related controls in the control activities component.~~

~~A135k~~A135i. As explained in paragraph A47b, the auditor's understanding of the entity and its environment, and the applicable financial framework, may assist the auditor in developing initial expectations about the classes of transactions, account balances and disclosures that may be significant classes of transactions, account balances and disclosures. In obtaining an understanding of the information system and communication component in accordance with paragraph 36(a), the auditor may use these initial expectations for the purpose of determining the extent of understanding of the entity's information processing activities to be obtained.

A135j. The auditor's understanding of the information system includes understanding the policies that define flows of information relating to the entity's significant classes of transactions, account balances, and disclosures, and other related aspects of the entity's information processing activities. This information, and the information obtained from the auditor's evaluation of the information system ~~assists~~may confirm or further influence the auditor's expectations about the significant classes of transactions, account balances and disclosures initially identified (see paragraph A135i).

A135k~~i~~. In obtaining an understanding of how information relating to significant classes of transactions, account balances and disclosures flows into, through, and out of the entity's information system, the auditor may also identify controls in the control activities component that are required to be identified in accordance with paragraph 39(a).~~A135l~~. The auditor's identification and evaluation of controls in the control activities component may first focus on controls over journal entries and controls that the auditor plans to test ~~in designing the nature, timing and extent of substantive procedures because such controls are identified independently of the auditor's risk assessments. The auditor may also controls in the control activities component that are required to be identify concurrently with the auditor's understanding of how information relating to significant classes of transactions, account balances and disclosures flows into, through, and out of the entity's information system. the operating effectiveness of in designing the nature, timing and extent of substantive procedures~~

~~A135m~~i. The auditor's assessment of inherent risk may also ~~drive~~influence the identification of controls in the control activities component. ~~The~~For example, the auditor's identification ~~and evaluation of~~ controls relating to significant risks, ~~and those risks that the auditor considered to have a reasonable possibility of being significant risks but determined not to be significant risks,~~ may ~~ordinarily~~ only be identifiable when the auditor has assessed inherent risk at the assertion level in accordance with ~~paragraphs~~paragraph 48. Furthermore, controls addressing risks for which the auditor has determined that substantive procedures alone do not provide sufficient appropriate audit evidence

(in accordance with paragraph 50) may also only be identifiable once the auditor's inherent risk assessments have been undertaken.

A135m. The auditor's identification and assessment of risks of material misstatement at the assertion level is influenced by both the auditor's:

- Understanding of the entity's policies for its information processing activities in the information system and communication component, and
- Identification and evaluation of controls in the control activities component.

Obtaining an Understanding of the Information System and Communication (Ref: Para. 36)

Appendix 3, Paragraphs 154–198, sets out further considerations relating to the information system and communication.

Scalability

A135n. The information system, and related business processes, in less complex entities are likely to be less sophisticated than in larger entities, and are likely to involve a less complex IT environment; however, but the role of the information system is just as important. Less complex entities with direct management involvement may not need extensive descriptions of accounting procedures, sophisticated accounting records, or written policies. Understanding the relevant aspects of the entity's information system may therefore require less effort in an audit of a less complex entity, and may involve a greater amount of inquiry than observation or inspection of documentation. The need to obtain an understanding, however, remains important to provide a basis for the design of further audit procedures in accordance with ISA 330 and may further assist the auditor in identifying or assessing risks of material misstatement (see paragraph A102).

Obtaining an understanding of the information system (Ref: Para. 36(a))

A136a. Included within the entity's system of internal control are aspects that relate to the entity's reporting objectives, including its financial reporting objectives, but may also include aspects that relate to its operations or compliance objectives, when such aspects are relevant to financial reporting. Understanding how the entity initiates transactions and captures information as part of the auditor's understanding of the information system may include information about the entity's systems (its policies) designed to address compliance and operations objectives because such information is relevant to the preparation of the financial statements. [From paragraph A94a] Further, some entities may have information systems that are highly integrated such that controls may be designed in a manner to simultaneously achieve financial reporting, compliance and operational objectives, and combinations thereof.

A136b. Understanding the entity's information system also includes an understanding of the resources to be used in such the entity's information processing activities. Information about the human resources involved that may be relevant to understanding risks to the integrity of the information system include:

- The competence of the individuals undertaking the work;
- Whether there are adequate resources; and

- Is there appropriate segregation of duties.

A137a. Matters the auditor may consider when understanding the policies that define the flows of information relating to the entity's significant classes of transactions, account balances, and disclosures in the information system and communication component include the nature of:

- (a) The data or information relating to transactions, other events and conditions to be processed;
- (b) The information processing to maintain the integrity of that data or information; and
- (c) The information processes, personnel and other resources used in the information processing process.

A137b. Obtaining an understanding of the entity's business processes, which include how transactions are originated, assists the auditor in obtaining an understanding of the entity's information system in a manner that is appropriate to the entity's circumstances.

A141c. The auditor's understanding of the information system may be obtained in various ways and may include:

- Inquiries of relevant personnel about the procedures used to initiate, record, process and report transactions or about the entity's financial reporting process;
- Inspection of policy or process manuals or other documentation of the entity's information system;
- Observation of the performance of the policies or procedures by entity's personnel; or
- ~~Selecting transactions and tracing them through the applicable process in the information system (i.e., performing a walk-through).~~
- ~~Inquiry alone, however, is not sufficient for such purposes.~~

Automated tools and techniques

A141e. The auditor may also use automated techniques to obtain direct access to, or a digital download from, the databases in the entity's information system that store accounting records of transactions. By applying automated tools or techniques to this information, the auditor may confirm the understanding obtained about how transactions flow through the information system by tracing journal entries, or other digital records related to a particular transaction, or an entire population of transactions, from initiation in the accounting records through to recording in the general ledger. Analysis of complete or large sets of transactions may also result in the identification of variations from the normal, or expected, processing procedures for these transactions, which may result in the identification of risks of material misstatement.

Information obtained from outside of the general and subsidiary ledgers

A142. Financial statements may contain information that is obtained from outside of the general and subsidiary ledgers. Examples of such information that the auditor may consider include:

- Information obtained from lease agreements relevant to disclosures in the financial statements.

- Information disclosed in the financial statements that is produced by an entity's risk management system.
- Fair value information produced by management's experts and disclosed in the financial statements.
- Information disclosed in the financial statements that has been obtained from models, or from other calculations used to develop accounting estimates recognized or disclosed in the financial statements, including information relating to the underlying data and assumptions used in those models, such as:
 - Assumptions developed internally that may affect an asset's useful life; or
 - Data such as interest rates that are affected by factors outside the control of the entity.
- Information disclosed in the financial statements about sensitivity analyses derived from financial models that demonstrates that management has considered alternative assumptions.
- Information recognized or disclosed in the financial statements that has been obtained from an entity's tax returns and records.
- Information disclosed in the financial statements that has been obtained from analyses prepared to support management's assessment of the entity's ability to continue as a going concern, such as disclosures, if any, related to events or conditions that have been identified that may cast significant doubt on the entity's ability to continue as a going concern.⁴⁴

A143. Certain amounts or disclosures in the entity's financial statements (such as disclosures about credit risk, liquidity risk, and market risk) may be based on information obtained from the entity's risk management system. However, the auditor is not required to understand all aspects of the risk management system, and uses professional judgment in determining the necessary understanding.

The entity's use of information technology in the information system

Why does the auditor understand the IT environment relevant to the information system

A144. The auditor's understanding of the information system includes the IT environment relevant to the flows of transactions and processing of information in the entity's information system because the entity's use of IT applications or other aspects in the IT environment may give rise to risks arising from the use of IT.

A144a. The understanding of the entity's business model and how it integrates the use of IT may also provide useful context to the nature and extent of IT expected in the information system.

Understanding the entity's use of IT

A144b. The auditor's understanding of the IT environment may focus on identifying, and understanding the nature and number of, the specific IT applications and other aspects of the IT environment, that are relevant to the flows of transactions and processing of information in the information system. Changes in the flow of transactions, or information within the information system may result from program

⁴⁴ See paragraphs 19–20 of ISA 570 (Revised), *Going Concern*

changes to IT applications, or direct changes to data in databases involved in processing, or storing those transactions or information.

A146. The auditor may identify the IT applications and supporting IT infrastructure concurrently with the auditor's understanding of how information relating to significant classes of transactions, account balances and disclosures flows into, through and out the entity's information system.

Obtaining an Understanding of the Entity's Communication (Ref: Para. 36(b))

Scalability

A158a. In larger, more complex entities, information the auditor may consider when understanding the entity's communication may come from policy manuals and financial reporting manuals.

A159. In less complex entities, communication may be less structured (e.g., formal manuals may not be used) due to fewer levels of responsibility and management's greater visibility and availability. Regardless of the size of the entity, open communication channels facilitate the reporting of exceptions and acting on them.

Evaluating Whether the Relevant Aspects of the Information System Support the Preparation of the Entity's Financial Statements (Ref: Para. 36(c))

A159a. The auditor's evaluation of whether the entity's information system and communication appropriately supports the preparation of the financial statements is ~~undertaken~~ based on the understanding obtained in paragraphs 36(a)–(b).

Control Activities (Ref: Para. 39)

Controls in the Control Activities Component (Ref: Para. 39)

Appendix 3, Paragraphs 20 and 21, set out further considerations relating to control activities.

A160. The control activities component includes controls that are designed to ensure the proper application of policies (which are also controls) in all the other components of the entity's system of internal control, and includes both direct and indirect controls.

Example:

The controls that an entity has established to ensure that its personnel are properly counting and recording the annual physical inventory relate directly to the risks of material misstatement relevant to the existence and completeness assertions for the inventory account balance.

A160a. The auditor's identification and evaluation of controls in the control activities component is focused on information processing controls, which are controls ~~related to~~ applied during the processing of information in the entity's information system that directly address risks to the integrity of information (i.e., the completeness, accuracy and validity of transactions and other information). However, the auditor is not required to identify and evaluate all information processing controls related to the entity's policies that define the flows of transactions and other aspects of the entity's information processing activities for the significant classes of transactions, account balances and disclosures.

A160b. There may also be direct controls that exist in the control environment, the entity's risk assessment process or the entity's process to monitor the system of internal control, which may be identified in accordance with paragraph 39. However, the more indirect the relationship between controls that support other controls and the control that is being considered, the less effective that control may be in preventing, or detecting and correcting related, misstatements.

Example:

A sales manager's review of a summary of sales activity for specific stores by region ordinarily is only indirectly related to the risks of material misstatement relevant to the completeness assertion for sales revenue. Accordingly, it may be less effective in addressing those risks than controls more directly related thereto, such as matching shipping documents with billing documents.

A160c. Paragraph 39 also requires the auditor to identify and evaluate general IT controls for IT applications and other aspects of the IT environment that the auditor has determined to be subject to risks arising from the use of IT, because general IT controls support the continued effective functioning of information processing controls. ~~Similarly, A~~ a general IT control alone is typically not sufficient to address a risk of material misstatement at the assertion level.

A160d. The controls that the auditor is required to identify and evaluate the design and determine the implementation of, in accordance with paragraph 39 are those:

- ~~For On Controls~~ which the auditor plans to test the operating effectiveness of in determining the nature, timing and extent of substantive procedures. ~~because t~~ The evaluation of such controls provides the basis for the auditor's design of test of control procedures in accordance with ISA 330. ~~Such These~~ controls also include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.
- ~~Controls tThat address risks of material misstatement at the assertion level that have been assessed as higher on the spectrum of inherent risk because ISA 330 requires more persuasive audit evidence the higher the auditor's assessment of risk⁴⁵. Such controls include~~ controls that address significant risks, ~~controls that address risks that could be but are not significant risks,~~ and controls over journal entries. The auditor's identification and evaluation of such controls may ~~provide also influence~~ the auditor's ~~with a greater~~ understanding of the risks of material misstatement, including the identification of additional risks of material misstatement ~~(see paragraph A102)~~. This understanding also provides the basis for the auditor's design of the nature, timing and extent of substantive audit procedures that are responsive to the related assessed risks of material misstatement.
- Other controls that the auditor considers are appropriate to enable the auditor to meet the objectives of paragraph 17 as it relates to risks with respect to risks of material misstatement at the assertion level.

A160e. Controls in the control activities component are required to be identified when such controls meet one or more of the criteria included in paragraph 39(a). However, when multiple controls each achieve the same objective, it is unnecessary to identify each of the controls related to such objective.

⁴⁵—ISA 330, paragraph 7(b)

Types of Controls in the Control Activities Component (Ref: Para. 39)

A160f. Examples of controls in the control activities component include authorizations and approvals, reconciliations, verifications (such as edit and validation checks or automated calculations), segregation of duties, and physical or logical controls, including those addressing safeguarding of assets.

A160g. Controls in the control activities component may also include controls established by management that address risks of material misstatement related to disclosures not being prepared in accordance with the applicable financial reporting framework. Such controls may relate to information included in the financial statements that is obtained from outside of the general and subsidiary ledgers.

A160h. Regardless of whether controls are within the IT environment or manual systems, controls may have various objectives and may be applied at various organizational and functional levels.

Scalability (Ref: Para. 39)

A161. Controls in the control activities component for less complex entities are likely to be similar to those in larger entities, but the formality with which they operate may vary. Further, in less complex entities, more controls may be directly applied by management.

Example:

Management's sole authority for granting credit to customers and approving significant purchases can provide strong control over important account balances and transactions.

A161a. It may be less practicable to establish segregation of duties in less complex entities that have fewer employees. However, in an owner-managed entity, the owner-manager may be able to exercise more effective oversight through direct involvement than in a larger entity, which may compensate for the generally more limited opportunities for segregation of duties. Although, as also explained in ISA 240, domination of management by a single individual can be a potential control deficiency since there is an opportunity for management override of controls.⁴⁶

Controls that Address Risks of Material Misstatement at the Assertion Level (Ref: Para. 39(a))

Controls that address risks that are determined to be a significant risk (Ref: Para. 39(a)(i))

A170. Regardless of whether the auditor plans to test the operating effectiveness of controls that address significant risks, the understanding obtained about management's approach to addressing those risks may provide a basis for—inform the design and performance of substantive procedures responsive to significant risks as required by ISA 330.⁴⁷ Although risks relating to significant non-routine or judgmental matters are often less likely to be subject to routine controls, management may have other responses intended to deal with such risks. Accordingly, the auditor's understanding of whether the entity has designed and implemented controls for significant risks arising from non-

⁴⁶ ISA 240, paragraph A28

⁴⁷ ISA 330, paragraph 21

routine or judgmental matters may include whether and how management responds to the risks. Such responses may include:

- Controls such as a review of assumptions by senior management or experts.
- Documented processes for accounting estimations.
- Approval by those charged with governance.

Example:

Where there are one-off events such as the receipt of a notice of a significant lawsuit, consideration of the entity's response may include such matters as whether it has been referred to appropriate experts (such as internal or external legal counsel), whether an assessment has been made of the potential effect, and how it is proposed that the circumstances are to be disclosed in the financial statements.

A172. ISA 240⁴⁸ requires the auditor to understand controls related to assessed risks of material misstatement due to fraud (which are treated as significant risks), and further explains that it is important for the auditor to obtain an understanding of these controls that management has designed, implemented and maintained to prevent and detect fraud.

Controls over journal entries (Ref: Para. 39(a)(iii))

A175.- Controls that address risks of material misstatement at the assertion level that are expected to be identified for all audits are controls over journal entries, because the manner in which an entity incorporates information from transaction processing into the general ledger ordinarily involves the use of journal entries, whether standard or non-standard, or automated or manual. The extent to which other controls are identified may vary based on the nature of the entity and the auditor's planned approach to further audit procedures.

Example:

In an audit of a less complex entity, the entity's information system may not be complex and the auditor may not plan to rely on the operating effectiveness of controls. Further, the auditor may not have identified any significant risks or any other risks of material misstatement for which it is necessary for the auditor to evaluate the design of controls and determine that they have been implemented. In such an audit, the auditor may determine that there are no identified controls other than the entity's controls over journal entries.

Automated tools and techniques

A175a.- In manual general ledger systems, non-standard journal entries may be identified through inspection of ledgers, journals, and supporting documentation. When automated procedures are used to maintain the general ledger and prepare financial statements, such entries may exist only in electronic form and may therefore be more easily identified through the use of automated techniques.

⁴⁸ ISA 240, paragraphs 28 and A33

Example:

In the audit of a less complex entity, the auditor may be able to extract a total listing of all journal entries into a simple spreadsheet. It may then be possible for the auditor to sort the journals by applying a variety of filters such as ~~dollar~~-~~currency~~ amount, name of the journal preparer or reviewer, entries that gross up the balance sheet and income statement only, or to view the listing by the date the journal entry was posted to the general ledger, to assist the auditor in designing their response to the risks identified relating to journal entries.

Controls for which the auditor plans to test the operating effectiveness (Ref: Para. 39(a)(~~iii~~~~v~~))

A175d. The auditor determines whether there are any risks of material misstatement at the assertion level for which it is not possible ~~or practicable~~ to obtain sufficient appropriate audit evidence through substantive procedures alone. The auditor is required, in accordance with ISA 330,⁴⁹ to design and perform tests of controls that address such risks of material misstatement when substantive procedures alone do not provide sufficient appropriate audit evidence at the assertion level. As a result, when such controls exist that address these risks, they are required to be identified and evaluated.

A176. In other cases, when the auditor plans to take into account the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures in accordance with ISA 330, such controls are also required to be identified because ISA 330⁵⁰ requires the auditor to design and perform tests of those controls.

Examples:

The auditor may plan to test the operating effectiveness of controls:

- Over routine classes of transactions because such testing may be more effective or efficient for large volumes of homogenous transactions.
- Over the completeness and accuracy of information produced by the entity (e.g., controls over the preparation of system-generated reports), to determine the reliability of that information, when the auditor intends to take into account the operating effectiveness of those controls in designing and performing further audit procedures.
- Relating to operations and compliance objectives when they relate to data the auditor evaluates or uses in applying audit procedures.

A177. The auditor's plans to test the operating effectiveness of controls may also be influenced by the identified risks of material misstatement at the financial statement level. For example, if deficiencies are identified related to the control environment, this may affect the auditor's overall expectations about the operating effectiveness of direct controls.

⁴⁹ ISA 330, paragraph 8(b)

⁵⁰ ISA 330, paragraph 8(a)

Other cControls that address risks that could be but are not determined to be significant risksthe auditor considers appropriate (Ref: Para. 39(a)(iv))

~~A1773a. Where the assessments of the risks of material misstatement at the assertion level fall on the spectrum of inherent risk, as well as the determination of significant risks, is a matter of the auditor's professional judgment. Other controls that the auditor may consider are appropriate to identify, and evaluate the design and determine the implementation, may include:~~

- ~~• Whether the auditor identifies cControls that address assessed risks for which the effect of the inherent risk factors indicates that there is a reasonable possibility that the assessed risks could be a significant risk. Controls that address risks assessed as higher on the spectrum of inherent risk but have not been determined to be a significant risk is also a matter of professional judgment.~~
- ~~• Controls related to reconciling detailed records to the general ledger; or~~
- ~~• Complementary user entity user controls, if using a service organization.⁵¹~~

~~A173b. The guidance in paragraph A173a also applies to controls that address risks that could but but are not determined to be significant risks.~~

Identifying IT Applications and Other Aspects of the IT Environment-, Risks Arising from the Use of IT and General IT Controls (Ref: Para. 39(b)–(c))

Appendix 5 includes example characteristics of IT applications and other aspects of the IT environment, and guidance related to those characteristics, that may be relevant in identifying IT applications and other aspects of the IT environment subject to risks arising from the use of IT.

Identifying IT applications and other aspects of the IT environment (Ref: Para. 39(b))

Why the auditor identifies risks arising from the use of IT and general IT controls related to identified IT applications and other aspects of the IT environment

A179a. Understanding the risks arising from the use of IT and the general IT controls implemented by the entity to address those risks may affect:

- The auditor's decision about whether to test the operating effectiveness of controls to address risks of material misstatement at the assertion level;

Example:

When general IT controls are not designed effectively or appropriately implemented to address risks arising from the use of IT (e.g., controls do not appropriately prevent or detect unauthorized program changes or unauthorized access to IT applications), this may affect the auditor's decision to rely on automated controls within the affected IT applications.

- The auditor's assessment of control risk at the assertion level;

⁵¹ [ISA 402, Auditor Considerations Relating to an Entity Using a Service Organization](#)

Example:

The ongoing operating effectiveness of an information processing control may depend on certain general IT controls that prevent or detect unauthorized program changes to the IT information processing control (i.e. program change controls over the related IT application). In such circumstances, the expected operating effectiveness (or lack thereof) of the general IT control may affect the auditor's assessment of control risk (e.g., control risk may be higher when such general IT controls are expected to be ineffective or if the auditor does not plan to test the general IT controls).

- The auditor's strategy for testing information produced by the entity that is produced by or involves information from the entity's IT applications;

Example:

When information produced by the entity to be used as audit evidence is produced by IT applications, the auditor may determine to test controls over system-generated reports, including identification and testing of the general IT controls that address risks of inappropriate or unauthorized program changes or direct data changes to the reports.

- The auditor's assessment of inherent risk at the assertion level; or

Example:

When there are significant or extensive programming changes to an IT application to address new or revised reporting requirements of the applicable financial reporting framework, this may be an indicator of the complexity of the new requirements and their effect on the entity's financial statements. When such extensive programming or data changes occur, the IT application is also likely to be subject to risks arising from the use of IT.

- The design of further audit procedures.

Example:

~~If~~ if information processing controls depend on general IT controls, the auditor may determine to test the operating effectiveness of the general IT controls, which will then require the design of tests of controls ~~procedures~~ procedures for ~~these-such~~ these general IT controls. If, in the same circumstances, the auditor determines not to test the operating effectiveness of the general IT controls, or the general IT controls are expected to be ineffective, the related risks arising from the use of IT may need to be addressed through the design of substantive procedures. However, the risks arising from the use of IT may not be able to be addressed when such risks relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence. In such circumstances, the auditor may need to consider the implications for the audit opinion.

Identifying IT applications that are subject to risks arising from the use of IT

A180. For the IT applications relevant to the information system, understanding the nature and complexity of the specific IT processes and general IT controls that the entity has in place may assist the auditor in determining which IT applications the entity is relying upon to accurately process and maintain the integrity of information in the entity's information system. Such IT applications may be subject to risks arising from the use of IT.

A180a. Identifying the IT applications that are subject to risks arising from the use of IT involves taking into account controls identified by the auditor because such controls may involve the use of IT or rely on IT. The auditor may focus on whether an IT application includes automated controls that management is relying on and that the auditor has identified, including controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence. The auditor may also consider how information is stored and processed in the information system relating to significant classes of transactions, account balances and disclosures and whether management is relying on general IT controls to maintain the integrity of that information.

A180b. The controls identified by the auditor may depend on system-generated reports, in which case the IT applications that produce those reports may be subject to risks arising from the use of IT. In other cases, the auditor may not plan to rely on controls over the system-generated reports and plan to directly test the inputs and outputs of such reports, in which case the auditor may not identify the related IT applications as being subject to risks arising from IT.

Scalability

A180c. The extent of the auditor's understanding of the IT processes, including the extent to which the entity has general IT controls in place, will vary with the nature and the circumstances of the entity and its IT environment, as well as based on the nature and extent of controls identified by the auditor. The number of IT applications that are subject to risks arising from the use of IT also will vary based on these factors.

Examples:

- An entity that uses commercial software and does not have access to the source code to make any program changes is unlikely to have a process for program changes, but may have a process or procedures to configure the software (e.g., the chart of accounts, reporting parameters or thresholds). In addition, the entity may have a process or procedures to manage access to the application (e.g., a designated individual with administrative access to the commercial software). In such circumstances, the entity is unlikely to have or need formalized general IT controls.
- In contrast, a larger entity may rely on IT to a great extent and the IT environment may involve multiple IT applications and the IT processes to manage the IT environment may be complex (e.g., a dedicated IT department exists that develops and implements program changes and manages access rights), including that the entity has implemented formalized general IT controls over its IT processes.

- When management is not relying on automated controls or general IT controls to process transactions or maintain the data, and the auditor has not identified any automated controls or other information processing controls (or any that depend on general IT controls), the auditor may plan to directly test any information produced by the entity involving IT and may not identify any IT applications that are subject to risks arising from the use of IT.
- When management relies on an IT application to process or maintain data and the volume of data is significant, and management relies upon the IT application to perform automated controls that the auditor has also identified, the IT application is likely to be subject to risks arising from the use of IT.

A180d. When an entity has greater complexity in its IT environment, identifying the IT applications and other aspects of the IT environment, determining the related risks arising from the use of IT, and identifying general IT controls is likely to require the involvement of team members with specialized skills in IT. Such involvement is likely to be essential, and may need to be extensive, for complex IT environments.

Identifying other aspects of the IT environment that are subject to risks arising from the use of IT

A188. The other aspects of the IT environment that may be subject to risks arising from the use of IT include the network, operating system and databases, and in certain circumstances interfaces between IT applications. Other aspects of the IT environment are ~~also generally~~ not identified when the auditor does not identify IT applications that are subject to risks arising from the use of IT. When the auditor has identified IT applications that are subject to risks arising from IT, other aspects of the IT environment (e.g., database, operating system, network) are likely to be identified because such aspects support and interact with the identified IT applications.

Identifying Risks Arising from the Use of IT and General IT Controls (Ref: Para. 39(c))

Appendix 6 sets out considerations for understanding general IT controls.

A188a. In identifying the risks arising from the use of IT, the auditor may consider the nature of the identified IT application or other aspect of the IT environment and the reasons for it being subject to risks arising from the use of IT. For some identified IT applications or other aspects of the IT environment, the auditor may identify applicable risks arising from the use of IT that relate primarily to unauthorized access or unauthorized program changes, as well as that address risks related to inappropriate data changes (e.g., the risk of inappropriate changes to the data through direct database access or the ability to directly manipulate information).

A189. The extent and nature of the applicable risks arising from the use of IT vary depending on the nature and characteristics of the identified IT applications and other aspects of the IT environment. Applicable IT risks may result when the entity uses external or internal service providers for identified aspects of its IT environment (e.g., outsourcing the hosting of its IT environment to a third party or using a shared service center for central management of IT processes in a group). Applicable risks arising from the use of IT may also be identified related to cybersecurity. It is more likely that there will be more risks arising from the use of IT when the volume or complexity of automated application

controls is higher and management is placing greater reliance on those controls for effective processing of transactions or the effective maintenance of the integrity of underlying information.

Evaluating the Design, and Determining Implementation of, Identified Controls in the Control Activities Component (Ref: Para 39(d))

A194. Evaluating the design of an identified control involves the auditor's consideration of whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements (i.e., the control objective).

A194a. The auditor determines the implementation of an identified control by establishing that the control exists and that the entity is using it. There is little point in the auditor assessing the implementation of a control that is not designed effectively. Therefore, the auditor evaluates the design of a control first. An improperly designed control may represent a control deficiency.

A198. Risk assessment procedures to obtain audit evidence about the design and implementation of identified controls in the control activities component may include:

- Inquiring of entity personnel.
- Observing the application of specific controls.
- Inspecting documents and reports.

Inquiry alone, however, is not sufficient for such purposes.

A198a. The auditor may expect, based on their experience from the previous audit or based on their current year period risk assessment procedures, that management does not have effectively designed or implemented controls to address a significant risk. In such instances, the procedures performed to address the requirement in paragraph 39(d) may consist of determining that such controls have not been effectively designed or implemented. If the results of the procedures indicate that controls have been newly designed or implemented, the auditor is required to perform the procedures in paragraph 39(b)-(d) to the newly designed or implemented controls.

A198~~b~~a. The auditor may conclude that a control, which is effectively designed and implemented, may be appropriate to test in order to take its operating effectiveness into account in designing substantive procedures. However, when a control is not designed or implemented effectively, there is no benefit in testing it. When the auditor plans to test a control, the information obtained about the extent to which the control addresses the risk(s) of material misstatement is an input to the auditor's control risk assessment at the assertion level.

A199. Evaluating the design and determining the implementation of identified controls in the control activities component is not sufficient to test their operating effectiveness. However, for automated controls, the auditor may plan to test the operating effectiveness of automated controls by identifying and testing general IT controls that provide for the consistent operation of an automated control instead of performing tests of operating effectiveness on the automated controls directly. Obtaining audit evidence about the implementation of a manual control at a point in time does not provide audit evidence about the operating effectiveness of the control at other times during the period under audit.

Tests of the operating effectiveness of controls, including tests of indirect controls, are further described in ISA 330.⁵²

A200. When the auditor does not plan to test the operating effectiveness of identified controls, the auditor's understanding may still assist in the design of the nature, timing and extent of substantive audit procedures that are responsive to the related risks of material misstatement.

Example:

The results of these risk assessment procedures may provide a basis for ~~inform~~ the auditor's consideration of possible deviations in a population when designing audit samples.

Control Deficiencies Within the Entity's System of Internal Control (Ref: Para. 43)

A200a. In performing the evaluations of each of the components of the entity's system of internal control,⁵³ the auditor may determine that certain of the entity's policies in a component are not appropriate to the nature and circumstances of the entity. Such a determination may be an indicator that assists the auditor in identifying control deficiencies.

A200b If the auditor has identified one or more control deficiencies the auditor considers the effect of those deficiencies on the identification and assessment of risk and the effect of the design of further audit procedures as required by paragraph ~~xx~~17.

A200c. If the auditor has identified one or more control deficiencies, ISA 265⁵⁴ requires the auditor to determine whether, individually or in combination, the deficiencies constitute a significant deficiency. The auditor uses professional judgment in determining whether a deficiency represents a significant control deficiency.⁵⁵

Examples:

Circumstances that may indicate a significant control deficiency exists include matters such as:

- The identification of fraud of any magnitude that involves senior management;
- Identified internal processes that are inadequate relating to the reporting and communication of deficiencies noted by internal audit;
- Previously communicated deficiencies that are not corrected by management in a timely manner;

⁵² ISA 330, paragraphs 8–11

⁵³ Paragraphs 28(b), 30(b), 31A(c), 36(c) and 39(d)

⁵⁴ ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, paragraph 8

⁵⁵ ISA 265, paragraphs A6–A7 set out indicators of significant deficiencies, and matters to be considered in determining whether a deficiency, or a combination of deficiencies, in internal control constitute a significant deficiency.

- Failure by management to respond to significant risks, for example, by not implementing controls over significant risks; and
- The restatement of previously issued financial statements.

Identifying and Assessing the Risks of Material Misstatement (Ref: Para. 45–54)

Why the Auditor Identifies and Assesses the Risks of Material Misstatement

A201. Risks of material misstatement are identified and assessed by the auditor in order to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

A201a. Information gathered by performing risk assessment procedures is used as audit evidence to provide the basis for the identification and assessment of the risks of material misstatement. For example, the audit evidence obtained when evaluating the design of identified controls and determining whether those controls have been implemented, in the control activities component, is used as audit evidence to support the risk assessment. ~~The basis for the risk assessment also provides. Such evidence for also provides at the~~ basis for the auditor to design overall responses to address the assessed risks of material misstatement at the financial statement level, as well as ~~designing and performing further audit procedures, whose the~~ nature, timing and extent ~~—are responsive to the assessed risks of material misstatement at the assertion level, of further audit procedures to be performed~~ in accordance with ISA 330.

Identifying Risks of Material Misstatement

~~A202. The identification of risks of material misstatement is performed before consideration of any related controls (i.e., the inherent risk), and is based on the auditor's preliminary consideration of misstatements that have a reasonable possibility of both occurring, and being material if they were to occur. there is a reasonable possibility of the misstatement being material.~~⁵⁶

A202a. Identifying the risks of material misstatement also provides the basis for the auditor's determination of relevant assertions, which assists the auditor's determination of the significant classes of transactions, account balances and disclosures.

Assertions

Why the Auditor Uses Assertions

A202b. In identifying and assessing the risks of material misstatement, the auditor uses assertions to consider the different types of potential misstatements that may occur. Assertions for which the auditor has identified related risks of material misstatement are relevant assertions.

⁵⁶ [ISA 200, paragraph A15a](#)

The Use of Assertions

A203. In identifying and assessing the risks of material misstatement, the auditor may use the categories of assertions as described in paragraph A204(a)–(b) below or may express them differently provided all aspects described below have been covered. The auditor may choose to combine the assertions about classes of transactions and events, and related disclosures, with the assertions about account balances, and related disclosures.

A204. Assertions used by the auditor in considering the different types of potential misstatements that may occur may fall into the following categories:

- (a) Assertions about classes of transactions and events, and related disclosures, for the period under audit:
 - (i) Occurrence—transactions and events that have been recorded or disclosed, have occurred, and such transactions and events pertain to the entity.
 - (ii) Completeness—all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
 - (iii) Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.
 - (iv) Cutoff—transactions and events have been recorded in the correct accounting period.
 - (v) Classification—transactions and events have been recorded in the proper accounts.
 - (vi) Presentation—transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.
- (b) Assertions about account balances, and related disclosures, at the period end:
 - (i) Existence—assets, liabilities, and equity interests exist.
 - (ii) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
 - (iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
 - (iv) Accuracy, valuation and allocation—assets, liabilities, and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.
 - (v) Classification—assets, liabilities and equity interests have been recorded in the proper accounts.

- (vi) Presentation—assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

A205. The assertions described in paragraph A204(a)–(b) above, adapted as appropriate, may also be used by the auditor in considering the different types of misstatements that may occur in disclosures not directly related to recorded classes of transactions, events, or account balances.

Example:

An example of such a disclosure includes where the entity may be required by the applicable financial reporting framework to describe its exposure to risks arising from financial instruments, including how the risks arise; the objectives, policies and processes for managing the risks; and the methods used to measure the risks.

Considerations Specific to Public Sector Entities

A206. When making assertions about the financial statements of public sector entities, in addition to those assertions set out in paragraph A204(a)–(b), management may often assert that transactions and events have been carried out in accordance with law, regulation or other authority. Such assertions may fall within the scope of the financial statement audit.

Risks of Material Misstatement at the Financial Statement Level (Ref: Para. 45(a) and Para. 47)

Why the Auditor Identifies and Assesses Risks of Material Misstatement at the Financial Statement Level

A206a. The auditor identifies risks of material misstatement at the financial statement level to determine whether the risks have a pervasive effect on the financial statements, and would therefore require an overall response in accordance with ISA 330.⁵⁷

A206aa. In addition, risks of material misstatement at the financial statement level may also affect individual assertions, and identifying these risks may assist the auditor in assessing risks of material misstatement at the assertion level, and in designing further audit procedures to address the identified risks.

Example:

~~Weak policies for recruiting of competent individuals may influence control risk in performing information processing controls.~~

Identifying and Assessing Risks of Material Misstatement at the Financial Statement Level

A207. Risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial statements as a whole, and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level (e.g., risk of management override of controls). Rather, they represent

⁵⁷ ISA 330, paragraph 5

circumstances that may pervasively increase the risks of material misstatement at the assertion level. The auditor's evaluation of whether risks identified relate pervasively to the financial statements supports the auditor's assessment of the risks of material misstatement at the financial statement level. In other cases, a number of assertions may also be identified as susceptible to the risk, and may therefore affect the auditor's risk identification and assessment of risks of material misstatement at the assertion level.

Example:

The entity faces operating losses and liquidity issues and is reliant on funding that has not yet been secured. In such a circumstance, the auditor may determine that the going concern basis of accounting gives rise to a risk of material misstatement at the financial statement level. In this situation, the accounting framework may need to be applied using a liquidation basis, which would likely affect all assertions pervasively.

A207a. The auditor's identification and assessment of risks of material misstatement at the financial statement level is influenced by the auditor's understanding of the entity's system of internal control, in particular the auditor's understanding of the control environment, the entity's risk assessment process and the entity's process to monitor the system of internal control, and:

- The outcome of the related evaluations required by paragraphs 28(b), 30(b), ~~and~~ 31A(c) and 36(c); and
- Any control deficiencies identified in accordance with paragraph 43.

In particular, risks at the financial statement level may arise from deficiencies in the control environment or from external events or conditions such as declining economic conditions.

A207b. Risks of material misstatement due to fraud may be particularly relevant to the auditor's consideration of the risks of material misstatement at the financial statement level.

Example:

The auditor understands from inquiries of management that the entity's financial statements are to be used in discussions with lenders in order to secure further financing to maintain working capital. The auditor may therefore determine that there is a greater susceptibility to misstatement due to ~~other~~ fraud risk factors that affect inherent risk (i.e., the susceptibility of the financial statements to material misstatement because of the risk of fraudulent financial reporting, such as overstatement of assets and revenue and under-statement of liabilities and expenses to ensure that financing will be obtained).

A207c. The auditor's understanding, including the related evaluations, of the control environment and other components of the system of internal control may raise doubts about the ~~ability of the financial statements to be audited, such that it may affect the auditor's expectations about the auditor's~~ ability to obtain audit evidence on which to base the audit opinion or be cause for withdrawal from the engagement where withdrawal is possible under applicable law or regulation.

Examples:

- ~~As a result of~~ evaluating the entity's control environment, the auditor has concerns about the integrity of the entity's management, which may be so serious as to cause the auditor to conclude that the risk of intentional misrepresentation by management ~~misrepresentation~~ in the financial statements is such that an audit cannot be conducted.
- ~~As a result of~~ evaluating the entity's information system and communication, the auditor determines that significant changes in the IT environment have been poorly managed, with little oversight from management and those charged with governance. The auditor concludes that there are significant concerns about the condition and reliability of the entity's accounting records. In such circumstances, the auditor may determine that it is unlikely that sufficient appropriate audit evidence will be available to support an unmodified opinion on the financial statements.

A207d. ISA 705 (Revised)⁵⁸ establishes requirements and provides guidance in determining whether there is a need for the auditor to express a qualified opinion or disclaim an opinion or, as may be required in some cases, to withdraw from the engagement where withdrawal is possible under applicable law or regulation.

Considerations Specific to Public Sector Entities

A207e. For public sector entities, the identification of risks at the financial statement level may include consideration of matters related to the political climate, public interest and program sensitivity.

Risks of Material Misstatement at the Assertion Level (Ref: Para. 45(b))

Appendix 2 sets out examples, in the context of ~~the~~ inherent risk factors, of events or ~~and~~ conditions that may indicate susceptibility to misstatement that may be material.

A208. Risks of material misstatements that do not relate pervasively to the financial statements are risks of material misstatement at the assertion level.

~~A208a. The identification of risks of material misstatement at the assertion level is performed before consideration of any related controls, and is based on the auditor's consideration/determination of those misstatements that could have a reasonable possibility of occurring (i.e., have a reasonable possibility to) occur, and if it were to occur, having a reasonable possibility of being/be material if they were to occur.⁵⁹~~

⁵⁸ ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

⁵⁹ ~~Proposed ISA 200, paragraphs 13(n) and A15~~ 51a

Relevant Assertions and Significant Classes of Transactions, Account Balances and Disclosures (Ref: Para. 46)

Why Relevant Assertions and Significant Classes of Transactions, Account Balances and Disclosures are Determined

A211. ~~In determining the relevant assertions, the auditor considers the information gathered from the auditor's risk assessment procedures to understand the entity and its environment, the applicable financial reporting framework and the entity's system of internal control (i.e., the information about the identified risks of material misstatement and the assertions that they may affect).~~ Determining the significant classes of transactions, account balances and disclosures provides the basis for the scope of the auditor's understanding of the entity's information system required to be obtained in accordance with paragraph 36. This understanding may further assist the auditor in identifying and assessing risks of material misstatement (see A102).

Automated Tools and Techniques

A213. The auditor may use automated techniques to assist in the identification of significant classes of transactions, account balances and disclosures.

Examples:

- An entire population of transactions may be analyzed using automated tools and techniques to understand their nature, source, size and volume. By applying automated techniques, the auditor may, for example, identify that an account with a zero balance at period end was comprised of numerous offsetting transactions and journal entries occurring during the period, indicating that the account balance or class of transactions may be significant (e.g., a payroll clearing account). This same payroll clearing account may also identify expense reimbursements to management (and other employees), which could be a significant disclosure due to these payments being made to related parties.
- By analyzing the flows of an entire population of revenue transactions, the auditor may more easily identify a significant class of transactions that had not previously been identified.

Disclosures that May be Significant

A214. Significant disclosures include both quantitative and qualitative disclosures for which there is one or more relevant assertions. Examples of disclosures that have qualitative aspects and that may have relevant assertions and may therefore be considered significant by the auditor include disclosures about:

- Liquidity and debt covenants of an entity in financial distress.
- Events or circumstances that have led to the recognition of an impairment loss.
- Key sources of estimation uncertainty, including assumptions about the future.
- The nature of a change in accounting policy, and other relevant disclosures required by the applicable financial reporting framework, where, for example, new financial reporting

requirements are expected to have a significant impact on the financial position and financial performance of the entity.

- Share-based payment arrangements, including information about how any amounts recognized were determined, and other relevant disclosures.
- Related parties, and related party transactions.
- Sensitivity analysis, including the effects of changes in assumptions used in the entity's valuation techniques intended to enable users to understand the underlying measurement uncertainty of a recorded or disclosed amount.

Assessing Risks of Material Misstatement at the Assertion Level

Assessing Inherent Risk (Ref: Para. 48–50)

Assessing the likelihood and magnitude of ~~the risks of material~~ misstatement ~~at the assertion level~~ (Ref: Para: 48)

Why the auditor assesses likelihood and magnitude of ~~risks of material~~ misstatement ~~at the assertion level~~

A220a. The auditor assesses the likelihood and magnitude of ~~material~~ misstatement for identified risks of material misstatement because the significance of the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement ~~should were the that~~ misstatement to occur determines where on the spectrum of inherent risk the identified risk is assessed, which informs the auditor's design of further audit procedures to address the risk.

A220b. Assessing the inherent risk of identified risks of material misstatement also assists the auditor in determining significant risks. The auditor determines significant risks because specific responses to significant risks are required in accordance with ISA 330 and other ISAs.

A221. ~~The~~ inherent risk factors influence the auditor's assessment of the likelihood and magnitude of misstatement for the identified risks of material misstatement at the assertion level. The greater the degree to which a class of transactions, account balance or disclosures is susceptible to material misstatement, the higher the inherent risk assessment is likely to be. Considering the ~~influence~~ degree to which ~~the~~ inherent risk factors affect the susceptibility of an assertion to misstatement assists the auditor in appropriately assessing inherent risk for the risks of material misstatement at the assertion level and in designing a more precise response to ~~an assessed~~ such a risk ~~of material misstatement~~.

Spectrum of inherent risk

A221a. In assessing inherent risk, the auditor uses professional judgment in determining the significance of the combination of the likelihood and magnitude of a misstatement.

A221b. The assessed inherent risk relating to a particular risk of material misstatement at the assertion level represents a judgment within a range, from lower to higher, on the spectrum of inherent risk. The judgment about where in the range ~~the~~ inherent risk is assessed may vary based on the nature, size and complexity of the entity, and takes into account the assessed likelihood and magnitude of the misstatement and ~~the~~ inherent risk factors.

A221c. In considering the likelihood of a misstatement, the auditor considers the possibility that a misstatement may occur, based on consideration of the inherent risk factors.

A222. In considering the magnitude of a misstatement, the auditor considers the qualitative and quantitative aspects of the possible misstatement (i.e., misstatements in assertions about classes of transactions, account balances or disclosures may be judged to be material due to size, nature or circumstances).

A222a. The auditor uses the significance of the combination of the likelihood and magnitude of a possible misstatement ~~to assist~~ in determining where on the spectrum of inherent risk (i.e., the range) inherent risk is assessed. The higher the combination of likelihood and magnitude, the higher the assessment of inherent risk; the lower the combination of likelihood and magnitude, the lower the assessment of inherent risk.

A222b. For a risk to be assessed as higher on the spectrum of inherent risk, it does not mean that both the magnitude and likelihood need to be assessed as high. Rather, it is the intersection of the magnitude and likelihood of the material misstatement on the spectrum of inherent risk that will determine whether the assessed inherent risk is higher or lower on the spectrum of inherent risk. A higher inherent risk assessment may also arise from different combinations of likelihood and magnitude, for example a higher inherent risk assessment could result from a lower likelihood but a very high magnitude.

A225. In order to develop appropriate strategies for responding to risks of material misstatement, the auditor may designate risks of material misstatement within categories along the spectrum of inherent risk, based on their assessment of inherent risk. These categories may be described in different ways. Regardless of the method of categorization used, the auditor's assessment of inherent risk is appropriate when the design and implementation of further audit procedures to address the identified risks of material misstatement at the assertion level is appropriately responsive to the assessment of inherent risk and the reasons for that assessment.

Pervasive Risks of Material Misstatement at the Assertion Level (Ref: Para 48(~~ba~~))

A226. In assessing the identified risks of material misstatement at the assertion level, the auditor may conclude that some risks of material misstatement relate more pervasively to the financial statements as a whole and potentially affect many assertions, in which case the auditor may update the identification of risks of material misstatement at the financial statement level.

A227. In circumstances in which risks of material misstatement are identified as financial statement level risks due to their pervasive effect on a number of assertions, and are identifiable with specific assertions, the auditor is required to take into account those risks when assessing ~~the~~ inherent risk for risks of material misstatement at the assertion level.

Considerations Specific to Public Sector Entities

A228. In exercising professional judgment as to the assessment of the risk of material misstatement, public sector auditors may consider the complexity of the regulations and directives, and the risks of non-compliance with authorities.

Significant Risks (Ref: Para. 49)

Why significant risks are determined and the implications for the audit

A228a. ~~The determination of significant risks allows for the auditor to focus more attention on those risks that are on the higher end of the spectrum, through the performance of certain~~ The significance of a risk of material misstatement at the assertion level is considered in the context of the implications of the assessment of its inherent risk for the performance of the audit, including the nature, timing and extent of the auditor's further audit procedures, and the persuasiveness of the audit evidence that will be required to reduce audit risk to an acceptably low level. When a risk is determined to be a significant risk, the design and implementation of an appropriate response to address the assessed risk may include, for example, the use of more experienced engagement team members, including those with specialized skills, to perform audit procedures or audit work may involve the use of experts. In addition, the ISAs set out required responses, including:

- Controls that address significant risks are required to be identified in accordance with paragraph 39(a)(i), with a requirement to evaluate whether the control has been designed effectively and implemented in accordance with paragraph 39(d).
- ISA 330 requires controls that address significant risks to be tested in the current period (when the auditor intends to rely on the operating effectiveness of such controls) and substantive procedures to be planned and performed that are specifically responsive to the identified significant risk.⁶⁰
- ISA 330 requires the auditor to obtain more persuasive audit evidence the higher the auditor's assessment of risk.⁶¹
- ISA 260 (Revised) requires communicating with those charged with governance about the significant risks identified by the auditor.⁶²
- ISA 701 requires the auditor to take into account significant risks when determining those matters that required significant auditor attention, which are matters that may be key audit matters.⁶³
- Timely r~~Review of audit documentation by the engagement partner on or before the date of the auditor's report which~~at the appropriate stages during the audit allows significant matters, including significant risks, to be resolved on a timely basis to the engagement partner's satisfaction on or before the date of the auditor's report.⁶⁴
- ISA 600 requires more involvement by the group engagement partner if the significant risk relates to a component in a group audit and for the group engagement team to direct the work required at the component by the component auditor.⁶⁵

⁶⁰ ISA 330, paragraphs 15 and 21

⁶¹ ISA 330, paragraph 7(b)

⁶² ISA 260 (Revised), paragraph 15

⁶³ ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, paragraph 9

⁶⁴ ISA 220, paragraphs 17 and –A19

⁶⁵ ISA 600, paragraphs 30 and 31

~~A229. Required responses to significant risks may also be appropriate for risks assessed as higher on the spectrum of inherent risk where there is a reasonable possibility that the assessed risks could be significant risks but that the auditor has determined is not a significant risk.~~

Determining significant risks

A229a. In determining significant risks, the auditor may first identify those assessed risks of material misstatement that have been assessed higher on the spectrum of inherent risk to form the basis for considering which risks may be close to the upper end. Being close to the upper end of the spectrum of inherent risk will differ from entity to entity, and will not necessarily be the same for an entity period on period. It may depend on the nature and circumstances of the entity for which the risk is being assessed.

A229aa. The determination of which of the assessed risks of material misstatement are close to the upper end of the spectrum of inherent risk, and are therefore significant risks, is a matter of professional judgment, unless the risk is of a type specified to be treated as a significant risk in accordance with the requirements of another ISA. ISA 240 provides further requirements and guidance in relation to the identification and assessment of the risks of material misstatement due to fraud.⁶⁶

Example:

- Cash at a supermarket retailer would ordinarily be determined to be a high likelihood of possible misstatement (due to the risk of cash being misappropriated), however the magnitude would typically be very low (due to the low levels of physical cash handled in the stores). The combination of these two factors on the spectrum of inherent risk would be unlikely to result in the existence of cash being determined to be a significant risk.
- An entity is in negotiations to sell a business segment. The auditor considers the effect on goodwill impairment, and may determine there is a higher likelihood of possible misstatement and a higher magnitude due to the impact of ~~the~~ inherent risk factors of subjectivity~~judgment~~, uncertainty, and susceptibility to management bias or other fraud risk factors. This may result in goodwill impairment being determined to be a significant risk.

A229b. The auditor also takes into the account the relative effects of ~~the~~ inherent risk factors when assessing inherent risk. The lower the effect of ~~the~~ inherent risk factors, the lower the assessed risk is likely to be. ~~However, r~~Risks of material misstatement that may be assessed as having higher inherent risk and may therefore be determined to be a significant risk, may arise from matters such as the following:

- Transactions for which there are multiple acceptable accounting treatments such that subjectivity is involved.
- Accounting estimates that have high estimation uncertainty or complex models.
- Complexity in data collection and processing to support account balances.
- Account balances or quantitative disclosures that involve complex calculations.

⁶⁶ ISA 240, paragraphs 26–28

- Accounting principles that may be subject to differing interpretation.
- Changes in the entity's business that involve changes in accounting, for example, mergers and acquisitions.

Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence (Ref: Para. 504)

Why risks for which substantive procedures alone do not provide sufficient appropriate audit evidence are required to be identified

A231a. Due to the nature of a risk of material misstatement, and the control activities that address that risk, in some circumstances the only way to obtain sufficient appropriate audit evidence is to test the operating effectiveness of controls. Accordingly, there is a requirement for the auditor to identify any such risks because of the implications for the design and performance of further audit procedures in accordance with ISA 330 to address risks of material misstatement at the assertion level.

A231b. Paragraph 39(a)(iv) also requires the identification of controls that address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence because the auditor is required, in accordance with ISA 330,⁶⁷ to design and perform tests of such controls.

Determining risks for which substantive procedures alone do not provide sufficient appropriate audit evidence

A231d. Where routine business transactions are subject to highly automated processing with little or no manual intervention, it may not be possible to perform only substantive procedures in relation to the risk. This may be the case in circumstances where a significant amount of an entity's information is initiated, recorded, processed, or reported only in electronic form such as in an information system that involves a high-degree of integration across its IT applications. In such cases:

- Audit evidence may be available only in electronic form, and its sufficiency and appropriateness usually depend on the effectiveness of controls over its accuracy and completeness.
- The potential for improper initiation or alteration of information to occur and not be detected may be greater if appropriate controls are not operating effectively.

Example:

It is typically not possible to obtain sufficient appropriate audit evidence relating to revenue for a telecommunications entity based on substantive procedures alone. This is because the evidence of call or data activity does not exist in a form that is observable. Instead, substantial controls testing is typically performed to determine that the origination and completion of calls, and data activity is correctly captured (e.g., minutes of a call or volume of a download) and recorded correctly in the entity's billing system.

⁶⁷ ISA 330, paragraph 8

A231e. ISA 540 (Revised) provides further guidance related to accounting estimates about risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.⁶⁸ In relation to accounting estimates this may not be limited to automated processing, but may also be applicable to complex models.

Assessing Control Risk (Ref: Para. 51)

A232. The auditor's plans to test the operating effectiveness of controls is based on the expectation that controls are operating effectively, and this will form the basis of the auditor's assessment of control risk. The initial expectation of the operating effectiveness of controls is based on the auditor's evaluation of the design, and the determination of implementation, of the identified controls in the control activities component. Once the auditor has tested the operating effectiveness of the controls in accordance with ISA 330, the auditor will be able to confirm the initial expectation about the operating effectiveness of controls. If the controls are not operating effectively as expected, then the auditor will need to revise the control risk assessment in accordance with paragraph 53.

A233. The auditor's assessment of control risk may be performed in different ways depending on preferred audit techniques or methodologies, and may be expressed in different ways.

A234. If the auditor plans to test the operating effectiveness of controls, it may be necessary to test a combination of controls ~~may be necessary to test~~ confirm the auditor's expectation that the controls are operating effectively ~~to address the assessed inherent risk for the risk of material misstatement.~~ The auditor may expect plan to test both direct and indirect controls, including general IT controls, and, if so, takes into account the combined expected effect of the controls when assessing control risk. ~~If To the extent that~~ the control to be tested does not fully address the assessed inherent risk ~~of the risk of material misstatement~~, the auditor determines the implications on the design of further audit procedures to reduce audit risk to an acceptably low level.

A235a. When the auditor plans to test the operating effectiveness of an automated control, the auditor may also plan to test the operating effectiveness of the relevant general IT controls that support the continued functioning of that automated control to address the risks arising from the use of IT, and to provide a basis for the auditor's expectation that the automated control operated effectively throughout the period. When the auditor expects related general IT controls to be ineffective, this determination may affect the auditor's assessment of control risk at the assertion level and the auditor's further audit procedures may need to include substantive procedures to address the applicable risks arising from the use of IT. Further guidance about the procedures that the auditor may perform in these circumstances is provided in ISA 330.⁶⁹

Evaluating Audit Evidence Obtained from Risk Assessment Procedures (Ref: Para 51A)

Why the Auditor Evaluates Audit Evidence from Risk Assessment Procedures

A239a. ~~Audit evidence obtained from performing risk assessment procedures provides the basis for the identification and assessment of the risk of material misstatement.~~ t. This ~~which~~ provides the basis for ~~t~~he auditor's design of the nature, timing and extent of further audit procedures responsive to

⁶⁸ ISA 540 (Revised), paragraphs A87–A89

⁶⁹ ISA 330, paragraphs A29–A30~~1~~

the assessed risks of material misstatement, at the assertion level, in accordance with ISA 330. Accordingly, the ~~auditor's consideration of the nature and sufficiency of~~ audit evidence obtained from the risk assessment procedures provides a basis for the identification and assessment of risks of material misstatement is whether due to fraud or error, at the financial statement and assertion levels, important to support the appropriateness of the auditor's risk assessments.

The Evaluation of the Audit Evidence

A239~~baa~~. Audit evidence from risk assessment procedures comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.⁷⁰
~~Obtaining audit evidence from risk assessment procedures in an unbiased manner may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence.~~

Professional skepticism

A239c. In evaluating the audit evidence from the risk assessment procedures, the auditor considers whether sufficient understanding about the entity and its environment, the applicable financial reporting framework and the entity's system of internal control has been obtained to be able to identify the risks of material misstatement, as well as whether there is any evidence that is contradictory that may indicate a risk of material misstatement.

Classes of Transactions, Account Balances and Disclosures that are Not Significant, but are Material (Ref: Para. 52)

A240. As explained in ISA 320,⁷¹ materiality and audit risk are considered when identifying and assessing the risks of material misstatement in classes of transactions, account balances and disclosures. The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial reporting needs of users of the financial statements.⁷² For the purpose of this ISA and paragraph 18 of ISA 330, classes of transactions, account balances or disclosures are material if omitting, misstating or obscuring information about them could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements as a whole.

A241. There may be classes of transactions, account balances or disclosures that are material but have not been determined to be significant classes of transactions, account balances or disclosures (i.e., there are no relevant assertions identified).

⁷⁰ ISA 500, paragraph A1

⁷¹ ISA 320, paragraph A1

⁷² ISA 320, paragraph 4

Example:

The entity may have a disclosure about executive compensation for which the auditor has not identified a risk of material misstatement. However, the auditor may determine that this disclosure is material based on the considerations in paragraph A240.

A242. Audit procedures to address classes of transactions, account balances or disclosures that are material but are not determined to be significant are addressed in ISA 330.⁷³ When a class of transactions, account balance or disclosure is determined to be significant as required by paragraph 46, the class of transactions, account balance or disclosure is also ~~treated as~~ a material class of transactions, account balance or disclosure for the purposes of paragraph 18 of ISA 330.

Revision of Risk Assessment (Ref: Para. 53)

A243. During the audit, [new or other](#) information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based.

Example:

The entity's risk assessment may be based on an expectation that certain controls are operating effectively. In performing tests of those controls, the auditor may obtain audit evidence that they were not operating effectively at relevant times during the audit. Similarly, in performing substantive procedures the auditor may detect misstatements in amounts or frequency greater than is consistent with the auditor's risk assessments. In such circumstances, the risk assessment may not appropriately reflect the true circumstances of the entity and the further planned audit procedures may not be effective in detecting material misstatements. Paragraphs 16 and 17 of ISA 330 provide further guidance about evaluating the operating effectiveness of controls.

Documentation (Ref: Para. 54)

A247-3a For recurring audits, certain documentation may be carried forward, updated as necessary to reflect changes in the entity's business or processes.

A243b8. Paragraph A7 of ISA 230 notes that, [among other considerations](#), although there may be no single way in which the auditor's exercise of professional skepticism is documented, the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism. For example, when the audit evidence obtained from risk assessment procedures includes evidence that both corroborates and contradicts management's assertions, the documentation may include how the auditor evaluated that evidence, including the professional judgments made in evaluating whether the audit evidence provides an appropriate basis for the auditor's identification and assessment of the risks of material misstatement. Examples of other requirements in this ISA for which documentation may provide evidence of the exercise of professional skepticism by the auditor include:

⁷³ ISA 330, paragraph 18

- Paragraph 17, which requires the auditor to design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may corroborate the existence of risks or towards excluding audit evidence that may contradict the existence of risks;
- Paragraph 22, which requires a discussion among key engagement team members of the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement;
- Paragraphs 23 (b) and 24, which require the auditor to obtain an understanding of the reasons for any changes to the entity's accounting policies and to evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework;
- Paragraphs 28 (b), 30 (b), 31 (b), 31A (b), 36 (c), 39 (d) and 43, which require the auditor to evaluate, based on the required understanding obtained, whether the components of the entity's system of internal control are appropriate to the entity's circumstances considering the nature and size complexity of the entity, and to determine whether one of more control deficiencies have been identified;
- Paragraph 51A, which requires the auditor to take into account all audit evidence obtained from risk assessment procedures, whether corroborative or contradictory to assertions made by management, and to evaluate whether the audit evidence obtained from risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement; and
- Paragraph 52, which requires the auditor to evaluate, when applicable, whether the auditor's determination that there are no risks of material misstatement for a material class of transactions, account balance or disclosure remains appropriate.

Scalability (Ref: Para. 54)

- A244. The manner in which the requirements of paragraph 54 are documented is for the auditor to determine using professional judgment. See ISA 230 for the auditor's responsibility to prepare audit documentation.
- A245. More detailed documentation, that is sufficient to enable an experienced auditor, having no previous experience with the audit, to understand the nature, timing and extent of the audit procedures performed, may be required to support the rationale for difficult judgments made.
- A246. For the audits of less complex entities, the form and extent of documentation may be simple ~~in form~~ and relatively brief. The form and extent of the auditor's documentation is influenced by the nature, size and complexity of the entity and its system of internal control, availability of information from the entity and the audit methodology and technology used in the course of the audit. It is not necessary to document the entirety of the auditor's understanding of the entity and matters related to it. Key elements⁷⁴ of understanding documented by the auditor may include those on which the auditor based the assessment of the risks of material misstatement. However, the auditor is not required to

⁷⁴ ISA 230, paragraph 8

document every inherent risk factor that was taken into account in identifying and assessing the risks of material misstatement at the assertion level.

Example:

In audits of less complex entities ~~the audit~~ documentation may be incorporated in the auditor's documentation of the overall strategy and audit plan.⁷⁵ Similarly, for example, the results of the risk assessment may be documented separately, or may be documented as part of the auditor's documentation of further audit procedures.⁷⁶

⁷⁵ ISA 300, *Planning an Audit of Financial Statements*, paragraphs 7 and 9

⁷⁶ ISA 330, paragraph 28

Appendix 1

(Ref: Para. A52–A63)

Considerations for Understanding the Entity and its Business Model

This appendix explains the objectives and scope of the entity's business model and provides examples of matters that the auditor may consider in understanding the activities of the entity that may be included in the business model. The auditor's understanding of the entity's business model, and how it is affected by its business strategy and business objectives, may assist the auditor in identifying business risks that may have an effect on the financial statements. In addition, this may assist the auditor in identifying risks of material misstatement.

Objectives and Scope of an Entity's Business Model

1. An entity's business model describes how an entity considers, for example its organizational structure, operations or scope of activities, business lines (including competitors and customers thereof), processes, growth opportunities, globalization, regulatory requirements and technologies. The entity's business model describes how the entity creates, preserves and captures financial or broader value, ~~such as public benefits~~, for its stakeholders.
2. Strategies are the approaches by which management plans to achieve the entity's objectives, including how the entity plans to address the risks and opportunities that it faces. An entity's strategies are changed over time by management, to respond to changes in its objectives and in the internal and external circumstances in which it operates.
3. A description of a business model typically includes:
 - The scope of the entity's activities, and why it does them.
 - The entity's structure and scale of its operations.
 - The markets or geographical or demographic spheres, and parts of the value chain, in which it operates, how it engages with those markets or spheres (main products, customer segments and distribution methods), and the basis on which it competes.
 - The entity's business or operating processes (e.g., investment, financing and operating processes) employed in performing its activities, focusing on those parts of the business processes that are important in creating, preserving or capturing value.
 - The resources (e.g., financial, human, intellectual, environmental and technological) and other inputs and relationships (e.g., customers, competitors, suppliers and employees) that are necessary or important to its success.
 - How the entity's business model integrates the use of IT in its interactions with customers, suppliers, lenders and other stakeholders through IT interfaces and other technologies.
4. A business risk may have an immediate consequence for the risk of material misstatement for classes of transactions, account balances, and disclosures at the assertion level or the financial statement level. For example, the business risk arising from a significant fall in real estate market values may increase the risk of material misstatement associated with the valuation assertion for a lender of

medium-term real estate backed loans. However, the same risk, particularly in combination with a severe economic downturn that concurrently increases the underlying risk of lifetime credit losses on its loans, may also have a longer-term consequence. The resulting net exposure to credit losses may cast significant doubt on the entity's ability to continue as a going concern. If so, this could have implications for management's, and the auditor's, conclusion as to the appropriateness of the entity's use of the going concern basis of accounting, and determination as to whether a material uncertainty exists. Whether a business risk may result in a risk of material misstatement is, therefore, considered in light of the entity's circumstances. Examples of events and conditions that may ~~indicate-give rise~~ to the existence of risks of material misstatement are indicated in **Appendix 2**.

Activities of the Entity

5. Examples of matters that the auditor may consider when obtaining an understanding of the activities of the entity (included in the entity's business model) include:
- (a) Business operations such as:
 - Nature of revenue sources, products or services, and markets, including involvement in electronic commerce such as Internet sales and marketing activities.
 - Conduct of operations (for example, stages and methods of production, or activities exposed to environmental risks).
 - Alliances, joint ventures, and outsourcing activities.
 - Geographic dispersion and industry segmentation.
 - Location of production facilities, warehouses, and offices, and location and quantities of inventories.
 - Key customers and important suppliers of goods and services, employment arrangements (including the existence of union contracts, pension and other post-employment benefits, stock option or incentive bonus arrangements, and government regulation related to employment matters).
 - Research and development activities and expenditures.
 - Transactions with related parties.
 - (b) Investments and investment activities such as:
 - Planned or recently executed acquisitions or divestitures.
 - Investments and dispositions of securities and loans.
 - Capital investment activities.
 - Investments in non-consolidated entities, including non-controlled partnerships, joint ventures and non-controlled special-purpose entities.
 - (c) Financing and financing activities such as:
 - Ownership structure of major subsidiaries and associated entities, including consolidated and non-consolidated structures.

- Debt structure and related terms, including off-balance-sheet financing arrangements and leasing arrangements.
- Beneficial owners (local, foreign, business reputation and experience) and related parties.
- Use of derivative financial instruments.

Nature of Special-Purpose Entities

6. A special-purpose entity (sometimes referred to as a special-purpose vehicle) is an entity that is generally established for a narrow and well-defined purpose, such as to effect a lease or a securitization of financial assets, or to carry out research and development activities. It may take the form of a corporation, trust, partnership or unincorporated entity. The entity on behalf of which the special-purpose entity has been created may often transfer assets to the latter (for example, as part of a derecognition transaction involving financial assets), obtain the right to use the latter's assets, or perform services for the latter, while other parties may provide the funding to the latter. As ISA 550 indicates, in some circumstances, a special-purpose entity may be a related party of the entity.⁷⁷
7. Financial reporting frameworks often specify detailed conditions that are deemed to amount to control, or circumstances under which the special-purpose entity should be considered for consolidation. The interpretation of the requirements of such frameworks often demands a detailed knowledge of the relevant agreements involving the special-purpose entity.

⁷⁷ ISA 550, paragraph A7

Appendix 2

(Ref: Para. 16(f), 23(c), A5-A6, A88a-A88d)

Understanding ~~the~~ Inherent Risk Factors

This appendix provides further explanation about the inherent risk factors, as well as matters that the auditor may consider in understanding and applying the inherent risk factors in identifying and assessing the risks of material misstatement at the assertion level.

The Inherent Risk Factors

1. ~~The~~ inherent risk factors are characteristics of events or conditions that affect susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or other fraud risk factors⁷⁸ insofar as they affect inherent risk. In obtaining the understanding of the entity and its environment, and the applicable financial reporting framework and entity's accounting policies, in accordance with paragraphs 23(a) and (b), the auditor also understands how~~considers the~~ inherent risk factors ~~that~~ affect susceptibility to misstatement of assertions, ~~and how they do so~~, in the preparation of the financial statements.
2. Inherent risk factors relating to the preparation of information required by the applicable financial reporting framework (referred to in this paragraph as “required information”) include:
 - *Complexity*—arises either from the nature of the information or in the way that the required information is prepared, including when such preparation processes are more inherently difficult to apply. For example, complexity may arise:
 - In calculating supplier rebate provisions because it may be necessary to take into account different commercial terms with many different suppliers, or many interrelated commercial terms that are all relevant in calculating the rebates due; or
 - When there are many potential data sources, with different characteristics used in making an accounting estimate, the processing of that data involves many inter-related steps, and the data is therefore inherently more difficult to identify, capture, access, understand or process.
 - *Subjectivity*—arises from inherent limitations in the ability to prepare required information in an objective manner, due to limitations in the availability of knowledge or information, such that management may need to make an election or subjective judgment about the appropriate approach to take and about the resulting information to include in the financial statements. Because of different approaches to preparing the required information, different outcomes could result from appropriately applying the requirements of the applicable financial reporting framework. As limitations in knowledge or data increase, the subjectivity in the judgments that could be made by reasonably knowledgeable and independent individuals, and the diversity in possible outcomes of those judgments will also increase.

⁷⁸ ISA 240, paragraphs A24–A27

- *Change*—results from events or conditions that, over time, affect the entity’s business or the economic, accounting, regulatory, industry or other aspects of the environment in which it operates, when the effects of those events or conditions are reflected in the required information. Such events or conditions may occur during, or between, financial reporting periods. For example, change may result from developments in the requirements of the applicable financial reporting framework, or in the entity and its business model, or in the environment in which the entity operates. Such change may affect management’s assumptions and judgments, including as they relate to management’s selection of accounting policies or how accounting estimates are made or related disclosures are determined.
 - *Uncertainty*—arises when the required information cannot be prepared based only on sufficiently precise and comprehensive data that is verifiable through direct observation. In these circumstances, an approach may need to be taken that applies the ~~best~~-available knowledge to prepare the information using sufficiently precise and comprehensive observable data, to the extent available, and reasonable assumptions supported by the ~~best~~-most appropriate available data, when it is not. Constraints on the availability of knowledge or data, which are not within the control of management (subject to cost constraints where applicable) are sources of uncertainty and their effect on the preparation of the required information cannot be eliminated. For example, estimation uncertainty arises when the required monetary amount cannot be determined with precision and the outcome of the estimate is not known before the date the financial statements are finalized.
 - *Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk*—susceptibility to management bias results from conditions that create susceptibility to intentional or unintentional failure by management to maintain neutrality in preparing the information. Management bias is often associated with certain conditions that have the potential to give rise to management not maintaining neutrality in exercising judgment (indicators of potential management bias), which could lead to a material misstatement of the information that would be fraudulent if intentional. Such indicators include incentives or pressures insofar as they affect inherent risk (for example, as a result of motivation to achieve a desired result, such as a desired profit target or capital ratio), and opportunity, not to maintain neutrality. Factors relevant to the susceptibility to misstatement due to fraud in the form of fraudulent financial reporting or misappropriation of assets are described in paragraphs A1 to A5 of ISA 240.
3. When complexity is an inherent risk factor, there may be an inherent need for more complex processes in preparing the information, and such processes may be inherently more difficult to apply. As a result, applying them may require specialized skills or knowledge, and may require the use of a management’s expert.
 4. When management judgment is more subjective, the susceptibility to misstatement due to management bias, whether unintentional or intentional, may also increase. For example, significant management judgment may be involved in making accounting estimates that have been identified as having high estimation uncertainty, and conclusions regarding methods, data and assumptions may reflect unintentional or intentional management bias.

Examples of Events or Conditions that ~~May Indicate the~~give rise to Existence of Risks of Material Misstatement

5. The following are examples of events (including transactions) and conditions that may indicate the existence of risks of material misstatement in the financial statements, ~~either~~ at the financial statement level or the assertion level. The examples provided by inherent risk factor cover a broad range of events and conditions; however, not all events and conditions are relevant to every audit engagement and the list of examples is not necessarily complete. The events and conditions have been categorized by the inherent risk factor that may have the greatest effect in the circumstances. Importantly, due to the interrelationships among ~~the~~ inherent risk factors, the example events and conditions also are likely to be subject to, or affected by, other inherent risk factors to varying degrees.

Relevant Inherent Risk Factor:	Examples of Events and Conditions That May Indicate the Existence of Risks of Material Misstatement at the Assertion Level:
Complexity	<p>Regulatory:</p> <ul style="list-style-type: none"> Operations that are subject to a high degree of complex regulation. <p>Business model:</p> <ul style="list-style-type: none"> The existence of complex alliances and joint ventures. <p>Applicable financial reporting framework:</p> <ul style="list-style-type: none"> Accounting measurements that involve complex processes. <p>Transactions:</p> <ul style="list-style-type: none"> Use of off-balance sheet finance, special-purpose entities, and other complex financing arrangements.
Subjectivity	<p>Applicable financial reporting framework:</p> <ul style="list-style-type: none"> A wide range of possible measurement criteria of an accounting estimate. For example, management's recognition of depreciation or construction income and expenses. Management's selection of a valuation technique or model for a non-current asset, such as investment properties.
Change	<p>Economic conditions:</p> <ul style="list-style-type: none"> Operations in regions that are economically unstable, for example, countries with significant currency devaluation or highly inflationary economies. <p>Markets:</p> <ul style="list-style-type: none"> Operations exposed to volatile markets, for example, futures trading. <p>Customer loss:</p>

Relevant Inherent Risk Factor:	Examples of Events and Conditions That May Indicate the Existence of Risks of Material Misstatement at the Assertion Level:
	<ul style="list-style-type: none"> • Going concern and liquidity issues including loss of significant customers. <p>Industry model:</p> <ul style="list-style-type: none"> • Changes in the industry in which the entity operates. <p>Business model:</p> <ul style="list-style-type: none"> • Changes in the supply chain. • Developing or offering new products or services, or moving into new lines of business. <p>Geography:</p> <ul style="list-style-type: none"> • Expanding into new locations. <p>Entity structure:</p> <ul style="list-style-type: none"> • Changes in the entity such as large acquisitions or reorganizations or other unusual events. • Entities or business segments likely to be sold. <p>Human resources competence:</p> <ul style="list-style-type: none"> • Changes in key personnel including departure of key executives. <p>IT:</p> <ul style="list-style-type: none"> • Changes in the IT environment. • Installation of significant new IT systems related to financial reporting. <p>Applicable financial reporting framework:</p> <ul style="list-style-type: none"> • Application of new accounting pronouncements. <p>Capital:</p> <ul style="list-style-type: none"> • New constraints on the availability of capital and credit. <p>Regulatory:</p> <ul style="list-style-type: none"> • <u>Inception of investigations into the entity's operations or financial results by regulatory or government bodies.</u> • <u>Impact of new legislation related to environmental protection.</u>
Uncertainty	<p>Reporting:</p> <ul style="list-style-type: none"> • Events or transactions that involve significant measurement uncertainty, including accounting estimates, and related disclosures.

Relevant Inherent Risk Factor:	Examples of Events and Conditions That May Indicate the Existence of Risks of Material Misstatement at the Assertion Level:
	<ul style="list-style-type: none"> Pending litigation and contingent liabilities, for example, sales warranties, financial guarantees and environmental remediation.
Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk	<p>Reporting:</p> <ul style="list-style-type: none"> Opportunities for management and employees to engage in fraudulent financial reporting, including omission, or obscuring, of significant information in disclosures. <p>Transactions:</p> <ul style="list-style-type: none"> Significant transactions with related parties. Significant amount of non-routine or non-systematic transactions including intercompany transactions and large revenue transactions at period end. Transactions that are recorded based on management's intent, for example, debt refinancing, assets to be sold and classification of marketable securities.

Other events or conditions that may indicate risks of material misstatement at the financial statement level:

- Lack of personnel with appropriate accounting and financial reporting skills.
- Control deficiencies — particularly in the control environment, risk assessment process and of monitoring, and especially those not addressed by management.
- Past misstatements, history of errors or a significant amount of adjustments at period end.

Appendix 3

(Ref: Para. 16(l), 28–39, A102–A200)

Understanding the Entity's System of Internal Control

1. The entity's system of internal control may be reflected in policy and procedures manuals, systems and forms, and the information embedded therein, and is effected by people. The entity's system of internal control is implemented by management, those charged with governance, and other personnel based on the structure of the entity. The entity's system of internal control can be applied, based on the decisions of management, those charged with governance ~~and or~~ other personnel and in the context of legal or regulatory requirements, to the operating model of the entity, the legal entity structure, or a combination of these.
2. This appendix further explains the components of, as well as the limitations of, the entity's system of internal control as set out in paragraphs 16(l), ~~287~~–39, and ~~A89402~~–A200, as they relate to a financial statement audit.
3. Included within the entity's system of internal control are aspects that relate to the entity's reporting objectives, including its financial reporting objectives, but it may also include aspects that relate to its operations or compliance objectives, when such aspects are relevant to financial reporting.

Example:

Controls over compliance with laws and regulations may be relevant to financial reporting when such controls are relevant to the entity's preparation of ~~contingency~~ disclosures of contingencies in the financial statements.

Components of the Entity's System of Internal Control

Control Environment

4. The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's system of internal control, and its importance in the entity. The control environment sets the tone of an organization, influencing the control consciousness of its people, and provides the overall foundation for the operation of the other components of the entity's system of internal control.
5. An entity's control consciousness is influenced by those charged with governance, because one of their roles is to counterbalance pressures on management in relation to financial reporting that may arise from market demands or remuneration schemes. The effectiveness of the design of the control environment in relation to participation by those charged with governance is therefore influenced by such matters as:
 - Their independence from management and their ability to evaluate the actions of management.
 - Whether they understand the entity's business transactions.

- The extent to which they evaluate whether the financial statements are prepared in accordance with the applicable financial reporting framework, including whether the financial statements include adequate disclosures.
6. The control environment encompasses the following elements:
- (a) *How management's ~~oversight~~ responsibilities are carried out, such as creating and maintaining the entity's culture and demonstrating the entity's culture and management's commitment to integrity and ethical values.* The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical behavior are the product of the entity's ethical and behavioral standards or codes of conduct, how they are communicated (e.g., through policy statements), and how they are reinforced in practice (e.g., through management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts). The communication of entity policies on integrity and ethical values may include the communication of behavioral standards to personnel through policy statements and codes of conduct and by example.
 - (b) *When those charged with governance are separate from management, how those charged with governance demonstrate independence from management and exercise oversight of the entity's system of internal control.* An entity's control consciousness is influenced significantly by those charged with governance. Considerations may include whether there are sufficient individuals who are independent from management and objective in their evaluations and decision-making; how those charged with governance identify and accept oversight responsibilities and whether those charged with governance retain oversight responsibility for management's design, implementation and conduct of the entity's system of internal control. The importance of the responsibilities of those charged with governance is recognized in codes of practice and other laws and regulations or guidance produced for the benefit of those charged with governance. Other responsibilities of those charged with governance include oversight of the design and effective operation of whistle blower procedures.
 - (c) *How the entity assigns authority and responsibility in pursuit of its objectives.* This may include considerations about:
 - Key areas of authority and responsibility and appropriate lines of reporting;
 - Policies relating to appropriate business practices, knowledge and experience of key personnel, and resource provided for carrying out duties; and
 - Policies and communications directed at ensuring that all personnel understand the entity's objectives, know how their individual actions interrelate and contribute to those objectives, and recognize how and for what they will be held accountable.
 - (d) *How the entity attracts, develops, and retains competent individuals in alignment with its objectives.* This includes how the entity ensures the individuals have the knowledge and skills necessary to accomplish the tasks that define the individual's job, such as:

- Standards for recruiting the most qualified individuals – with an emphasis on educational background, prior work experience, past accomplishments, and evidence of integrity and ethical behavior.
 - Training policies that communicate prospective roles and responsibilities, including practices such as training schools and seminars that illustrate expected levels of performance and behavior; and
 - Periodic performance appraisals driving promotions that demonstrate the entity's commitment to the advancement of qualified personnel to higher levels of responsibility.
- (e) *How the entity holds individuals accountable for their responsibilities in pursuit of the objectives of the entity's system of internal control.* This may be accomplished through, for example:
- Mechanisms to communicate and hold individuals accountable for performance of internal controls responsibilities and implement corrective actions as necessary;
 - Establishing performance measures, incentives and rewards for those responsible for the entity's system of internal control, including how the measures are evaluated and maintain their relevance;
 - How pressures associated with the achievement of internal control objectives impact the individual's responsibilities and performance measures; and
 - How the individuals are disciplined as necessary.

The appropriateness of the above matters will be different for every entity depending on its size, the complexity of its structure and the nature of its activities.

The Entity's Risk Assessment Process

7. The entity's risk assessment process is an iterative process for identifying and analyzing risks to achieving the entity's objectives, and forms the basis for how management or those charged with governance determine the risks to be managed.
8. For financial reporting purposes, the entity's risk assessment process includes how management identifies business risks relevant to the preparation of financial statements in accordance with the entity's applicable financial reporting framework, estimates their significance, assesses the likelihood of their occurrence, and decides upon actions to ~~respond to and~~ manage them and the results thereof. For example, the entity's risk assessment process may address how the entity considers the possibility of unrecorded transactions or identifies and analyzes significant estimates recorded in the financial statements.
9. Risks relevant to reliable financial reporting include external and internal events, transactions or circumstances that may occur and adversely affect an entity's ability to initiate, record, process, and report financial information consistent with the assertions of management in the financial statements. Management may initiate plans, programs, or actions to address specific risks or it may decide to accept-assume a risk because of cost or other considerations. Risks can arise or change due to circumstances such as the following:

- *Changes in operating environment.* Changes in the regulatory, economic or operating environment can result in changes in competitive pressures and significantly different risks.
- *New personnel.* New personnel may have a different focus on or understanding of the entity's system of internal control.
- *New or revamped information system.* Significant and rapid changes in the information system can change the risk relating to the entity's system of internal control.
- *Rapid growth.* Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.
- *New technology.* Incorporating new technologies into production processes or the information system may change the risk associated with the entity's system of internal control.
- *New business models, products, or activities.* Entering into business areas or transactions with which an entity has little experience may introduce new risks associated with the entity's system of internal control.
- *Corporate restructurings.* Restructurings may be accompanied by staff reductions and changes in supervision and segregation of duties that may change the risk associated with the entity's system internal control.
- *Expanded foreign operations.* The expansion or acquisition of foreign operations carries new and often unique risks that may affect internal control, for example, additional or changed risks from foreign currency transactions.
- *New accounting pronouncements.* Adoption of new accounting principles or changing accounting principles may affect risks in preparing financial statements.
- *Use of IT.* Risks relating to:
 - Maintaining the integrity of data and information processing;
 - Risks to the entity business strategy that arise if the entity's IT strategy does not effectively supporting the entity's business strategy; or
 - Changes or interruptions in the entity's IT environment or turnover of IT personnel or when the entity does not make necessary updates to the IT environment or such updates are not timely.

The Entity's Process to Monitor the System of Internal Control

10. The entity's process to monitor the system of internal control is a continuous process to evaluate the effectiveness of the entity's system of internal control, and to take necessary remedial actions on a timely basis. The entity's process to monitor the entity's system of internal control may consist of ongoing activities, separate evaluations (conducted periodically), or some combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and may include regular management and supervisory activities. The entity's process will likely vary in scope and frequency depending on the assessment of the risks by the entity.

11. The objectives and scope of internal audit functions typically include activities designed to evaluate or monitor the effectiveness of the entity's system of internal control.⁷⁹ The entity's process to monitor the entity's system of internal control may include activities such as management's review of whether bank reconciliations are being prepared on a timely basis, internal auditors'⁸⁰ evaluation of sales personnel's compliance with the entity's policies on terms of sales contracts, and a legal department's oversight of compliance with the entity's ethical or business practice policies. Monitoring is done also to ensure that controls continue to operate effectively over time. For example, if the timeliness and accuracy of bank reconciliations are not monitored, personnel are likely to stop preparing them.
12. Controls related to the entity's process to monitor the entity's system of internal control, including those that monitor underlying automated controls, may be automated or manual, or a combination of both. For example, an entity may use automated monitoring controls over access to certain technology with automated reports of unusual activity to management, who manually investigate identified anomalies.
13. When distinguishing between a monitoring activity and a control related to the information system, the underlying details of the activity are considered, especially when the activity involves some level of supervisory review. ~~As also explained in the application material, s~~Supervisory reviews are not automatically classified as monitoring activities and it may be a matter of judgment whether a review is classified as a control related to the information system or a monitoring activity. For example, the intent of a monthly completeness control would be to detect and correct errors, where a monitoring activity would ask why errors are occurring and assign management the responsibility of fixing the process to prevent future errors. In simple terms, a control related to the information system responds to a specific risk, whereas a monitoring activity assesses whether controls within each of the five components of the entity's system of internal control are operating as intended.
14. Monitoring activities may include using information from communications from external parties that may indicate problems or highlight areas in need of improvement. Customers implicitly corroborate billing data by paying their invoices or complaining about their charges. In addition, regulators may communicate with the entity concerning matters that affect the functioning of the entity's system of internal control, for example, communications concerning examinations by bank regulatory agencies. Also, management may consider in performing monitoring activities any communications relating to the entity's system of internal control from external auditors.

The Information System and Communication

15. The information system relevant to the preparation of the financial statements in consists of activities and policies, and accounting and supporting records, designed and established to:

⁷⁹ ISA 610 (Revised 2013), Using the Work of Internal Auditors, and Appendix 4 of this ISA provides further guidance related to internal audit.

⁸⁰ ~~The objectives and scope of internal audit functions typically include activities designed to evaluate or monitor the effectiveness of the entity's internal control. ISA 610 (Revised), Using the Work of Internal Auditors, and Appendix 4 of this ISA provides further guidance related to internal audit.~~

- Initiate, record and process entity transactions (as well as to capture, process and disclose information about events and conditions other than transactions) 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;
 - Incorporate information from transaction processing in the general ledger (e.g., transferring of accumulated transactions from a subsidiary ledger);
 - Capture and process information relevant to the preparation of the financial statements for events and conditions other than transactions, such as the depreciation and amortization of assets and changes in the recoverability of assets; 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.
16. An entity's business processes include the activities designed to:
- Develop, purchase, produce, sell and distribute an entity's products and services;
 - Ensure compliance with laws and regulations; and
 - Record information, including accounting and financial reporting information.
- Business processes result in the transactions that are recorded, processed and reported by the information system.
17. The quality of information affects management's ability to make appropriate decisions in managing and controlling the entity's activities and to prepare reliable financial reports.
18. Communication, which involves providing an understanding of individual roles and responsibilities pertaining to the entity's system of internal control, may take such forms as policy manuals, accounting and financial reporting manuals, and memoranda. Communication also can be made electronically, orally, and through the actions of management.
19. Communication by the entity of the financial reporting roles and responsibilities and of significant matters relating to financial reporting involves providing an understanding of individual roles and responsibilities pertaining to the entity's system of internal control relevant to financial reporting. It may include such matters as the extent to which personnel understand how their activities in the information system relate to the work of others and the means of reporting exceptions to an appropriate higher level within the entity.

Control Activities

20. Controls in the control activities component ~~consist of controls related to all the components of the entity's system of internal control~~ are identified in accordance with paragraph 39. Such controls include information processing controls and general IT controls, both of which may be manual or automated in nature. The greater the extent of automated controls, or controls involving automated

aspects, that management uses and relies on in relation to its financial reporting, the more important it may become for the entity to implement general IT controls that address the continued functioning of the automated aspects of information processing controls. Controls in the control activities component may pertain to the following:

- *Authorization and approvals.* An authorization affirms that a transaction is valid (i.e. it represents an actual economic event or is within an entity's policy). An authorization typically takes the form of an approval by a higher level of management or of verification and a determination if the transaction is valid. For example, a supervisor approves an expense report after reviewing whether the expenses seem reasonable and within policy. An example of an automated approval is when an invoice unit cost is automatically compared with the related purchase order unit cost within a pre-established tolerance level. Invoices within the tolerance level are automatically approved for payment. Those invoices outside the tolerance level are flagged for additional investigation.
- *Reconciliations* – Reconciliations compare two or more data elements. If differences are identified, action is taken to bring the data into agreement. Reconciliations generally address the completeness or accuracy of processing transactions.
- *Verifications* – Verifications compare two or more items with each other or compare an item with a policy, and may will likely involve a follow-up action when the two items do not match or the item is not consistent with policy. Verifications generally address the completeness, accuracy, or validity of processing transactions.
- *Physical or logical controls, including those that address security of assets against unauthorized access, acquisition, use or disposal.* Controls that encompass:
 - The physical security of assets, including adequate safeguards such as secured facilities over access to assets and records.
 - The authorization for access to computer programs and data files (i.e., logical access).
 - The periodic counting and comparison with amounts shown on control records (for example, comparing the results of cash, security and inventory counts with accounting records).

The extent to which physical controls intended to prevent theft of assets are relevant to the reliability of financial statement preparation depends on circumstances such as when assets are highly susceptible to misappropriation.

- *Segregation of duties.* Assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets. Segregation of duties is intended to reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of the person's duties.

For example, a manager authorizing credit sales is not responsible for maintaining accounts receivable records or handling cash receipts. If one person is able to perform all these activities he or she could, for example, create a fictitious sale that could go undetected. Similarly, salespersons should not have the ability to modify product price files or commission rates.

Sometimes segregation is not practical, cost effective, or feasible. For example, smaller and less complex entities may lack sufficient resources to achieve ideal segregation, and the cost of hiring additional staff may be prohibitive. In these situations, management may institute alternative controls. In the example above, if the salesperson can modify product price files, a detective control activity can be put in place to have personnel unrelated to the sales function periodically review whether and under what circumstances the salesperson changed prices.

21. Certain controls may depend on the existence of appropriate supervisory controls established by management or those charged with governance. For example, authorization controls may be delegated under established guidelines, such as investment criteria set by those charged with governance; alternatively, non-routine transactions such as major acquisitions or divestments may require specific high-level approval, including in some cases that of shareholders.

Limitations of Internal Control

22. The entity's system of internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. The likelihood of their achievement is affected by the inherent limitations of internal control. These include the realities that human judgment in decision-making can be faulty and that breakdowns in the entity's system of internal control can occur because of human error. For example, there may be an error in the design of, or in the change to, a control. Equally, the operation of a control may not be effective, such as where information produced for the purposes of the entity's system of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.
23. Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of internal controls. For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in an IT application that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled.
24. Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.

Appendix 4

(Ref: Para 18(a), A25-A29, A129-A131)

Considerations for Understanding an Entity's Internal Audit Function

This appendix provides further considerations relating to understanding the entity's internal audit function when such a function exists.

Objectives and Scope of the Internal Audit Function

1. The objectives and scope of an internal audit function, the nature of its responsibilities and its status within the organization, including the function's authority and accountability, vary widely and depend on the size, complexity and structure of the entity and the requirements of management and, where applicable, those charged with governance. These matters may be set out in an internal audit charter or terms of reference.
2. The responsibilities of an internal audit function may include performing procedures and evaluating the results to provide assurance to management and those charged with governance regarding the design and effectiveness of risk management, the entity's system of internal control and governance processes. If so, the internal audit function may play an important role in the entity's process to monitor the entity's system of internal control. However, the responsibilities of the internal audit function may be focused on evaluating the economy, efficiency and effectiveness of operations and, if so, the work of the function may not directly relate to the entity's financial reporting.

Inquiries of the Internal Audit Function

3. If an entity has an internal audit function, inquiries of the appropriate individuals within the function may provide information that is useful to the auditor in obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, and in identifying and assessing risks of material misstatement at the financial statement and assertion levels. In performing its work, the internal audit function is likely to have obtained insight into the entity's operations and business risks, and may have findings based on its work, such as identified control deficiencies or risks, that may provide valuable input into the auditor's understanding of the entity and its environment, the applicable financial reporting framework, the entity's system of internal control, the auditor's risk assessments or other aspects of the audit. The auditor's inquiries are therefore made whether or not the auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed.⁸¹ Inquiries of particular relevance may be about matters the internal audit function has raised with those charged with governance and the outcomes of the function's own risk assessment process.
4. If, based on responses to the auditor's inquiries, it appears that there are findings that may be relevant to the entity's financial reporting and the audit of the financial statements, the auditor may consider it appropriate to read related reports of the internal audit function. Examples of reports of the internal audit function that may be relevant include the function's strategy and planning documents and

⁸¹ The relevant requirements are contained in ISA 610 (Revised 2013).

reports that have been prepared for management or those charged with governance describing the findings of the internal audit function's examinations.

5. In addition, in accordance with ISA 240,⁸² if the internal audit function provides information to the auditor regarding any actual, suspected or alleged fraud, the auditor takes this into account in the auditor's identification of risk of material misstatement due to fraud.
6. Appropriate individuals within the internal audit function with whom inquiries are made are those who, in the auditor's judgment, have the appropriate knowledge, experience and authority, such as the chief internal audit executive or, depending on the circumstances, other personnel within the function. The auditor may also consider it appropriate to have periodic meetings with these individuals.

Consideration of the Internal Audit Function in Understanding the Control Environment

7. In understanding the control environment, the auditor may consider how management has responded to the findings and recommendations of the internal audit function regarding identified control deficiencies relevant to the preparation of the financial statements, including whether and how such responses have been implemented, and whether they have been subsequently evaluated by the internal audit function.

Understanding the Role that the Internal Audit Function Plays in the Entity's Process to Monitor the System of Internal Control

8. If the nature of the internal audit function's responsibilities and assurance activities are related to the entity's financial reporting, the auditor may also be able to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the auditor in obtaining audit evidence. Auditors may be more likely to be able to use the work of an entity's internal audit function when it appears, for example, based on experience in previous audits or the auditor's risk assessment procedures, that the entity has an internal audit function that is adequately and appropriately resourced relative to the size-complexity of the entity and the nature of its operations, and has a direct reporting relationship to those charged with governance.
9. If, based on the auditor's preliminary understanding of the internal audit function, the auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed, ISA 610 (Revised 2013) applies.
10. As is further discussed in ISA 610 (Revised 2013), the activities of an internal audit function are distinct from other monitoring controls that may be relevant to financial reporting, such as reviews of management accounting information that are designed to contribute to how the entity prevents or detects misstatements.
11. Establishing communications with the appropriate individuals within an entity's internal audit function early in the engagement, and maintaining such communications throughout the engagement, can facilitate effective sharing of information. It creates an environment in which the auditor can be informed of significant matters that may come to the attention of the internal audit function when such matters may affect the work of the auditor. ISA 200 discusses the importance of the auditor planning

⁸² ISA 240, paragraph 2019

and performing the audit with professional skepticism, including being alert to information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence. Accordingly, communication with the internal audit function throughout the engagement may provide opportunities for internal auditors to bring such information to the auditor's attention. The auditor is then able to take such information into account in the auditor's identification and assessment of risks of material misstatement.

Appendix 5

(Ref: Para. 23(a), 36, A97, A179a)

Considerations for Understanding Information Technology (IT)

This appendix provides further matters that the auditor may consider in understanding the entity's use of IT in its system of internal control.

Understanding the Entity's Use of Information Technology in the Components of the Entity's System of Internal Control

1. An entity's system of internal control contains manual elements and automated elements (i.e., manual and automated controls and other resources used in the entity's system of internal control). An entity's mix of manual and automated elements varies with the nature and complexity of the entity's use of IT. An entity's use of IT affects the manner in which the information relevant to the preparation of the financial statements in accordance with the applicable financial reporting framework is processed, stored and communicated, and therefore affects the manner in which the entity's system of internal control is designed and implemented. Each component of the entity's system of internal control may use some extent of IT.

Generally, IT benefits an entity's system of internal control by enabling an entity to:

- Consistently apply predefined business rules and perform complex calculations in processing large volumes of transactions or data;
 - Enhance the timeliness, availability, and accuracy of information;
 - Facilitate the additional analysis of information;
 - Enhance the ability to monitor the performance of the entity's activities and its policies and procedures;
 - Reduce the risk that controls will be circumvented; and
 - Enhance the ability to achieve effective segregation of duties by implementing security controls in IT applications, databases, and operating systems.
2. The characteristics of manual or automated elements are relevant to the auditor's identification and assessment of the risks of material misstatement, and further audit procedures based thereon. Automated controls may be more reliable than manual controls because they cannot be as easily bypassed, ignored, or overridden, and they are also less prone to simple errors and mistakes. Automated controls may be more effective than manual controls in the following circumstances:
 - High volume of recurring transactions, or in situations where errors that can be anticipated or predicted can be prevented, or detected and corrected, through automation
 - Controls where the specific ways to perform the control can be adequately designed and automated.

Understanding the Entity's Use of Information Technology in the Information System (Ref: Para. 36(a))

3. The entity's information system may include the use of manual and automated elements, which also affect the manner in which transactions are initiated, recorded, processed, and reported. In particular, procedures to initiate, record, process, and report transactions may be enforced through the IT applications used by the entity, and how the entity has configured those applications. In addition, records in the form of digital information may replace or supplement records in the form of paper documents.
4. In obtaining an understanding of the IT environment relevant to the flows of transactions and information processing in the information system, the auditor gathers information about the nature and characteristics of the IT applications used, as well as the supporting IT infrastructure and IT. The following table includes examples of matters that the auditor may consider in obtaining the understanding of the IT environment and includes examples of typical characteristics of IT environments based on the complexity of IT applications used in the entity's information system. However, such characteristics are directional and may differ depending on the nature of the specific IT applications in use by an entity.

	Examples of typical characteristics of:		
	Non-complex commercial software	Mid-size and moderately complex commercial software or IT applications	Large or complex IT applications (e.g., ERP systems)
Matters related to extent of automation and use of data:			
<ul style="list-style-type: none"> The extent of automated procedures for processing, and the complexity of those procedures, including, whether there is highly automated, paperless processing 	N/A	N/A	Extensive and often complex automated procedures
<ul style="list-style-type: none"> The extent of the entity's reliance on system-generated reports in the processing of information. 	Simple automated report logic	Simple relevant automated report logic	Complex automated report logic; Report-writer software
<ul style="list-style-type: none"> How data is input (i.e., manual input, customer or vendor input, or file load). 	Manual data inputs	Small number of data inputs or simple interfaces	Large number of data inputs or complex interfaces

<ul style="list-style-type: none"> How IT facilitates communication between applications, databases or other aspects of the IT environment, internally and externally, as appropriate, through system interfaces. 	No automated interfaces (manual inputs only)	Small number of data inputs or simple interfaces	Large number of data inputs or complex interfaces
<ul style="list-style-type: none"> The volume and complexity of data in digital form being processed by the information system, including whether accounting records or other information are stored in digital form and the location of stored data. 	Low volume of data or simple data that is able to be verified manually; Data available locally	Low volume of data or simple data	Large volume of data or complex data; Data warehouses; ⁸³ Use of internal or external IT service providers (e.g., third-party storage or hosting of data)
Matters related to the IT applications and IT infrastructure:			
<ul style="list-style-type: none"> The type of application (e.g., a commercial application with little or no customization, or a highly-customized or highly-integrated application that may have been purchased and customized, or developed in-house). 	Purchased application with little or no customization	Purchased application or simple legacy or low-end ERP applications with little or no customization	Custom developed applications or more complex ERPs with significant customization
<ul style="list-style-type: none"> The complexity of the nature of the IT applications and the underlying IT infrastructure. 	Small, simple laptop or client server-based solution	Mature and stable mainframe, small or simple client server, software as a service cloud	Complex mainframe, large or complex client server, web-facing, infrastructure as a service cloud

⁸³ A data warehouse is generally described as a central repository of integrated data from one or more disparate sources (such as multiple databases) from which reports may be generated or that may be used by the entity for other data analysis activities. A report-writer is an IT application that is used to extract data from one or more sources (such as a data warehouse, a database or an IT application) and present the data in a specified format.

<ul style="list-style-type: none"> Whether there is third-party hosting or outsourcing of IT. 	If outsourced, competent, mature, proven provider (e.g., cloud provider)	If outsourced, competent, mature, proven provider (e.g. cloud provider)	Competent, mature proven provider for certain applications and new or start-up provider for others
<ul style="list-style-type: none"> Whether the entity is using emerging technologies that affect its financial reporting. 	No use of emerging technologies	Limited use of emerging technologies in some applications	Mixed use of emerging technologies across platforms
Matters related to IT processes:			
<ul style="list-style-type: none"> The personnel involved in maintaining the IT environment (the number and skill level of the IT support resources that manage security and changes to the IT environment) 	Few personnel with limited IT knowledge to process vendor upgrades and manage access	Limited personnel with IT skills / dedicated to IT	Dedicated IT departments with skilled personnel, including programming skills
<ul style="list-style-type: none"> The complexity of processes to manage access rights 	Single individual with administrative access manages access rights	Few individuals with administrative access manages access rights	Complex processes managed by IT department for access rights
<ul style="list-style-type: none"> The complexity of the security over the IT environment, including vulnerability of the IT applications, databases, and other aspects of the IT environment to cyber risks, particularly when there are web-based transactions or transactions involving external interfaces. 	Simple on-premise access with no external web-facing elements;	Some web-based applications with primarily simple, role-based security	Multiple platforms with web-based access and complex security models
<ul style="list-style-type: none"> Whether program changes have been made to the manner in which information is processed, and the extent of such changes during the period. 	Commercial software with no source code installed	Some commercial applications with no source code and other mature applications with a small number or simple changes;	New or large number or complex changes, several development cycles each year

		traditional systems development lifecycle	
<ul style="list-style-type: none"> The extent of change within the IT environment (e.g., new aspects of the IT environment or significant changes in the IT applications or the underlying IT infrastructure) 	Changes limited to version upgrades of commercial software	Changes consist of commercial software upgrades, ERP version upgrades, or legacy enhancements	New or large number or complex changes, several development cycles each year, heavy ERP customization
<ul style="list-style-type: none"> Whether there was a major data conversion during the period and, if so, the nature and significance of the changes made, and how the conversion was undertaken. 	Software upgrades provided by vendor. No data conversion features for upgrade.	Minor version upgrades for commercial software applications with limited data being converted	Major version upgrade, new release, platform change

Emerging Technologies

- Entities may use emerging technologies (e.g., blockchain, robotics or artificial intelligence) because such technologies may present specific opportunities to increase operational efficiencies or enhance financial reporting. When emerging technologies are used in the entity's information system relevant to the preparation of the financial statements, the auditor may include such technologies in the identification of IT applications and other aspects of the IT environment that are subject to risks arising from the use of IT. While emerging technologies may be seen to be more sophisticated or more complex compared to existing technologies, the auditor's responsibilities in relation to IT applications and identified general IT controls in accordance with paragraph 39 remain unchanged.

Scalability

- Obtaining an understanding of the entity's IT environment may be more easily accomplished for a less complex entity that uses commercial software and when the entity does not have access to the source code to make any program changes. Such entities may not have dedicated IT resources but may have a person assigned in an administrator role for the purpose of granting employee access or installing vendor-provided updates to the IT applications. Specific matters that the auditor may consider in understanding the nature of a commercial accounting software package, which may be the single IT application used by a less complex entity in its information system, may include:
 - The extent to which the software is well established and has a reputation for reliability;
 - The extent to which it is possible for the entity to modify the source code of the software to include additional modules (i.e., add-ons) to the base software, or to make direct changes to data;

- The nature and extent of modifications that have been made to the software. Although an entity may not be able to modify the source code of the software, many software packages allow for configuration (e.g., setting or amending reporting parameters). These do not usually involve modifications to source code; however, the auditor may consider the extent to which the entity is able to configure the software when considering the completeness and accuracy of information produced by the software that is used as audit evidence; and
 - The extent to which data related to the preparation of the financial statements can be directly accessed (i.e., direct access to the database without using the IT application) and the volume of data that is processed. The greater the volume of data, the more likely the entity may need controls that address maintaining the integrity of the data, which may include general IT controls over unauthorized access and changes to the data.
7. Complex IT environments may include highly-customized or highly-integrated IT applications and may therefore require more effort to understand. Financial reporting processes or IT applications may be integrated with other IT applications. Such integration may involve IT applications that are used in the entity's business operations and that provide information to the IT applications relevant to the flows of transactions and information processing in the entity's information system. In such circumstances, certain IT applications used in the entity's business operations may also be relevant to the preparation of the financial statements. Complex IT environments also may require dedicated IT departments that have structured IT processes supported by personnel that have software development and IT environment maintenance skills. In other cases, an entity may use internal or external service providers to manage certain aspects of, or IT processes within, its IT environment (e.g., third-party hosting).

Identifying IT Applications that are Subject to Risks Arising from the use of IT

8. Through understanding the nature and complexity of the entity's IT environment, including the nature and extent of information processing controls, the auditor may determine which IT applications the entity is relying upon to accurately process and maintain the integrity of financial information. The identification of IT applications on which the entity relies, may affect the auditor's decision to test the automated controls within such IT applications, ~~also~~ assuming that such automated controls address identified risks of material misstatement. Conversely, if the entity is not relying on an IT application, the automated controls within such IT application are unlikely to be appropriate or sufficiently precise for purposes of operating effectiveness tests. Automated controls that may be identified in accordance with paragraph 39(a) may include, for example, automated calculations or input, processing and output controls, such as a three-way match of a purchase order, vendor shipping document, and vendor invoice. When automated controls are identified by the auditor and the auditor determines through the understanding of the IT environment that the entity is relying on the IT application that includes those automated controls, it may be more likely for the auditor to identify the IT application as one that is subject to risks arising from the use of IT.
9. In considering whether the IT applications for which the auditor has identified automated controls are subject to risks arising from the use of IT, the auditor is likely to consider whether, and the extent to which, the entity may have access to source code that enables management to make program changes to such controls or the IT applications. The extent to which the entity makes program or

configuration changes and the extent to which the IT processes over such changes are formalized may also be relevant considerations. The auditor is also likely to consider the risk of inappropriate access or changes to data.

10. System-generated reports that the auditor may intend to use as audit evidence may include, for example, a trade receivable aging report or an inventory valuation report. For such reports, the auditor may obtain audit evidence about the completeness and accuracy of the reports by substantively testing the inputs and outputs of the report. In other cases, the auditor may plan to test the operating effectiveness of the controls over the preparation and maintenance of the report, in which case the IT application from which it is produced is likely to be subject to risks arising from the use of IT. In addition to testing the completeness and accuracy of the report, the auditor may plan to test the operating effectiveness of general IT controls that address risks related to inappropriate or unauthorized program changes to, or data changes in, the report.
11. Some IT applications may include report-writing functionality within them while some entities may also utilize separate report-writing applications (i.e., report-writers). In such cases, the auditor may need to determine the sources of system-generated reports (i.e., the application that prepares the report and the data sources used by the report) to determine the IT applications subject to risks arising from the use of IT.
12. The data sources used by IT applications may be databases that, for example, can only be accessed through the IT application or by IT personnel with database administration privileges. In other cases, the data source may be a data warehouse that may itself be considered to be an IT application subject to risks arising from the use of IT.
13. The auditor may have identified a risk for which substantive procedures alone are not sufficient because of the entity's use of highly-automated and paperless processing of transactions, which may involve multiple integrated IT applications. In such circumstances, the controls identified by the auditor are likely to include automated controls. Further, the entity may be relying on general IT controls to maintain the integrity of the transactions processed and other information used in processing. In such cases, the IT applications involved in the processing and the storage of the information are likely subject to risks arising from the use of IT.

End-User Computing

14. Although audit evidence may also come in the form of system-generated output that is used in a calculation performed in an end-user computing tool (e.g., spreadsheet software or simple databases), such tools are not typically identified as IT applications in the context of paragraph 39(b). Designing and implementing controls around access and change to end-user computing tools may be challenging, and such controls are rarely equivalent to, or as effective as, general IT controls. Rather, the auditor may consider a combination of information processing controls, taking into account the purpose and complexity of the end-user computing involved, such as:
 - Information processing controls over the initiation and processing of the source data, including relevant automated or interface controls to the point from which the data is extracted (i.e. the data warehouse);

- Controls to check that the logic is functioning as intended, for example, controls which ‘prove’ the extraction of data, such as reconciling the report to the data from which it was derived, comparing the individual data from the report to the source and vice versa, and controls which check the formulas or macros; or
- Use of validation software tools, which systematically check formulas or macros, such as spreadsheet integrity tools.

Scalability

15. The entity’s ability to maintain the integrity of information stored and processed in the information system may vary based on the complexity and volume of the related transactions and other information. The greater the complexity and volume of data that supports a significant class of transactions, account balance or disclosure, the less likely it may become for the entity to maintain integrity of that information through information processing controls alone (e.g., input and output controls or review controls). It also becomes less likely that the auditor will be able to obtain audit evidence about the completeness and accuracy of such information through substantive testing alone when such information is used as audit evidence. In some circumstances, when volume and complexity of transactions are lower, management may have an information processing control that is sufficient to verify the accuracy and completeness of the data (e.g., individual sales orders processed and billed may be reconciled to the hard copy originally entered into the IT application). When the entity relies on general IT controls to maintain the integrity of certain information used by IT applications, the auditor may determine that the IT applications that maintain that information are subject to risks arising from the use of IT.

Example characteristics of an IT application that is likely not subject to risks arising from IT	Example characteristics of an IT application that is likely subject to risks arising from IT
<ul style="list-style-type: none"> • Standalone applications • The volume of data (transactions) is not significant. • The application’s functionality is not complex. • Each transaction is supported by original hard copy documentation. 	<ul style="list-style-type: none"> • Applications are interfaced. • The volume of data (transactions) is significant/ • The application’s functionality is complex as <ul style="list-style-type: none"> – The application automatically initiates transactions; and – There are a variety of complex calculations underlying automated entries.
<p>IT application is likely not subject to risks arising from IT because:</p> <ul style="list-style-type: none"> • The volume of data is not significant and therefore management is not relying upon 	<p>IT application is likely subject to risks arising from IT because:</p> <ul style="list-style-type: none"> • Management relies on an application system to process or maintain data as the volume of data is significant.

<p>general IT controls to process or maintain the data.</p> <ul style="list-style-type: none"> • Management does not rely on automated controls or other automated functionality. The auditor has not identified automated controls in accordance with paragraph 39(a). • Although management uses system-generated reports in their controls, they do not rely on these reports. Instead, they reconcile the reports back to the hard copy documentation and verify the calculations in the reports. • We will directly test information produced by the entity used as audit evidence. 	<ul style="list-style-type: none"> • Management relies upon the application system to perform certain automated controls that the auditor has also identified.
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Other Aspects of the IT Environment that Are Subject to Risks Arising from the Use of IT

16. When the auditor identifies IT applications that are subject to risks arising from the use of IT, other aspects of the IT environment are also typically subject to risks arising from the use of IT. The IT infrastructure includes the databases, operating system, and network. Databases store the data used by IT applications and may consist of many interrelated data tables. Data in databases may also be accessed directly through database management systems by IT or other personnel with database administration privileges. The operating system is responsible for managing communications between hardware, IT applications, and other software used in the network. As such, IT applications and databases may be directly accessed through the operating system. A network is used in the IT infrastructure to transmit data and to share information, resources and services through a common communications link. The network also typically establishes a layer of logical security (enabled through the operating system) for access to the underlying resources.
17. When IT applications are identified by the auditor to be subject to risks arising from IT, the database(s) that stores the data processed by an identified IT application is typically also identified. Similarly, because an IT application's ability to operate is often dependent on the operating system and IT applications and databases may be directly accessed from the operating system, the operating system is typically subject to risks arising from the use of IT. The network may be identified when it is a central point of access to the identified IT applications and related databases or when an IT application interacts with vendors or external parties through the internet, or when web-facing IT applications are identified by the auditor.

Identifying Risks arising from the Use of IT and General IT Controls

18. Examples of risks arising from the use of IT include risks related to inappropriate reliance on IT applications that are inaccurately processing data, processing inaccurate data, or both, such as
- Unauthorized access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
 - The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
 - Unauthorized changes to data in master files.
 - Unauthorized changes to IT applications or other aspects of the IT environment.
 - Failure to make necessary changes to IT applications or other aspects of the IT environment.
 - Inappropriate manual intervention.
 - Potential loss of data or inability to access data as required.
19. The auditor's consideration of unauthorized access may include risks related to unauthorized access by internal or external parties (often referred to as cybersecurity risks). Such risks may not necessarily affect financial reporting, as an entity's IT environment may also include IT applications and related data that address operational or compliance needs. It is important to note that cyber incidents usually first occur through the perimeter and internal network layers, which tend to be further removed from the IT application, database and operating systems that affect the preparation of the financial statements. Accordingly, if information about a security breach has been identified, the auditor ordinarily ~~first~~ considers the extent to which such a breach had the potential to affects financial reporting. If financial reporting may be affected, the auditor may decide to understand, and test the related controls to determine the possible impact or scope of potential misstatements in the financial statements or may determine that the entity has provided adequate disclosures in relation to such security breach.
20. In addition, laws and regulations that may have a direct or indirect effect on the entity's financial statements may include data protection legislation. Considering an entity's compliance with such laws or regulations, in accordance with ISA 250 (Revised),⁸⁴ may involve understanding the entity's IT processes and general IT controls that the entity has implemented to address the relevant laws or regulations.
21. General IT controls are implemented to address risks arising from the use of IT. Accordingly, the auditor uses the understanding obtained about the identified IT applications and other aspects of the IT environment and the applicable risks arising from the use of IT in determining the general IT controls to identify. In some cases, an entity may use common IT processes across its IT environment or across certain IT applications, in which case common risks arising from the use of IT and common general IT controls may be identified.

⁸⁴ ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

22. In general, a greater number of general IT controls related to IT applications and databases are likely to be identified than for other aspects of the IT environment. This is because these aspects are the most closely concerned with the information processing and storage of information in the entity's information system. In identifying general IT controls, the auditor may consider controls over actions of both end users and of the entity's IT personnel or IT service providers.
23. Appendix 6 provides further explanation of the nature of the general IT controls typically implemented for different aspects of the IT environment. In addition, examples of general IT controls for different IT processes are provided.

Appendix 6

(Ref: Para. 39(c)(ii), A188a-A189)

Considerations for Understanding General IT Controls

This appendix provides further matters that the auditor may consider in understanding general IT controls.

1. The nature of the general IT controls typically implemented for each of the aspects of the IT environment

(a) Applications

General IT controls at the IT application layer will correlate to the nature and extent of application functionality and the access paths allowed in the technology. For example, more controls will be relevant for highly-integrated IT applications with complex security options than a legacy IT application supporting a small number of account balances with access methods only through transactions.

(b) Database

General IT controls at the database layer typically address risks arising from the use of IT related to unauthorized updates to financial reporting information in the database through direct database access or execution of a script or program.

(c) Operating system

General IT controls at the operating system layer typically address risks arising from the use of IT related to administrative access, which can facilitate the override of other controls. This includes actions such as compromising other user's credentials, adding new, unauthorized users, loading malware or executing scripts or other unauthorized programs.

(d) Network

General IT controls at the network layer typically address risks arising from the use of IT related to network segmentation, remote access, and authentication. Network controls may be relevant when an entity has web-facing applications used in financial reporting. Network controls are also may be relevant when the entity has significant business partner relationships or third-party outsourcing, which may increase data transmissions and the need for remote access.

2. Examples of general IT controls that may ~~be~~-exist, organized by IT process include:

(a) Process to manage access:

○ *Authentication*

Controls that ensure a user accessing the IT application or other aspect of the IT environment is using their own log-in credentials (i.e., the user is not using another user's credentials).

- *Authorization*
Controls that allow users to access the information necessary for their job responsibilities and nothing further, which facilitates appropriate segregation of duties.
 - *Provisioning*
Controls to authorize new users and modifications to existing users' access privileges.
 - *Deprovisioning*
Controls to remove user access upon termination or transfer.
 - *Privileged access*
Controls over administrative or powerful users' access.
 - *User access reviews*
Controls to recertify or evaluate user access for ongoing authorization over time.
 - *Security configuration controls*
Each technology generally has key configuration settings that help restrict access to the environment.
 - *Physical access*
Controls over physical access to the data center and hardware, as such access may be used to override other controls.
- (b) Process to manage program or other changes to the IT environment
- *Change management process*
Controls over the process to design, program, test and migrate changes to a production (i.e., end user) environment.
 - *Segregation of duties over change migration*
Controls that segregate access to make and migrate changes to a production environment.
 - *Systems development or acquisition or implementation*
Controls over initial IT application development or implementation (or in relation to other aspects of the IT environment).
 - *Data conversion*
Controls over the conversion of data during development, implementation or upgrades to the IT environment.
- (c) Process to manage IT Operations
- *Job scheduling*

Controls over access to schedule and initiate jobs or programs that may affect financial reporting.

- *Job monitoring*

Controls to monitor financial reporting jobs or programs for successful execution.

- *Backup and recovery*

Controls to ensure backups of financial reporting data occur as planned and that such data is available and able to be accessed for timely recovery in the event of an outage or attack.

- *Intrusion detection*

Controls to monitor for vulnerabilities and or intrusions in the IT environment.

The table below ~~illustrates~~ ~~includes~~ examples of general IT controls ~~that may be identified~~ to address examples ~~of~~ risks arising from the use of IT, ~~including –based for different on the nature of the identified~~ IT applications ~~based on their nature~~.

<u>Process</u>	<u>Risks</u>	<u>Controls</u>	<u>IT Applications applicable to:</u>		
IT Process	Example Risks Arising from the Use of IT	Example General IT Controls	Non-complex commercial software	Mid-size and moderately complex commercial software or IT applications	Large or complex IT applications (e.g., ERP systems)
Manage Access	User-access privileges: Users have access privileges beyond those necessary to perform their assigned duties, which may create improper segregation of duties.	Management approves the nature and extent of user-access privileges for new and modified user access, including standard application profiles/roles, critical financial reporting transactions, and segregation of duties.	Yes – instead of user access reviews below	Yes	Yes
		Access for terminated and/or transferred users is	Yes – instead of	Yes	Yes

		removed or modified in a timely manner.	user access reviews below		
		User access is periodically reviewed.	Yes – instead of provisioning/Deprovisioning controls above	Yes for certain applications	Yes
		Segregation of duties is monitored and conflicting access is either removed or mapped to mitigating controls, which are documented and tested.	N/A – no system enabled segregation	Yes for certain applications	Yes
		Privileged-level access (e.g., configuration, data and security administrators) is authorized and appropriately restricted.	Yes – likely at IT application layer only	Yes at IT application and certain layers of IT environment for platform	Yes at all layers of IT environment for platform
Manage Access	Direct data access: Inappropriate changes are made directly to financial data through means other than application transactions.	Access to application data files and/or database objects/tables/data is limited to authorized personnel, based on their job responsibilities and assigned role, and such access is approved by management.	N/A	Yes for certain applications and databases	Yes
Manage Access	System settings: Systems are not adequately	Access is authenticated through unique user	Yes – password	Yes – mix of password and	Yes

	configured or updated to restrict system access to properly authorized and appropriate users.	IDs and passwords or other methods as a mechanism for validating that users are authorized to gain access to the system. Password parameters meet company and/or industry standards (e.g., password minimum length and complexity, expiration, account lockout).	authentication only	multi-factor authentication	
		The key attributes of the security configuration are appropriately implemented.	N/A – no technical security configurations exist	Yes for certain applications and databases	Yes
Manage Change	Application changes: Inappropriate changes are made to application systems or programs that contain relevant automated controls (i.e., configurable settings, automated algorithms, automated calculations, and automated data extraction) and/or report logic.	Application changes are appropriately tested and approved before being moved into the production environment.	N/A-would verify no source code installed	Yes for non-commercial software	Yes
		Access to implement changes into the application production environment is appropriately restricted and segregated from the development environment.	N/A	Yes for non-commercial software	Yes

Manage Change	Database changes: Inappropriate changes are made to the database structure and relationships between the data.	Database changes are appropriately tested and approved before being moved into the production environment.	N/A – no database changes made at entity	<u>Yes</u> X for non-commercial software	X <u>Yes</u>
Manage Change	System software changes: Inappropriate changes are made to system software (e.g., operating system, network, change-management software, access-control software).	System software changes are appropriately tested and approved before being moved to production.	N/A – no system software changes are made at entity	<u>Yes</u> X	X <u>Yes</u>
Manage Change	Data conversion: Data converted from legacy systems or previous versions introduces data errors if the conversion transfers incomplete, redundant, obsolete, or inaccurate data.	Management approves the results of the conversion of data (e.g., balancing and reconciliation activities) from the old application system or data structure to the new application system or data structure and monitors that the conversion is performed in accordance with established conversion policies and procedures.	N/A – Addressed through manual controls	X <u>Yes</u>	X <u>Yes</u>

IT Operations	Network: The network does not adequately prevent unauthorized users from gaining inappropriate access to information systems.	Access is authenticated through unique user IDs and passwords or other methods as a mechanism for validating that users are authorized to gain access to the system. Password parameters meet company and/or professional policies and standards (e.g., password minimum length and complexity, expiration, account lockout).	N/A – no separate network authentication method exists	Yes	Yes
		Network is architected to segment web-facing applications from the internal network, where ICFR relevant applications are accessed.	N/A – no network segmentation employed	Yes - with judgment	Yes - with judgment
		On a periodic basis, vulnerability scans of the network perimeter are performed by the network management team, which also investigates potential vulnerabilities.	N/A	Yes - with judgment	Yes - with judgment
		On a periodic basis, alerts are generated to provide notification of	N/A	Yes - with judgment	Yes - with judgment

		threats identified by the intrusion detection systems. These threats are investigated by the network management team.			
		Controls are implemented to restrict Virtual Private Network (VPN) access to authorized and appropriate users.	N/A – no VPN	X-Yes - with judgment	X-Yes - with judgment
IT Operations	Data backup and recovery: Financial data cannot be recovered or accessed in a timely manner when there is a loss of data.	Financial data is backed up on a regular basis according to an established schedule and frequency.	N/A – relying on manual backups by finance team	X-Yes	X-Yes
IT Operations	Job scheduling: Production systems, programs, and/or jobs result in inaccurate, incomplete, or unauthorized processing of data.	Only authorized users have access to update the batch jobs (including interface jobs) in the job scheduling software.	N/A – no batch jobs	X-Yes for certain applications	X-Yes
		Critical systems, programs, and/or jobs are monitored, and processing errors are corrected to ensure successful completion.	N/A – no job monitoring	X-Yes for certain applications	X-Yes

Agenda Item 2-I (Updated)

CONFORMING AND CONSEQUENTIAL AMENDMENTS ARISING FROM DRAFT PROPOSED ISA 315 (REVISED)¹

Revised Appendix 2

This Agenda Item presents the proposed conforming amendments arising from changes to ED-315. This Agenda Item (together with the supplement to this Agenda Item) sets out all of the conforming amendments that the Board will be asked to approve.

The changes that are shown in marked (color) are new from Board discussions on Monday September 16th, 2019 with all other conforming and consequential amendments agreed to date hard-coded changes

Within this Appendix, only those paragraphs that have been affected by conforming amendments are presented, for example, a paragraph in the requirements section of the applicable standard is presented if:

- There was a conforming amendment in the paragraph itself, or*
- A footnote, included in the paragraph, has changed; or*
- Application material, related to the paragraph, has changed.*

In all instances, paragraphs that have no changes but are presented for context have been greyed.

The Supplement to this Agenda Item presents all the conforming amendments to other ISAs that will need to be made. For the purpose of the approval, they have been presented in the Supplement (whereas in ED-315 they were described within a table).

There were no further changes to the Supplement arising from the Board discussions.

¹ International Standard on Auditing (ISA), 315 (Revised), *Identifying and Assessing Risks of Material Misstatement*

INTERNATIONAL STANDARD ON AUDITING 200

OVERALL OBJECTIVES OF THE INDEPENDENT AUDITOR AND THE CONDUCT OF AN AUDIT IN ACCORDANCE WITH INTERNATIONAL STANDARDS ON AUDITING

Scope of this ISA

...

An Audit of Financial Statements

...

7. The ISAs contain objectives, requirements and application and other explanatory material that are designed to support the auditor in obtaining reasonable assurance. The ISAs require that the auditor exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit and, among other things:
- Identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, the applicable financial reporting framework and including the entity's system of internal control.
 - Obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
 - Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained.

...

Effective Date

...

Overall Objectives of the Auditor

...

Definitions

13. For purposes of the ISAs, the following terms have the meanings attributed below:

...

- (n) Risk of material misstatement – The risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level: (Ref: Para. A15a)
- (i) Inherent risk – The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

- (ii) Control risk – The risk that a misstatement that could occur in an assertion about a class of transactions, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal controls.

...

Requirements

Ethical Requirements Relating to an Audit of Financial Statements

...

Professional Skepticism

...

Professional Judgment

...

Sufficient Appropriate Audit Evidence and Audit Risk

17. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. (Ref: Para. A30–A54)

Conduct of an Audit in Accordance with ISAs

Complying with ISAs Relevant to the Audit

...

19. The auditor shall have an understanding of the entire text of an ISA, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: Para. A60–A68)

...

Objectives Stated in Individual ISAs

...

Complying with Relevant Requirements

...

Failure to Achieve an Objective

...

Application and Other Explanatory Material

An Audit of Financial Statements

Scope of the Audit (Ref: Para. 3)

...

Preparation of the Financial Statements (Ref: Para. 4)

...

Considerations Specific to Audits in the Public Sector

...

Form of the Auditor's Opinion (Ref: Para. 8)

...

Definitions

Financial Statements (Ref: Para. 13(f))

...

Risk of Material Misstatement (Ref: Para. 13(n))

A15a. ~~In identifying risks of material misstatement, the auditor considers those misstatements that could (i.e., have a reasonable possibility to)~~ For the purposes of the ISAs, a risk of material misstatement exists when:

- (a) There is a reasonable possibility of a misstatement occurring (i.e., its likelihood); and
- (b) If it were to occur, there is a reasonable possibility of the misstatement being material ~~if they were to occur~~ (i.e., its magnitude).

Ethical Requirements Relating to an Audit of Financial Statements (Ref: Para. 14)

...

Professional Skepticism (Ref: Para. 15)

...

Professional Judgment (Ref: Para. 16)

...

Sufficient Appropriate Audit Evidence and Audit Risk (Ref: Para. 5 and 17)

Sufficiency and Appropriateness of Audit Evidence

A30. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has

determined whether changes have occurred since the previous audit that may affect its relevance to the current audit²) or a firm's quality control procedures for client acceptance and continuance. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by an expert employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.

...

Audit Risk

...

Risks of Material Misstatement

...

A40. Inherent risk is influenced by ~~the~~ inherent risk factors. ~~the characteristics of events or conditions that affect the susceptibility to misstatement of an~~ higher for some assertions about a and related classes of transactions, account balances, ~~or and~~ disclosures than for others. Depending on the **extent degree** to which the inherent risk factors affect the susceptibility to misstatement of an assertion ~~is subject to, or affected by, such inherent risk factors~~, the level of inherent risk varies on a scale that is referred to as the spectrum of inherent risk. The auditor determines significant classes of transactions, account balances and disclosures, and their relevant assertions, as part of the process of identifying and assessing the risks of material misstatement. For example, it ~~may be higher for complex calculations or for accounts~~ balances consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty may be identified as significant account balances, and the auditor's assessment of inherent risk for the related risks at the assertion level may be higher because of the high estimation uncertainty.

A40a. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. Factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.

A41. Control risk is a function of the effectiveness of the design, implementation and maintenance of ~~internal controls~~ by management to address identified risks that threaten the achievement of the entity's objectives relevant to preparation of the entity's financial statements. However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, because of the inherent limitations of ~~internal~~

² ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph 219

controls. These include, for example, the possibility of human errors or mistakes, or of controls being circumvented by collusion or inappropriate management override. Accordingly, some control risk will always exist. The ISAs provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures to be performed.³

A42.⁴ The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made. ~~In most cases, the ISAs typically do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the “risks of material misstatement.” rather than to inherent risk and control risk separately.~~ However, ISA 540~~315~~ (Revised)⁵ requires a ~~separate assessment of inherent risk to be assessed separately from and control risk at the assertion level~~ to provide a basis for designing and performing further audit procedures to respond to the assessed risks of material misstatement at the assertion level, including significant risks, for accounting estimates at the assertion level in accordance with ISA 330.⁶ ~~In identifying and assessing risks of material misstatement for significant classes of transactions, account balances or disclosures other than accounting estimates, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations.~~

A43a. Risks of material misstatement are assessed at the assertion level in order to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence.⁷

Detection Risk

...

Inherent Limitations of an Audit

...

The Nature of Financial Reporting

...

³ ISA 330, *The Auditor's Responses to Assessed Risks*, paragraphs 7–17

⁴ Note that paragraph A42 of ISA 200 is marked to the updated paragraph presented separately as a conforming amendment relating to ISA 540 (Revised) and its conforming amendments and presented as a Supplement to ED-315.

⁵ ISA 540~~315~~ (Revised), *Auditing Accounting Estimates and Disclosures*, paragraph 15 Identifying and Assessing the Risks of Material Misstatement

⁶ ISA 330, paragraph 7(b)

⁷ ISA 330, paragraph 6

The Nature of Audit Procedures

...

Timeliness of Financial Reporting and the Balance between Benefit and Cost

...

A52. In light of the approaches described in paragraph A51, the ISAs contain requirements for the planning and performance of the audit and require the auditor, among other things, to:

- Have a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels by performing risk assessment procedures and related activities;⁸ and
- Use testing and other means of examining populations in a manner that provides a reasonable basis for the auditor to draw conclusions about the population.⁹

Other Matters that Affect the Inherent Limitations of an Audit

...

Conduct of an Audit in Accordance with ISAs

Nature of the ISAs (Ref: Para. 18)

...

Considerations Specific to Audits in the Public Sector

...

Contents of the ISAs (Ref: Para. 19)

A60. In addition to objectives and requirements (requirements are expressed in the ISAs using “shall”), an ISA contains related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context relevant to a proper understanding of the ISA, and definitions. The entire text of an ISA, therefore, is relevant to an understanding of the objectives stated in an ISA and the proper application of the requirements of an ISA.

A61. Where necessary, the application and other explanatory material provides further explanation of the requirements of an ISA and guidance for carrying them out. In particular, it may:

- Explain more precisely what a requirement means or is intended to cover. including in some ISAs, such as ISA 315 (Revised), why a procedure is required ~~and presented under specific headings.~~
- Include examples of procedures that may be appropriate in the circumstances. In some ISAs, such as ISA 315 (Revised), examples are presented in boxes.

While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements of an ISA. The application and other explanatory material may also provide

⁸ ISA 315 (Revised), paragraphs 175–224~~9~~

⁹ ISA 330; ISA 500; ISA 520, *Analytical Procedures*; ISA 530, *Audit Sampling*

background information on matters addressed in an ISA. ~~In some ISAs (such as ISA 315 (Revised)), examples in the application and other explanatory material may be formatted differently from other ISAs (e.g., examples may be presented within boxes). Regardless, these examples form an integral part of the application and other explanatory material.~~

~~A61a. Some ISAs (e.g., ISA 315 (Revised)) describe why a procedure is required within the application or other explanatory material. These paragraphs assist with understanding the context of the requirement, but do not establish additional requirements within the relevant ISA.~~

Considerations Specific to Smaller Entities Scalability Considerations

A65a Scalability considerations have been included in some ISAs (ISA 315 (Revised)), illustrating the application of the requirements to all entities ~~whose~~ regardless of whether their nature and circumstances are less complex, ~~as well as those that are~~ or more complex. Less complex entities are entities for which ~~the majority of~~ the characteristics in paragraph may A66 apply.

~~A65b~~67. [Previously paragraph A67] The “considerations specific to smaller entities” included in ~~some~~ the ISAs have been developed primarily with unlisted entities in mind. Some of the considerations, however, may be helpful in audits of smaller listed entities.

A66. For purposes of specifying additional considerations to audits of smaller entities, a “smaller entity” refers to an entity which typically possesses qualitative characteristics such as:

- (a) Concentration of ownership and management in a small number of individuals (often a single individual – either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and
- (b) One or more of the following:
 - (i) Straightforward or uncomplicated transactions;
 - (ii) Simple record-keeping;
 - (iii) Few lines of business and few products within business lines;
 - (iv) Simpler systems of ~~Few~~ internal controls;
 - (v) Few levels of management with responsibility for a broad range of controls; or
 - (vi) Few personnel, many having a wide range of duties.

These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all of these characteristics.

A67 [Moved – now A65b]

~~A66a [Previously A67a] Some ISAs (for example, ISA 315 (Revised)) incorporate considerations specific to audits of smaller less complex entities when such entities are also less complex (i.e., smaller entities for which the majority of the characteristics in paragraph A66(b) apply). Accordingly, in this context, ISA 315 (Revised) these ISAs refers to ‘smaller and less complex entities.’~~

Considerations Specific to Automated Tools and Techniques

A67a. The considerations specific to “automated tools and techniques” included in some ISAs (for example, ISA 315 (Revised)) have been developed to explain how the auditor may apply certain requirements when using automated tools and techniques in performing audit procedures.

Objectives Stated in Individual ISAs (Ref: Para. 21)

...

Use of Objectives to Determine Need for Additional Audit Procedures (Ref: Para. 21(a))

...

Use of Objectives to Evaluate Whether Sufficient Appropriate Audit Evidence Has Been Obtained (Ref: Para. 21(b))

...

Complying with Relevant Requirements

Relevant Requirements (Ref: Para. 22)

...

Departure from a Requirement (Ref: Para. 23)

...

Failure to Achieve an Objective (Ref: Para. 24)

...

INTERNATIONAL STANDARD ON AUDITING 240

THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS

Introduction

Scope of this ISA

...

Characteristics of Fraud

...

Responsibility for the Prevention and Detection of Fraud

...

Responsibilities of the Auditor

...

7. Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override controls ~~procedures~~ designed to prevent similar frauds by other employees.

...

Effective Date

...

Objectives

...

Definitions

...

Requirements

Professional Skepticism

12. In accordance with ISA 200,¹⁰ the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance. (Ref: Para. A7–A8)

¹⁰ ISA 200, paragraph 15

13. Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. If conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further. (Ref: Para. A9)
14. Where responses to inquiries of management or those charged with governance are inconsistent, the auditor shall investigate the inconsistencies.

Discussion among the Engagement Team

15. ISA 315 (Revised) requires a discussion among the engagement team members and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion.¹¹ This discussion shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. The discussion shall occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity. (Ref: Para. A10–A11)

Risk Assessment Procedures and Related Activities

16. When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, the applicable financial reporting framework and including the entity's system of internal control, required by ISA 315 (Revised),¹² the auditor shall perform the procedures in paragraphs ~~2317–43424~~ to obtain information for use in identifying the risks of material misstatement due to fraud.

Management and Others within the Entity

...

Those Charged with Governance

20. Unless all of those charged with governance are involved in managing the entity,¹³ the auditor shall obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the ~~internal controls~~ that management has established to mitigate these risks. (Ref: Para. A19–A21)

...

Unusual or Unexpected Relationships Identified

...

Other Information

¹¹ ISA 315 (Revised), paragraph ~~22–22A~~ 40

¹² ~~ISA 315 (Revised), paragraphs 5–24~~

¹³ ISA 260 (Revised), *Communication with Those Charged with Governance*, paragraph 13

23. The auditor shall consider whether other information obtained by the auditor indicates risks of material misstatement due to fraud. (Ref: Para. A22)

Evaluation of Fraud Risk Factors

24. The auditor shall evaluate whether the information obtained from the other risk assessment procedures and related activities performed indicates that one or more fraud risk factors are present. While fraud risk factors may not necessarily indicate the existence of fraud, they have often been present in circumstances where frauds have occurred and therefore may indicate risks of material misstatement due to fraud. (Ref: Para. A23–A27)

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

25. In accordance with ISA 315 (Revised), the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures.¹⁴
26. When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. Paragraph 47 specifies the documentation required where the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud. (Ref: Para. A28–A30)
27. The auditor shall treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the auditor shall ~~obtain an understanding of the entity's related~~ identify the entity's controls, including control activities, relevant to that address such risks as controls relevant to the audit, and evaluate their design and determine whether they have been implemented.¹⁵ (Ref: Para. A31–A32)

Responses to the Assessed Risks of Material Misstatement Due to Fraud

Overall Responses

...

Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level

...

Audit Procedures Responsive to Risks Related to Management Override of Controls

...

32. Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to:

¹⁴ ISA 315 (Revised), paragraphs ~~2–45~~, 47 and 48

¹⁵ ISA 315 (Revised), paragraph 39(a)(i) and 39(d)

- (a) Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. In designing and performing audit procedures for such tests, the auditor shall:
- (i) Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
 - (ii) Select journal entries and other adjustments made at the end of a reporting period; and
 - (iii) Consider the need to test journal entries and other adjustments throughout the period.
- (Ref: Para. A41–A44)

...

Evaluation of Audit Evidence (Ref: Para. A49)

...

Auditor Unable to Continue the Engagement

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Written Representations

...

Communications to Management and with Those Charged with Governance

...

Communications to Regulatory and Enforcement Authorities

...

Documentation

44. The auditor shall include the following in the audit documentation¹⁶ ~~of the auditor's understanding of the entity and its environment and of the identification and~~ the assessment of the risks of material misstatement required by ISA 315 (Revised):¹⁷
- (a) The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud; ~~and~~
 - (b) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level; ~~and~~
 - (c) ~~Controls identified to be relevant to the audit because they~~ Identified controls in the control activities component that address assessed risks of material misstatement due to fraud.

...

¹⁶ ISA 230, *Audit Documentation*, paragraphs 8–11, and paragraph A6

¹⁷ ISA 315 (Revised), paragraph ~~54~~32

Application and Other Explanatory Material

Characteristics of Fraud (Ref: Para. 3)

...

Professional Skepticism (Ref: Para. 12–14)

- A7. Maintaining professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information to be used as audit evidence and ~~the identified controls in the control activities component, if any, over its preparation and maintenance, where when such controls are identified to be controls relevant to the audit.~~ Due to the characteristics of fraud, the auditor's professional skepticism is particularly important when considering the risks of material misstatement due to fraud.

...

Discussion Among the Engagement Team (Ref: Para. 15)

...

Risk Assessment Procedures and Related Activities

Inquiries of Management

Management's Assessment of the Risk of Material Misstatement Due to Fraud (Ref: Para. 17(a))

...

Inquiry of Internal Audit (Ref: Para. 19)

- A18. ISA 315 (Revised) and ISA 610 (Revised 2013) establish requirements and provide guidance relevant to audits of those entities that have an internal audit function.¹⁸ In carrying out the requirements of those ISAs in the context of fraud, the auditor may inquire about specific activities of the function including, for example:

- The procedures performed, if any, by the internal auditor function during the year to detect fraud.
- Whether management has satisfactorily responded to any findings resulting from those procedures.

Obtaining an Understanding of Oversight Exercised by Those Charged with Governance (Ref: Para. 20)

- A19. Those charged with governance of an entity oversee the entity's systems for monitoring risk, financial control and compliance with the law. In many countries, corporate governance practices are well developed and those charged with governance play an active role in oversight of the entity's assessment of the risks of fraud and ~~of the relevant internal control the controls that address such risks.~~ Since the responsibilities of those charged with governance and management may vary by

¹⁸ ISA 315 (Revised), paragraphs 186(a) and 31A(a)(ii)-23, and ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

entity and by country, it is important that the auditor understands their respective responsibilities to enable the auditor to obtain an understanding of the oversight exercised by the appropriate individuals.¹⁹

- A20. An understanding of the oversight exercised by those charged with governance may provide insights regarding the susceptibility of the entity to management fraud, the adequacy of ~~internal controls~~ that address ~~over~~ risks of fraud, and the competency and integrity of management. The auditor may obtain this understanding in a number of ways, such as by attending meetings where such discussions take place, reading the minutes from such meetings or making inquiries of those charged with governance.

Considerations Specific to Smaller Entities

...

Consideration of Other Information (Ref: Para. 23)

- A22. In addition to information obtained from applying analytical procedures, other information obtained about the entity and its environment, the applicable financial reporting framework and the entity's system of internal control may be helpful in identifying the risks of material misstatement due to fraud. The discussion among team members may provide information that is helpful in identifying such risks. In addition, information obtained from the auditor's client acceptance and retention processes, and experience gained on other engagements performed for the entity, for example, engagements to review interim financial information, may be relevant in the identification of the risks of material misstatement due to fraud.

Evaluation of Fraud Risk Factors (Ref: Para. 24)

...

- A25. Examples of fraud risk factors related to fraudulent financial reporting and misappropriation of assets are presented in Appendix 1. These illustrative risk factors are classified based on the three conditions that are generally present when fraud exists:
- An incentive or pressure to commit fraud;
 - A perceived opportunity to commit fraud; and
 - An ability to rationalize the fraudulent action.

Fraud risk factors may relate to incentives, pressures or opportunities that arise from conditions that create susceptibility to misstatement, before consideration of controls. Fraud risk factors, which includes intentional management bias, are, which are inherent risk factors insofar as they affect inherent risk, are inherent risk factors. and may be due to management bias or fraud (which is an inherent risk factor).²⁰ Alternatively, Fraud risk factors may also relate to conditions within the entity's system of internal control that provide opportunity to commit fraud or that may affect management's attitude or ability to rationalize fraudulent actions. Fraud rRisk factors reflective of an attitude that

¹⁹ ISA 260 (Revised), paragraphs A1–A8, discuss with whom the auditor communicates when the entity's governance structure is not well defined.

²⁰ ISA 315 (Revised), paragraph 16(f)

permits rationalization of the fraudulent action may not be susceptible to observation by the auditor. Nevertheless, the auditor may become aware of the existence of such information through, for example, the required understanding of the entity's control environment.²¹ Although the fraud risk factors described in Appendix 1 cover a broad range of situations that may be faced by auditors, they are only examples and other risk factors may exist.

...

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

Risks of Fraud in Revenue Recognition (Ref: Para. 26)

...

Identifying and Assessing the Risks of Material Misstatement Due to Fraud and Understanding the Entity's Related Controls (Ref: Para. 27)

A31. Management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume. In determining which controls to implement to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated as a result of fraud. As part of this consideration, management may conclude that it is not cost effective to implement and maintain a particular control in relation to the reduction in the risks of material misstatement due to fraud to be achieved.

A32. It is therefore important for the auditor to obtain an understanding of the controls that management has designed, implemented and maintained to prevent and detect fraud. ~~In doing so, In identifying the controls relevant to the audit that address the risks of material misstatement due to fraud, the~~ auditor may learn, for example, that management has consciously chosen to accept the risks associated with a lack of segregation of duties. Information from ~~obtaining this understanding identifying these controls, and evaluating their design and determining whether they have been implemented,~~ may also be useful in identifying fraud risks factors that may affect the auditor's assessment of the risks that the financial statements may contain material misstatement due to fraud.

Responses to the Assessed Risks of Material Misstatement Due to Fraud

Overall Responses (Ref: Para. 28)

...

Assignment and Supervision of Personnel (Ref: Para. 29(a))

...

Unpredictability in the Selection of Audit Procedures (Ref: Para. 29(c))

...

Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level (Ref: Para. 30)

...

²¹ ISA 315 (Revised), paragraphs 28

Audit Procedures Responsive to Risks Related to Management Override of Controls

Journal Entries and Other Adjustments (Ref: Para. 32(a))

...

A42. Further, the auditor's consideration of the risks of material misstatement associated with inappropriate override of controls over journal entries²² is important since automated processes and controls may reduce the risk of inadvertent error but do not overcome the risk that individuals may inappropriately override such automated processes, for example, by changing the amounts being automatically passed to the general ledger or to the financial reporting system. Furthermore, where IT is used to transfer information automatically, there may be little or no visible evidence of such intervention in the information systems.

A43. When identifying and selecting journal entries and other adjustments for testing and determining the appropriate method of examining the underlying support for the items selected, the following matters are of relevance:

- *The identification and assessment of the risks of material misstatement due to fraud – the presence of fraud risk factors and other information obtained during the auditor's identification and assessment of the risks of material misstatement due to fraud may assist the auditor to identify specific classes of journal entries and other adjustments for testing.*
- *Controls that have been implemented over journal entries and other adjustments – effective controls over the preparation and posting of journal entries and other adjustments may reduce the extent of substantive testing necessary, provided that the auditor has tested the operating effectiveness of the controls.*
- *The entity's financial reporting process and the nature of evidence that can be obtained – for many entities routine processing of transactions involves a combination of manual and automated ~~steps and procedures~~ controls. Similarly, the processing of journal entries and other adjustments may involve both manual and automated ~~procedures~~ and controls. Where information technology is used in the financial reporting process, journal entries and other adjustments may exist only in electronic form.*
- *The characteristics of fraudulent journal entries or other adjustments – inappropriate journal entries or other adjustments often have unique identifying characteristics. Such characteristics may include entries (a) made to unrelated, unusual, or seldom-used accounts, (b) made by individuals who typically do not make journal entries, (c) recorded at the end of the period or as post-closing entries that have little or no explanation or description, (d) made either before or during the preparation of the financial statements that do not have account numbers, or (e) containing round numbers or consistent ending numbers.*
- *The nature and complexity of the accounts – inappropriate journal entries or adjustments may be applied to accounts that (a) contain transactions that are complex or unusual in nature, (b) contain significant estimates and period-end adjustments, (c) have been prone to misstatements in the past, (d) have not been reconciled on a timely basis or contain unreconciled differences, (e) contain inter-company transactions, or (f) are otherwise associated with an identified risk of material*

²² ISA 315 (Revised), paragraph 39(a)(iii)

misstatement due to fraud. In audits of entities that have several locations or components, consideration is given to the need to select journal entries from multiple locations.

- *Journal entries or other adjustments processed outside the normal course of business* – non standard journal entries may not be subject to the same ~~level of internal nature and extent of controls~~ as those journal entries used on a recurring basis to record transactions such as monthly sales, purchases and cash disbursements.

...

Accounting Estimates (Ref: Para. 32(b))

...

Business Rationale for Significant Transactions (Ref: Para. 32(c))

...

Evaluation of Audit Evidence (Ref: Para. 34–37)

...

Analytical Procedures Performed Near the End of the Audit in Forming an Overall Conclusion (Ref: Para. 34)

...

Consideration of Identified Misstatements (Ref: Para. 35–37)

...

Auditor Unable to Continue the Engagement (Ref: Para. 38)

...

Written Representations (Ref: Para. 39)

...

Communications to Management and with Those Charged with Governance

Communication to Management (Ref: Para. 40)

...

Communication with Those Charged with Governance (Ref: Para. 41)

...

Other Matters Related to Fraud (Ref: Para. 42)

...

Communications to Regulatory and Enforcement Authorities (Ref: Para. 43)

...

Appendix 1

(Ref: Para. A25)

Examples of Fraud Risk Factors

The fraud risk factors identified in this Appendix are examples of such factors that may be faced by auditors in a broad range of situations. Separately presented are examples relating to the two types of fraud relevant to the auditor's consideration – that is, fraudulent financial reporting and misappropriation of assets. For each of these types of fraud, the risk factors are further classified based on the three conditions generally present when material misstatements due to fraud occur: (a) incentives/pressures, (b) opportunities, and (c) attitudes/rationalizations. Although the risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different size or with different ownership characteristics or circumstances. Also, the order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

Fraud risk factors may related to incentives or pressures, or opportunities, typically may that arise from conditions that create susceptibility to misstatement before consideration of controls (i.e., the, which are inherent risk) factors. Such factors are inherent risk factors, insofar as they affect inherent risk, and may be due to management bias or fraud (which is an inherent risk factor). Fraud risk factors related to opportunities may also arise from other identified inherent risk factors (e.g., for example, complexity or uncertainty may create opportunities that result in susceptibility to misstatement due to fraud). Fraud risk factors related to opportunities may also relate to conditions within the entity's system of internal control, such as limitations or deficiencies in the entity's internal control that create such opportunities. Fraud risk factors related to attitudes or rationalizations may arise, in particular, from limitations or deficiencies in the entity's control environment.

Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting

The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting.

Incentives/Pressures

Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by):

...

Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:

...

Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity's financial performance arising from the following:

...

Opportunities

The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

...

The monitoring of management is not effective as a result of the following:

...

There is a complex or unstable organizational structure, as evidenced by the following:

...

~~Internal control components are deficient~~ Deficiencies in internal control as a result of the following:

- Inadequate ~~monitoring of controls~~ process to monitor the entity's system of internal control, including automated controls and controls over interim financial reporting (where external reporting is required).
- High turnover rates or employment of staff in accounting, information technology, or the internal audit function that are not effective.
- Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

Attitudes/Rationalizations

...

Risk Factors Arising from Misstatements Arising from Misappropriation of Assets

Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization. Some of the risk factors related to misstatements arising from fraudulent financial reporting also may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring of management and other deficiencies in internal control may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.

Incentives/Pressures

...

Opportunities

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

...

~~Inadequate internal controls~~ over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

- Inadequate segregation of duties or independent checks.
- Inadequate oversight of senior management expenditures, such as travel and other re-imbursements.
- Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.
- Inadequate job applicant screening of employees with access to assets.
- Inadequate record keeping with respect to assets.
- Inadequate system of authorization and approval of transactions (for example, in purchasing).
- Inadequate physical safeguards over cash, investments, inventory, or fixed assets.
- Lack of complete and timely reconciliations of assets.
- Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
- Lack of mandatory vacations for employees performing key control functions.
- Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.
- Inadequate access controls over automated records, including controls over and review of computer systems event logs.

Attitudes/Rationalizations

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- Disregard for ~~internal controls~~ over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.
- Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- Changes in behavior or lifestyle that may indicate assets have been misappropriated.
- Tolerance of petty theft.

Appendix 2

(Ref: Para. A40)

Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud

The following are examples of possible audit procedures to address the assessed risks of material misstatement due to fraud resulting from both fraudulent financial reporting and misappropriation of assets. Although these procedures cover a broad range of situations, they are only examples and, accordingly they may not be the most appropriate nor necessary in each circumstance. Also the order of the procedures provided is not intended to reflect their relative importance.

Consideration at the Assertion Level

Specific responses to the auditor's assessment of the risks of material misstatement due to fraud will vary depending upon the types or combinations of fraud risk factors or conditions identified, and the classes of transactions, account balances, disclosures and assertions they may affect.

The following are specific examples of responses:

...

- If the work of an expert becomes particularly significant with respect to a financial statement item for which the assessed risk of material misstatement due to fraud is high, performing additional procedures relating to some or all of the expert's assumptions, methods or findings to determine that the findings are not unreasonable, or engaging another expert for that purpose.

...

Specific Responses—Misstatement Resulting from Fraudulent Financial Reporting

Examples of responses to the auditor's assessment of the risks of material misstatement due to fraudulent financial reporting are as follows:

...

Appendix 3

(Ref: Para. A49)

Examples of Circumstances that Indicate the Possibility of Fraud

The following are examples of circumstances that may indicate the possibility that the financial statements may contain a material misstatement resulting from fraud.

...

INTERNATIONAL STANDARD ON AUDITING 330 THE AUDITOR'S RESPONSES TO ASSESSED RISKS

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with ISA 315 (Revised)²³ in an audit of financial statements.

Effective Date

2. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009.

Objective

3. The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks.

Definitions

4. For purposes of the ISAs, the following terms have the meanings attributed below:
 - (a) Substantive procedure – An audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise:
 - (i) Tests of details (of classes of transactions, account balances, and disclosures); and
 - (ii) Substantive analytical procedures.
 - (b) Test of controls – An audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

Requirements

Overall Responses

5. The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level. (Ref: Para. A1–A3)

²³ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

6. The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level. (Ref: Para. A4–A8; A42–A52)
7. In designing the further audit procedures to be performed, the auditor shall:
 - (a) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each significant class of transactions, account balance, and disclosure, including:
 - (i) The likelihood and magnitude of ~~material~~ misstatement due to the particular characteristics of the ~~relevant~~ significant class of transactions, account balance, or disclosure (that is, the inherent risk); and
 - (ii) Whether the risk assessment takes account of ~~relevant~~ controls that address the risk of material misstatement (that is, the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the auditor ~~intends to rely on~~ plans to test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); and (Ref: Para. A9–A18)
 - (b) Obtain more persuasive audit evidence the higher the auditor's assessment of risk. (Ref: Para. A19)

Tests of Controls

8. The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of ~~relevant~~ controls if:
 - (a) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (that is, the auditor ~~intends plans to test to rely on~~ the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or
 - (b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. (Ref: Para. A20–A24)
9. In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control. (Ref: Para. A25)

Nature and Extent of Tests of Controls

10. In designing and performing tests of controls, the auditor shall:
 - (a) Perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including:
 - (i) How the controls were applied at relevant times during the period under audit;
 - (ii) The consistency with which they were applied; and

(iii) By whom or by what means they were applied. (Ref: Para. A26–A29a)

(b) To the extent not already addressed, ~~d~~Determine whether the controls to be tested depend upon other controls (indirect controls), and, if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls. (Ref: Para. A30–A31)

Timing of Tests of Controls

11. The auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls, subject to paragraphs 12 and 15 below, in order to provide an appropriate basis for the auditor's intended reliance. (Ref: Para. A32)

Using audit evidence obtained during an interim period

12. If the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the auditor shall:

- (a) Obtain audit evidence about significant changes to those controls subsequent to the interim period; and
- (b) Determine the additional audit evidence to be obtained for the remaining period. (Ref: Para. A33–A34)

Using audit evidence obtained in previous audits

13. In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control, the auditor shall consider the following:

- (a) The effectiveness of other ~~elements—components of the entity's system of~~ internal control, including the control environment, the entity's process to monitoring of the system of internal controls, and the entity's risk assessment process;
- (b) The risks arising from the characteristics of the control, including whether it is manual or automated;
- (c) The effectiveness of general IT controls;
- (d) The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control;
- (e) Whether the lack of a change in a particular control poses a risk due to changing circumstances; and
- (f) The risks of material misstatement and the extent of reliance on the control. (Ref: Para. A35)

14. If the auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, the auditor shall establish the continuing relevance and reliability of that evidence by obtaining audit evidence about whether significant changes in those controls have occurred subsequent to the previous audit. The auditor shall obtain this evidence by performing inquiry combined with observation or inspection, to confirm the understanding of those specific controls, and:

- (a) If there have been changes that affect the continuing relevance of the audit evidence from the previous audit, the auditor shall test the controls in the current audit. (Ref: Para. A36)
- (b) If there have not been such changes, the auditor shall test the controls at least once in every third audit, and shall test some controls each audit to avoid the possibility of testing all the controls on which the auditor intends to rely in a single audit period with no testing of controls in the subsequent two audit periods. (Ref: Para. A37–A39)

Controls over significant risks

- 15. If the auditor ~~plans to~~ intends to rely ~~test~~ on controls over a risk the auditor has determined to be a significant risk, the auditor shall test those controls in the current period.

Evaluating the Operating Effectiveness of Controls

- 16. When evaluating the operating effectiveness of ~~relevant~~ controls upon which the auditor intends to rely, the auditor shall evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective. (Ref: Para. A40)
- 17. If deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether: (Ref: Para. A41)
 - (a) The tests of controls that have been performed provide an appropriate basis for reliance on the controls;
 - (b) Additional tests of controls are necessary; or
 - (c) The ~~potential~~ risks of material misstatement need to be addressed using substantive procedures.

Substantive Procedures

- 18. Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material ~~material~~ class of transactions, account balance, and disclosure ~~that is quantitatively or qualitatively material~~. (Ref: Para. A42–A47)
- 19. The auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures. (Ref: Para. A48–A51)

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 in the financial statements with the underlying accounting records, including agreeing or reconciling information in disclosures, whether such information is obtained from within or outside of 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)

Substantive Procedures Responsive to Significant Risks

21. If the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details. (Ref: Para. A53)

Timing of Substantive Procedures

22. If substantive procedures are performed at an interim date, the auditor shall cover the remaining period by performing:
- (a) substantive procedures, combined with tests of controls for the intervening period; or
 - (b) if the auditor determines that it is sufficient, further substantive procedures only,
- that provide a reasonable basis for extending the audit conclusions from the interim date to the period end. (Ref: Para. A54–A57)
23. If misstatements that the auditor did not expect when assessing the risks of material misstatement are detected at an interim date, the auditor shall evaluate whether the related assessment of risk and the planned nature, timing or extent of substantive procedures covering the remaining period need to be modified. (Ref: Para. A58)

Adequacy of Presentation of the Financial Statements

24. The auditor shall perform audit procedures to evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework. In making this evaluation, the auditor shall consider whether the financial statements are presented in a manner that reflects the appropriate:
- Classification and description of financial information and the underlying transactions, events and conditions; and
 - Presentation, structure and content of the financial statements. (Ref: Para. A59)

Evaluating the Sufficiency and Appropriateness of Audit Evidence

25. Based on the audit procedures performed and the audit evidence obtained, the auditor shall evaluate before the conclusion of the audit whether the assessments of the risks of material misstatement at the assertion level remain appropriate. (Ref: Para. A60–A61)
26. The auditor shall conclude whether sufficient appropriate audit evidence has been obtained. In forming an opinion, the auditor shall consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements. (Ref: Para. A62)
27. If the auditor has not obtained sufficient appropriate audit evidence ~~as to the risk of material misstatement~~ related to an material financial statement relevant assertion about a class of transactions, account balance or disclosure, the auditor shall attempt to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements.

Documentation

28. The auditor shall include in the audit documentation:²⁴

- (a) The overall responses to address the assessed risks of material misstatement at the financial statement level, and the nature, timing and extent of the further audit procedures performed;
- (b) The linkage of those procedures with the assessed risks at the assertion level; and
- (c) The results of the audit procedures, including the conclusions where these are not otherwise clear. (Ref: Para. A63)

29. If the auditor plans to use audit evidence about the operating effectiveness of controls obtained in previous audits, the auditor shall include in the audit documentation the conclusions reached about relying on such controls that were tested in a previous audit.

30. The auditor's documentation shall demonstrate that information in the financial statements agrees or reconciles with the underlying accounting records, including agreeing or reconciling disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers.

Application and Other Explanatory Material

Overall Responses (Ref: Para. 5)

A1. Overall responses to address the assessed risks of material misstatement at the financial statement level may include:

- Emphasizing to the engagement team the need to maintain professional skepticism.
- Assigning more experienced staff or those with special skills or using experts.
- ~~Providing more supervision~~ Changes to the nature, timing and extent of direction and supervision of members of the engagement team and the review of the work performed.
- Incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.
- Changes to the overall audit strategy as required by ISA 300, or planned audit procedures, and may include changes to:
 - The auditor's determination of performance materiality in accordance with ISA 320.
 - The auditor's plans to test the operating effectiveness of controls, and the persuasiveness of audit evidence needed to support the planned reliance on the operating effectiveness of the controls, particularly when deficiencies in the control environment or the entity's monitoring activities are identified.
 - The nature, timing and extent of substantive procedures. For example, it may be appropriate to perform substantive procedures at or near the date of the financial statements when the risk of material misstatement is assessed as higher.

²⁴ ISA 230, *Audit Documentation*, paragraphs 8–11, and A6

- ~~Making general changes to the nature, timing or extent of audit procedures, for example: performing substantive procedures at the period end instead of at an interim date; or modifying the nature of audit procedures to obtain more persuasive audit evidence.~~

A2. The assessment of the risks of material misstatement at the financial statement level, and thereby the auditor's overall responses, is affected by the auditor's understanding of the control environment. An effective control environment may allow the auditor to have more confidence in internal control and the reliability of audit evidence generated internally within the entity and thus, for example, allow the auditor to conduct some audit procedures at an interim date rather than at the period end. Deficiencies in the control environment, however, have the opposite effect; for example, the auditor may respond to an ineffective control environment by:

- Conducting more audit procedures as of the period end rather than at an interim date.
- Obtaining more extensive audit evidence from substantive procedures.
- Increasing the number of locations to be included in the audit scope.

A3. Such considerations, therefore, have a significant bearing on the auditor's general approach, for example, an emphasis on substantive procedures (substantive approach), or an approach that uses tests of controls as well as substantive procedures (combined approach).

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)

A4. The auditor's assessment of the identified risks of material misstatement at the assertion level provides a basis for considering the appropriate audit approach for designing and performing further audit procedures. For example, the auditor may determine that:

- (a) Only by performing tests of controls may the auditor achieve an effective response to the assessed risk of material misstatement for a particular assertion;
- (b) Performing only substantive procedures is appropriate for particular assertions and, therefore, the auditor excludes the effect of controls from the ~~relevant risk assessment~~ assessment of the risk of material misstatement. This may be because the ~~auditor's risk assessment procedures have not identified any effective controls relevant to the assertion, or because auditor is not required to test the operating effectiveness of controls~~ has not identified a risk for which substantive procedures alone cannot provide sufficient appropriate audit evidence and therefore is not required to test the operating effectiveness of controls ~~considers that testing controls would be inefficient, and therefore, the auditor does not intend to rely on~~ plan to test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures; or
- (c) A combined approach using both tests of controls and substantive procedures is an effective approach.

Auditors need not design and perform further audit procedures where the assessment of the risk of material misstatement is acceptably low. However, as required by paragraph 18, irrespective of the approach selected and the assessed risk of material misstatement, the auditor designs and performs substantive procedures for each material ~~material~~ class of transactions, account balance, and

disclosure. ~~that is quantitatively or qualitatively material. Auditors need not design and perform further audit procedures for risks of material misstatement at the assertion level that have been assessed as reasonably low. Auditors need not design and perform further audit procedures where the assessment of the risk of material misstatement is below the acceptably low level.~~

- A5. The nature of an audit procedure refers to its purpose (that is, test of controls or substantive procedure) and its type (that is, inspection, observation, inquiry, confirmation, recalculation, reperformance, or analytical procedure). The nature of the audit procedures is of most importance in responding to the assessed risks.
- A6. Timing of an audit procedure refers to when it is performed, or the period or date to which the audit evidence applies.
- A7. Extent of an audit procedure refers to the quantity to be performed, for example, a sample size or the number of observations of a control activity.
- A8. Designing and performing further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level provides a clear linkage between the auditor's further audit procedures and the risk assessment.

Responding to the Assessed Risks at the Assertion Level (Ref: Para. 7(a))

Nature

- A9. ISA 315 (Revised) requires that the auditor's assessment of the risks of material misstatement at the assertion level is performed by assessing inherent risk and control risk. The auditor assesses inherent risk by assessing the likelihood and magnitude of a material misstatement taking into account how, and the degree to which the inherent risk factors affect the susceptibility to misstatement of relevant assertions. , identified events or conditions relating to significant classes of transactions, account balances or disclosures are subject to, or affected by, the inherent risk factors.²⁵ The auditor's assessed risks, including the reasons for those assessed risks, may affect both the types of audit procedures to be performed and their combination. For example, when an assessed risk is high, the auditor may confirm the completeness of the terms of a contract with the counterparty, in addition to inspecting the document. Further, certain audit procedures may be more appropriate for some assertions than others. For example, in relation to revenue, tests of controls may be most responsive to the assessed risk of material misstatement of the completeness assertion, whereas substantive procedures may be most responsive to the assessed risk of material misstatement of the occurrence assertion.
- A10. The reasons for the assessment given to a risk are relevant in determining the nature of audit procedures. For example, if an assessed risk is lower because of the particular characteristics of a class of transactions without consideration of the related controls, then the auditor may determine that substantive analytical procedures alone provide sufficient appropriate audit evidence. On the other hand, if the assessed risk is lower because ~~of internal~~ the auditor plans intends to test the operating effectiveness of controls, and the auditor intends to base the substantive procedures on that low assessment, then the auditor performs tests of those controls, as required by paragraph 8(a).

²⁵ ISA 315 paragraph 48

This may be the case, for example, for a class of transactions of reasonably uniform, non-complex characteristics that are routinely processed and controlled by the entity's information system.

Timing

A11. The auditor may perform tests of controls or substantive procedures at an interim date or at the period end. The higher the risk of material misstatement, the more likely it is that the auditor may decide it is more effective to perform substantive procedures nearer to, or at, the period end rather than at an earlier date, or to perform audit procedures unannounced or at unpredictable times (for example, performing audit procedures at selected locations on an unannounced basis). This is particularly relevant when considering the response to the risks of fraud. For example, the auditor may conclude that, when the risks of intentional misstatement or manipulation have been identified, audit procedures to extend audit conclusions from interim date to the period end would not be effective.

A12. On the other hand, performing audit procedures before the period end may assist the auditor in identifying significant matters at an early stage of the audit, and consequently resolving them with the assistance of management or developing an effective audit approach to address such matters.

A13. In addition, certain audit procedures can be performed only at or after the period end, for example:

- Agreeing or reconciling information in the financial statements with the underlying accounting records, including agreeing or reconciling disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers;
- Examining adjustments made during the course of preparing the financial statements; and
- Procedures to respond to a risk that, at the period end, the entity may have entered into improper sales contracts, or transactions may not have been finalized.

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, the statement of comprehensive income, the statement of changes in equity or the statement of cash flows.

Extent

A15. The extent of an audit procedure judged necessary is determined after considering the materiality, the assessed risk, and the degree of assurance the auditor plans to obtain. When a single purpose

is met by a combination of procedures, the extent of each procedure is considered separately. In general, the extent of audit procedures increases as the risk of material misstatement increases. For example, in response to the assessed risk of material misstatement due to fraud, increasing sample sizes or performing substantive analytical procedures at a more detailed level may be appropriate. However, increasing the extent of an audit procedure is effective only if the audit procedure itself is relevant to the specific risk.

- A16. The use of computer-assisted audit techniques (CAATs) may enable more extensive testing of electronic transactions and account files, which may be useful when the auditor decides to modify the extent of testing, for example, in responding to the risks of material misstatement due to fraud. Such techniques can be used to select sample transactions from key electronic files, to sort transactions with specific characteristics, or to test an entire population instead of a sample.

Considerations specific to public sector entities

- A17. For the audits of public sector entities, the audit mandate and any other special auditing requirements may affect the auditor's consideration of the nature, timing and extent of further audit procedures.

Considerations specific to smaller entities

- A18. In the case of very small entities, there may not be many controls ~~activities~~ that could be identified by the auditor, or the extent to which their existence or operation have been documented by the entity may be limited. In such cases, it may be more efficient for the auditor to perform further audit procedures that are primarily substantive procedures. In some rare cases, however, the absence of controls ~~activities~~ or of other components of the system of internal control may make it impossible to obtain sufficient appropriate audit evidence.

Higher Assessments of Risk (Ref: Para 7(b))

- A19. When obtaining more persuasive audit evidence because of a higher assessment of risk, the auditor may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable, for example, by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources.

Tests of Controls

Designing and Performing Tests of Controls (Ref: Para. 8)

- A20. Tests of controls are performed only on those controls that the auditor has determined are suitably designed to prevent, or detect and correct, a material misstatement in an relevant assertion, and the auditor intends to rely upon ~~plans to test those controls~~. If substantially different controls were used at different times during the period under audit, each is considered separately.
- A21. Testing the operating effectiveness of controls is different from obtaining an understanding of and evaluating the design and implementation of controls. However, the same types of audit procedures are used. The auditor may, therefore, decide it is efficient to test the operating effectiveness of controls at the same time as evaluating their design and determining that they have been implemented.

A22. Further, although some risk assessment procedures may not have been specifically designed as tests of controls, they may nevertheless provide audit evidence about the operating effectiveness of the controls and, consequently, serve as tests of controls. For example, the auditor's risk assessment procedures may have included:

- Inquiring about management's use of budgets.
- Observing management's comparison of monthly budgeted and actual expenses.
- Inspecting reports pertaining to the investigation of variances between budgeted and actual amounts.

These audit procedures provide knowledge about the design of the entity's budgeting policies and whether they have been implemented, but may also provide audit evidence about the effectiveness of the operation of budgeting policies in preventing or detecting material misstatements in the classification of expenses.

A23. In addition, the auditor may design a test of controls to be performed concurrently with a test of details on the same transaction. Although the purpose of a test of controls is different from the purpose of a test of details, both may be accomplished concurrently by performing a test of controls and a test of details on the same transaction, also known as a dual-purpose test. For example, the auditor may design, and evaluate the results of, a test to examine an invoice to determine whether it has been approved and to provide substantive audit evidence of a transaction. A dual-purpose test is designed and evaluated by considering each purpose of the test separately.

A24. In some cases, the auditor may find it impossible to design effective substantive procedures that by themselves provide sufficient appropriate audit evidence at the assertion level.²⁶ This may occur when an entity conducts its business using IT and no documentation of transactions is produced or maintained, other than through the IT system. In such cases, paragraph 8(b) requires the auditor to perform tests of relevant controls that address the risk for which substantive procedures alone cannot provide sufficient appropriate audit evidence.

Audit Evidence and Intended Reliance (Ref: Para. 9)

A25. A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.

Nature and Extent of Tests of Controls

Other audit procedures in combination with inquiry (Ref: Para. 10(a))

A26. Inquiry alone is not sufficient to test the operating effectiveness of controls. Accordingly, other audit procedures are performed in combination with inquiry. In this regard, inquiry combined with inspection or reperformance may provide more assurance than inquiry and observation, since an observation is pertinent only at the point in time at which it is made.

A27. The nature of the particular control influences the type of procedure required to obtain audit evidence about whether the control was operating effectively. For example, if operating effectiveness is

²⁶ ISA 315 (Revised), paragraph 5130

evidenced by documentation, the auditor may decide to inspect it to obtain audit evidence about operating effectiveness. For other controls, however, documentation may not be available or relevant. For example, documentation of operation may not exist for some factors in the control environment, such as assignment of authority and responsibility, or for some types of controls—~~activities~~, such as automated controls—activities performed by a computer. In such circumstances, audit evidence about operating effectiveness may be obtained through inquiry in combination with other audit procedures such as observation or the use of CAATs.

Extent of tests of controls

A28. When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control. As well as the degree of reliance on controls, matters the auditor may consider in determining the extent of tests of controls include the following:

- The frequency of the performance of the control by the entity during the period.
- The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
- The expected rate of deviation from a control.
- The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.
- The extent to which audit evidence is obtained from tests of other controls related to the assertion.

ISA 530²⁷ contains further guidance on the extent of testing.

A29. Because of the inherent consistency of IT processing, it may not be necessary to increase the extent of testing of an automated control. An automated controls can be expected to function consistently unless the ~~program~~ IT application (including the tables, files, or other permanent data used by the ~~program~~ IT application) is changed. Once the auditor determines that an automated control is functioning as intended (which could be done at the time the control is initially implemented or at some other date), the auditor may consider performing tests to determine that the control continues to function effectively. Such tests ~~might~~ may include testing the general IT controls related to the IT application. ~~determining that:~~

- ~~Changes to the program are not made without being subject to the appropriate program change controls;~~
- ~~The authorized version of the program is used for processing transactions; and~~
- ~~Other relevant general controls are effective.~~

~~Such tests also might include determining that changes to the programs have not been made, as may be the case when the entity uses packaged software applications without modifying or maintaining them. For example, the auditor may inspect the record of the administration of IT security to obtain audit evidence that unauthorized access has not occurred during the period.~~

²⁷ ISA 530, *Audit Sampling*

A29a. Similarly, the auditor may perform tests of controls that address risks of material misstatement related to the integrity of the entity's data, or the completeness and accuracy of the entity's system-generated reports, or to address risks of material misstatement for which substantive procedures alone cannot provide sufficient appropriate audit evidence. These tests of controls may include tests of general IT controls that address the matters in paragraph 10(a). When this is the case, the auditor may not need to perform any further testing to obtain audit evidence about the matters in paragraph 10(a).

A29b. When the auditor determines that a general IT control is deficient, the auditor may consider the nature of the ~~related applicable~~related risk(s) arising from the use of IT that were identified in accordance with ISA 315 (Revised)²⁸ to provide the basis for the design of the auditor's additional procedures to ~~determine whether the underlying controls affected by the deficient general IT control functioned throughout the period~~ address the assessed risk of material misstatement. Such procedures may address determining whether:

- The ~~related applicable~~related risk(s) arising from IT has occurred. For example, if users have unauthorized access to an IT application (but cannot access or modify the system logs that track access), the auditor may inspect the system logs to obtain audit evidence that those users did not access the IT application during the period.
- There are any alternate or redundant general IT controls, or any other controls, that address the ~~related applicable~~related risk(s) arising from the use of IT. If so, the auditor may ~~determine~~identify such controls ~~to be relevant to the audit~~ (if not already relevant to the audit identified) and therefore evaluate their design, determine that they have been implemented and perform tests of their operating effectiveness. For example, if a general IT control related to user access is deficient, the entity may have an alternate control whereby IT management reviews end user access reports on a timely basis. Circumstances when an application control may address a risk arising from the use of IT may include when the information that may be affected by the general IT control deficiency can be reconciled to external sources (e.g., a bank statement) or internal sources not affected by the general IT control deficiency (e.g., a separate IT application or data source).

Testing of indirect controls (Ref: Para. 10(b))

A30. In some circumstances, it may be necessary to obtain audit evidence supporting the effective operation of indirect controls (e.g., general IT controls). As explained in paragraphs A29 to A29b, general IT controls may have been ~~determined to be relevant to the audit~~ identified in accordance with ISA 315 (Revised) because of their support of the operating effectiveness of automated controls or due to their support in maintaining the integrity of information used in the entity's financial reporting, including system-generated reports. The requirement in paragraph 10(b) acknowledges that the auditor may have already tested certain indirect controls to address the matters in paragraph 10(a). For example, when the auditor decides to test the effectiveness of a user review of exception reports detailing sales in excess of authorized credit limits, the user review and related follow-up is the control that is directly of relevance to the auditor. Controls over the accuracy of the information in the reports (for example, general IT controls) are described as "indirect" controls.

²⁸ ISA 315 (Revised), paragraph 41

A31. ~~Because of the inherent consistency of IT processing, audit evidence about the implementation of an automated application control, when considered in combination with audit evidence about the operating effectiveness of the entity's general controls (in particular, change controls), may also provide substantial audit evidence about its operating effectiveness.~~

Timing of Tests of Controls

Intended period of reliance (Ref: Para. 11)

A32. Audit evidence pertaining only to a point in time may be sufficient for the auditor's purpose, for example, when testing controls over the entity's physical inventory counting at the period end. If, on the other hand, the auditor intends to rely on a control over a period, tests that are capable of providing audit evidence that the control operated effectively at relevant times during that period are appropriate. Such tests may include tests of controls in the entity's process to monitoring of the system of internal controls.

Using audit evidence obtained during an interim period (Ref: Para. 12(b))

A33. Relevant factors in determining what additional audit evidence to obtain about controls that were operating during the period remaining after an interim period, include:

- The significance of the assessed risks of material misstatement at the assertion level.
- The specific controls that were tested during the interim period, and significant changes to them since they were tested, including changes in the information system, processes, and personnel.
- The degree to which audit evidence about the operating effectiveness of those controls was obtained.
- The length of the remaining period.
- The extent to which the auditor intends to reduce further substantive procedures based on the reliance of controls.
- The control environment.

A34. Additional audit evidence may be obtained, for example, by extending tests of controls over the remaining period or testing the entity's monitoring of controls.

Using audit evidence obtained in previous audits (Ref: Para. 13)

A35. In certain circumstances, audit evidence obtained from previous audits may provide audit evidence where the auditor performs audit procedures to establish its continuing relevance and reliability. For example, in performing a previous audit, the auditor may have determined that an automated control was functioning as intended. The auditor may obtain audit evidence to determine whether changes to the automated control have been made that affect its continued effective functioning through, for example, inquiries of management and the inspection of logs to indicate what controls have been changed. Consideration of audit evidence about these changes may support either increasing or decreasing the expected audit evidence to be obtained in the current period about the operating effectiveness of the controls.

Controls that have changed from previous audits (Ref: Para. 14(a))

A36. Changes may affect the relevance and reliability of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance. For example, changes in a system that enable an entity to receive a new report from the system probably do not affect the relevance of audit evidence from a previous audit; however, a change that causes data to be accumulated or calculated differently does affect it.

Controls that have not changed from previous audits (Ref: Para. 14(b))

A37. The auditor's decision on whether to rely on audit evidence obtained in previous audits for controls that:

- (a) have not changed since they were last tested; and
- (b) are not controls that mitigate a significant risk,

is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment, but is required by paragraph 14 (b) to be at least once in every third year.

A38. In general, the higher the risk of material misstatement, or the greater the reliance on controls, the shorter the time period elapsed, if any, is likely to be. Factors that may decrease the period for retesting a control, or result in not relying on audit evidence obtained in previous audits at all, include the following:

- A deficient control environment.
- A deficiency in the entity's process to monitoring of the system of internal controls.
- A significant manual element to ~~the relevant~~ controls.
- Personnel changes that significantly affect the application of the control.
- Changing circumstances that indicate the need for changes in the control.
- Deficient general IT controls.

A39. When there are a number of controls for which the auditor intends to rely on audit evidence obtained in previous audits, testing some of those controls in each audit provides corroborating information about the continuing effectiveness of the control environment. This contributes to the auditor's decision about whether it is appropriate to rely on audit evidence obtained in previous audits.

Evaluating the Operating Effectiveness of Controls (Ref: Para.16–17)

A40. A material misstatement detected by the auditor's procedures is a strong indicator of the existence of a significant deficiency in internal control.

A41. The concept of effectiveness of the operation of controls recognizes that some deviations in the way controls are applied by the entity may occur. Deviations from prescribed controls may be caused by such factors as changes in key personnel, significant seasonal fluctuations in volume of transactions and human error. The detected rate of deviation, in particular in comparison with the expected rate, may indicate that the control cannot be relied on to reduce risk at the assertion level to that assessed by the auditor.

Substantive Procedures (Ref: Para. 6, 18)

A42. Paragraph 18 requires the auditor to design and perform substantive procedures for each ~~material~~ material class of transactions, account balance, and disclosure, ~~irrespective of the assessed risks of material misstatement. that is quantitatively or qualitatively material.~~ For significant classes of transactions, account balances and disclosures, substantive procedures may have already been performed because paragraph 6 requires the auditor to design and perform further audit procedures that are responsive to the assessed risks of material misstatement at the assertion level. Accordingly, substantive procedures are required to be designed and performed in accordance with paragraph 18:

- ~~When the further audit procedures designed and performed in accordance with paragraph 6 for significant classes of transactions, account balances or disclosures, designed and performed in accordance with paragraph 6, did not include substantive procedures; or~~
- ~~For each class of transactions, account balance or disclosure that is not a significant class of transactions, account balance or disclosure, but that has been identified as quantitatively or qualitatively material in accordance with ISA 315 (Revised).~~²⁹

This requirement reflects the facts that: (a) the auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement; and (b) there are inherent limitations to internal controls, including management override.

A42a. ~~Not all assertions within a material class of transactions, account balance or disclosure are required to be tested. Rather, in designing the substantive procedures to be performed, the auditor's consideration of the assertion(s) in which, if a possible misstatement could occur, and if it were to occur, there is a reasonable possibility of the misstatement effect of that misstatement would have a reasonable possibility of being material, be most material,~~ may assist in identifying the appropriate nature, timing and extent of the procedures to be performed.

Nature and Extent of Substantive Procedures

A43. Depending on the circumstances, the auditor may determine that:

- Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level. For example, where the auditor's assessment of risk is supported by audit evidence from tests of controls.
- Only tests of details are appropriate.
- A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.

A44. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. ISA 520³⁰ establishes requirements and provides guidance on the application of analytical procedures during an audit.

A45. ~~The nature assessment of the risk and or the nature of the assertion~~ is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve

²⁹ ISA 315 (Revised), paragraph 52

³⁰ ISA 520, *Analytical Procedures*

selecting from items contained in a financial statement amount and obtaining the relevant audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included.

- A46. Because the assessment of the risk of material misstatement takes account of ~~internal controls upon which the auditor intends to rely~~ plans to test, the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory. However, increasing the extent of an audit procedure is appropriate only if the audit procedure itself is relevant to the specific risk.
- A47. In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters are also relevant, including whether it is more effective to use other selective means of testing. See ISA 500.³¹

Considering Whether External Confirmation Procedures Are to Be Performed (Ref: Para. 19)

- A48. External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions. For example, a request may specifically seek confirmation that no “side agreement” exists that may be relevant to an entity’s revenue cutoff assertion. Other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement include:
- Bank balances and other information relevant to banking relationships.
 - Accounts receivable balances and terms.
 - Inventories held by third parties at bonded warehouses for processing or on consignment.
 - Property title deeds held by lawyers or financiers for safe custody or as security.
 - Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date.
 - Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
 - Accounts payable balances and terms.
- A49. Although external confirmations may provide relevant audit evidence relating to certain assertions, there are some assertions for which external confirmations provide less relevant audit evidence. For example, external confirmations provide less relevant audit evidence relating to the recoverability of accounts receivable balances, than they do of their existence.
- A50. The auditor may determine that external confirmation procedures performed for one purpose provide an opportunity to obtain audit evidence about other matters. For example, confirmation requests for bank balances often include requests for information relevant to other financial statement assertions. Such considerations may influence the auditor’s decision about whether to perform external confirmation procedures.

³¹ ISA 500, *Audit Evidence*, paragraph 10

A51. Factors that may assist the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include:

- The confirming party's knowledge of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.
- The ability or willingness of the intended confirming party to respond – for example, the confirming party:
 - May not accept responsibility for responding to a confirmation request;
 - May consider responding too costly or time consuming;
 - May have concerns about the potential legal liability resulting from responding;
 - May account for transactions in different currencies; or
 - May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.

In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.

- The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

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.

Substantive Procedures Responsive to Significant Risks (Ref: Para. 21)

A53. Paragraph 21 of this ISA requires the auditor to perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks. Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error. For example, if the auditor identifies that management is under pressure to meet earnings expectations, there may be a risk that management is inflating sales by improperly recognizing revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment. In these circumstances, the auditor may, for example, design external confirmation procedures not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return and delivery terms. In addition, the auditor may find it effective to supplement such external confirmation procedures with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms.

Timing of Substantive Procedures (Ref: Para. 22–23)

A54. In most cases, audit evidence from a previous audit's substantive procedures provides little or no audit evidence for the current period. There are, however, exceptions, for example, a legal opinion obtained in a previous audit related to the structure of a securitization to which no changes have occurred, may be relevant in the current period. In such cases, it may be appropriate to use audit evidence from a previous audit's substantive procedures if that evidence and the related subject matter have not fundamentally changed, and audit procedures have been performed during the current period to establish its continuing relevance.

Using audit evidence obtained during an interim period (Ref: Para. 22)

A55. In some circumstances, the auditor may determine that it is effective to perform substantive procedures at an interim date, and to compare and reconcile information concerning the balance at the period end with the comparable information at the interim date to:

- (a) Identify amounts that appear unusual;
- (b) Investigate any such amounts; and
- (c) Perform substantive analytical procedures or tests of details to test the intervening period.

A56. Performing substantive procedures at an interim date without undertaking additional procedures at a later date increases the risk that the auditor will not detect misstatements that may exist at the period end. This risk increases as the remaining period is lengthened. Factors such as the following may influence whether to perform substantive procedures at an interim date:

- The control environment and other ~~relevant~~ controls.
- The availability at a later date of information necessary for the auditor's procedures.
- The purpose of the substantive procedure.
- The assessed risk of material misstatement.
- The nature of the class of transactions or account balance and related assertions.
- The ability of the auditor to perform appropriate substantive procedures or substantive procedures combined with tests of controls to cover the remaining period in order to reduce the risk that misstatements that may exist at the period end will not be detected.

A57. Factors such as the following may influence whether to perform substantive analytical procedures with respect to the period between the interim date and the period end:

- Whether the period-end balances of the particular classes of transactions or account balances are reasonably predictable with respect to amount, relative significance, and composition.
- Whether the entity's procedures for analyzing and adjusting such classes of transactions or account balances at interim dates and for establishing proper accounting cutoffs are appropriate.
- Whether the information system ~~relevant to financial reporting~~ will provide information concerning the balances at the period end and the transactions in the remaining period that is sufficient to permit investigation of:

- (a) Significant unusual transactions or entries (including those at or near the period end);
- (b) Other causes of significant fluctuations, or expected fluctuations that did not occur; and
- (c) Changes in the composition of the classes of transactions or account balances.

Misstatements detected at an interim date (Ref: Para. 23)

A58. When the auditor concludes that the planned nature, timing or extent of substantive procedures covering the remaining period need to be modified as a result of unexpected misstatements detected at an interim date, such modification may include extending or repeating the procedures performed at the interim date at the period end.

Adequacy of Presentation of the Financial Statements (Ref: Para. 24)

A59. Evaluating the appropriate presentation, arrangement 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.

Evaluating the Sufficiency and Appropriateness of Audit Evidence (Ref: Para. 25–27)

A60. An audit of financial statements is a cumulative and iterative process. As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing or extent of other planned audit procedures. Information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based. For example:

- The extent of misstatements that the auditor detects by performing substantive procedures may alter the auditor's judgment about the risk assessments and may indicate a significant deficiency in internal control.
- The auditor may become aware of discrepancies in accounting records, or conflicting or missing evidence.
- Analytical procedures performed at the overall review stage of the audit may indicate a previously unrecognized risk of material misstatement.

In such circumstances, the auditor may need to reevaluate the planned audit procedures, based on the revised consideration of assessed risks of material misstatement ~~for all or some of~~ and the effect on the significant classes of transactions, account balances, or disclosures and ~~related their relevant~~ assertions. ISA 315 (Revised) contains further guidance on revising the auditor's risk assessment.³²

A61. The auditor cannot assume that an instance of fraud or error is an isolated occurrence. Therefore, the consideration of how the detection of a misstatement affects the assessed risks of material misstatement is important in determining whether the assessment remains appropriate.

A62. The auditor's judgment as to what constitutes sufficient appropriate audit evidence is influenced by such factors as the following:

³² ISA 315 (Revised), paragraph 5334

- Significance of the potential misstatement in the assertion and the likelihood of its having a material effect, individually or aggregated with other potential misstatements, on the financial statements.
- Effectiveness of management's responses and controls to address the risks.
- Experience gained during previous audits with respect to similar potential misstatements.
- Results of audit procedures performed, including whether such audit procedures identified specific instances of fraud or error.
- Source and reliability of the available information.
- Persuasiveness of the audit evidence.
- Understanding of the entity and its environment, the applicable financial reporting framework and including the entity's system of internal control.

Documentation (Ref: Para. 28)

A63. The form and extent of audit documentation is a matter of professional judgment, and is influenced by the nature, size and complexity of the entity and its system of internal control, availability of information from the entity and the audit methodology and technology used in the audit.

INTERNATIONAL STANDARD ON AUDITING 540 (REVISED)

AUDITING ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibilities relating to accounting estimates and related disclosures in an audit of financial statements. Specifically, it includes requirements and guidance that refer to, or expand on, how ISA 315 (Revised),³³ ISA 330,³⁴ ISA 450,³⁵ ISA 500³⁶ and other relevant ISAs are to be applied in relation to accounting estimates and related disclosures. It also includes requirements and guidance on the evaluation of misstatements of accounting estimates and related disclosures, and indicators of possible management bias.

Nature of Accounting Estimates

2. Accounting estimates vary widely in nature and are required to be made by management when the monetary amounts cannot be directly observed. The measurement of these monetary amounts is subject to estimation uncertainty, which reflects inherent limitations in knowledge or data. These limitations give rise to inherent subjectivity and variation in the measurement outcomes. The process of making accounting estimates involves selecting and applying a method using assumptions and data, which requires judgment by management and can give rise to complexity in measurement. The effects of complexity, subjectivity or other inherent risk factors on the measurement of these monetary amounts affects their susceptibility to misstatement. (Ref: Para. A1–A6, Appendix 1)
3. Although this ISA applies to all accounting estimates, the degree to which an accounting estimate is subject to estimation uncertainty will vary substantially. The nature, timing and extent of the risk assessment and further audit procedures required by this ISA will vary in relation to the estimation uncertainty and the assessment of the related risks of material misstatement. For certain accounting estimates, estimation uncertainty may be very low, based on their nature, and the complexity and subjectivity involved in making them may also be very low. For such accounting estimates, the risk assessment procedures and further audit procedures required by this ISA would not be expected to be extensive. When estimation uncertainty, complexity or subjectivity are very high, such procedures would be expected to be much more extensive. This ISA contains guidance on how the requirements of this ISA can be scaled. (Ref: Para. A7)

³³ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

³⁴ ISA 330, *The Auditor's Responses to Assessed Risks*

³⁵ ISA 450, *Evaluation of Misstatements Identified during the Audit*

³⁶ ISA 500, *Audit Evidence*

Key Concepts of This ISA

4. ~~This ISA 315 (Revised) requires a separate assessment of inherent risk for identified risks of material misstatement at the assertion level.³⁷ purposes of assessing the risks of material misstatement at the assertion level for accounting estimates.~~ In the context of ISA 540 (Revised), and ~~D~~depending on the nature of a particular accounting estimate, the susceptibility of an assertion to a misstatement that could be material may be subject to or affected by estimation uncertainty, complexity, subjectivity or other inherent risk factors, and the interrelationship among them. As explained in ISA 200,³⁸ inherent risk is higher for some assertions and related classes of transactions, account balances and disclosures than for others. Accordingly, the assessment of inherent risk depends on the degree to which the inherent risk factors affect the likelihood or magnitude of misstatement, and varies on a scale that is referred to in ~~this ISA~~ as the spectrum of inherent risk. (Ref: Para. A8–A9, A65–A66, Appendix 1)
5. This ISA refers to relevant requirements in ISA 315 (Revised) and ISA 330, and provides related guidance, to emphasize the importance of the auditor's decisions about controls relating to accounting estimates, including decisions about whether:
 - There are controls ~~relevant to the audit~~ required to be identified by ISA 315 (Revised), for which the auditor is required to evaluate their design and determine whether they have been implemented.
 - To test the operating effectiveness of ~~relevant~~ controls.
6. ~~This ISA 315 (Revised) also requires a separate assessment of control risk when assessing the risks of material misstatement at the assertion level for accounting estimates. In assessing control risk, the auditor takes into account whether the auditor's further audit procedures contemplate planned reliance on the operating effectiveness of controls. If the auditor does not perform intend plan to tests the operating effectiveness of controls, or does not intend to rely on the operating effectiveness of controls, the auditor's assessment of the risk of material misstatement at the assertion level control risk cannot be reduced for the effective operation of controls with respect to the particular assertion is such that the assessment of the risk of material misstatement is the same as the assessment of inherent risk.³⁹ (Ref: Para. A10)~~
7. This ISA emphasizes that the auditor's further audit procedures (including, where appropriate, tests of controls) need to be responsive to the reasons for the assessed risks of material misstatement at the assertion level, taking into account the effect of one or more inherent risk factors and the auditor's assessment of control risk.
8. The exercise of professional skepticism in relation to accounting estimates is affected by the auditor's consideration of inherent risk factors, and its importance increases when accounting estimates are subject to a greater degree of estimation uncertainty or are affected to a greater degree by complexity, subjectivity or other inherent risk factors. Similarly, the exercise of professional

³⁷ ED-315, paragraph 48

³⁸ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph A40

³⁹ ISA 530, *Audit Sampling*, Appendix 3

skepticism is important when there is greater susceptibility to misstatement due to management bias or ~~fraud~~ other fraud risk factors insofar as they affect inherent risk. (Ref: Para. A11)

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Objective

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Definitions

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Requirements

Risk Assessment Procedures and Related Activities

13. When obtaining an understanding of the entity and its environment, the applicable financial reporting framework and including the entity's system of internal control, as required by ISA 315 (Revised),⁴⁰ the auditor shall obtain an understanding of the following matters related to the entity's accounting estimates. The auditor's procedures to obtain the understanding shall be performed to the extent necessary to obtain sufficient appropriate audit evidence as to that provides an appropriate provide an appropriate basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. (Ref: Para. A19–A22)

Obtaining an Understanding of tThe Entity and Its Environment and the Applicable Financial Reporting Framework

- (a) The entity's transactions and other events orand conditions that may give rise to the need for, or changes in, accounting estimates to be recognized or disclosed in the financial statements. (Ref: Para. A23)
- (b) The requirements of the applicable financial reporting framework related to accounting estimates (including the recognition criteria, measurement bases, and the related presentation and disclosure requirements); and how they apply in the context of the nature and circumstances of the entity and its environment, including how ~~transactions and other events or conditions are subject to, or affected by,~~ the inherent risk factors affect susceptibility to misstatement of assertions. (Ref: Para. A24–A25)
- (c) Regulatory factors relevant to the entity's accounting estimates, including, when applicable, regulatory frameworks related to prudential supervision. (Ref: Para. A26)
- (d) The nature of the accounting estimates and related disclosures that the auditor expects to be included in the entity's financial statements, based on the auditor's understanding of the matters in 13(a)–(c) above. (Ref: Para. A27)

⁴⁰ ISA 315 (Revised), paragraphs 3, 5–6, 9, 11–12, 15–17, and 20–21 ~~23–34~~ 434

Obtaining an Understanding of the Entity's System of Internal Control

- (e) The nature and extent of oversight and governance that the entity has in place over management's financial reporting process relevant to accounting estimates. (Ref: Para. A28–A30).
 - (f) How management identifies the need for, and applies, specialized skills or knowledge related to accounting estimates, including with respect to the use of a management's expert. (Ref: Para. A31)
 - (g) How the entity's risk assessment process identifies and addresses risks relating to accounting estimates. (Ref: Para. A32–A33)
 - (h) The entity's information system as it relates to accounting estimates, including:
 - (i) How information relating to accounting estimates and related disclosures for significant classes of transactions, account balances or disclosures flows through the entity's information system ~~The classes of transactions, events and conditions, that are significant to the financial statements and that give rise to the need for, or changes in, accounting estimates and related disclosures;~~ and (Ref: Para. A34–A35)
 - (ii) For such accounting estimates and related disclosures, how management:
 - a. Identifies the relevant methods, assumptions or sources of data, and the need for changes in them, that are appropriate in the context of the applicable financial reporting framework, including how management: (Ref: Para. A36–A37)
 - i. Selects or designs, and applies, the methods used, including the use of models; (Ref: Para. A38–A39)
 - ii. Selects the assumptions to be used, including consideration of alternatives, and identifies significant assumptions; (Ref: Para. A40–A43); and
 - iii. Selects the data to be used; (Ref: Para. A44)
 - b. Understands the degree of estimation uncertainty, including through considering the range of possible measurement outcomes; and (Ref: Para. A45)
 - c. Addresses the estimation uncertainty, including selecting a point estimate and related disclosures for inclusion in the financial statements. (Ref: Para. A46–A49)
 - (i) Identified controls in the control activities component⁴¹ ~~activities relevant to the audit~~ over management's process for making accounting estimates as described in paragraph 13(h)(ii). (Ref: Para. A50–A54)
 - (j) How management reviews the outcome(s) of previous accounting estimates and responds to the results of that review.
14. The auditor shall review the outcome of previous accounting estimates, or, where applicable, their subsequent re-estimation to assist in identifying and assessing the risks of material misstatement in the current period. The auditor shall take into account the characteristics of the accounting estimates

⁴¹ ISA 315 (Revised), paragraphs 39(a)–(c)

in determining the nature and extent of that review. The review is not intended to call into question judgments about previous period accounting estimates that were appropriate based on the information available at the time they were made. (Ref: Para. A55–A60)

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Identifying and Assessing the Risks of Material Misstatement

16. In identifying and assessing the risks of material misstatement relating to an accounting estimate and related disclosures at the assertion level, including separately assessing inherent risk and control risk at the assertion level, as required by ISA 315 (Revised),⁴² the auditor shall ~~separately assess inherent risk and control risk~~. The auditor shall take the following into account in identifying the risks of material misstatement and in assessing inherent risk: (Ref: Para. A64–A71)

- (a) The degree to which the accounting estimate is subject to estimation uncertainty; and (Ref: Para. A72–A75)
- (b) The degree to which the following are affected by complexity, subjectivity, or other inherent risk factors: (Ref: Para. A76–A79)
 - (i) The selection and application of the method, assumptions and data in making the accounting estimate; or
 - (ii) The selection of management's point estimate and related disclosures for inclusion in the financial statements.

17. The auditor shall determine whether any of the risks of material misstatement identified and assessed in accordance with paragraph 16 are, in the auditor's judgment, a significant risk.⁴³ If the auditor has determined that a significant risk exists, the auditor shall identify controls that obtain an understanding of the entity's controls, including control activities, relevant to address that risk,⁴⁴ and evaluate whether such controls have been designed effectively, and determine whether they have been implemented.⁴⁵ (Ref: Para. A80)

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19. As required by ISA 330,⁴⁶ the auditor shall design and perform tests to obtain sufficient appropriate audit evidence as to the operating effectiveness of ~~relevant~~ controls, if:
- (a) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively; or
 - (b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

⁴² ISA 315 (Revised), paragraph ~~25 and 26~~48 and 51

⁴³ ISA 315 (Revised), paragraph ~~49~~27

⁴⁴ ISA 315 (Revised), paragraph ~~39(a)(i)~~29

⁴⁵ ISA 315 (Revised), Paragraph ~~39(d)~~

⁴⁶ ISA 330, paragraph 8

In relation to accounting estimates, the auditor's tests of such controls shall be responsive to the reasons for the assessment given to the risks of material misstatement. In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control.⁴⁷ (Ref: Para. A85–A89)

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Other Considerations Relating to Audit Evidence

30. In obtaining audit evidence regarding the risks of material misstatement relating to accounting estimates, irrespective of the sources of information to be used as audit evidence, the auditor shall comply with the relevant requirements in ISA 500.

When using the work of a management's expert, the requirements in paragraphs 21–29 of this ISA may assist the auditor in evaluating the appropriateness of the expert's work as audit evidence for a relevant assertion in accordance with paragraph 8(c) of ISA 500. In evaluating the work of the management's expert, the nature, timing and extent of the further audit procedures are affected by the auditor's evaluation of the expert's competence, capabilities and objectivity, the auditor's understanding of the nature of the work performed by the expert, and the auditor's familiarity with the expert's field of expertise. (Ref: Para. A126–A132)

...

Documentation

39. The auditor shall include in the audit documentation:⁴⁸ (Ref: Para. A149–A152)
- (a) Key elements of the auditor's understanding of the entity and its environment, including the entity's internal control related to the entity's accounting estimates;
 - (b) The linkage of the auditor's further audit procedures with the assessed risks of material misstatement at the assertion level,⁴⁹ taking into account the reasons (whether related to inherent risk or control risk) given to the assessment of those risks;
 - (c) The auditor's response(s) when management has not taken appropriate steps to understand and address estimation uncertainty;
 - (d) Indicators of possible management bias related to accounting estimates, if any, and the auditor's evaluation of the implications for the audit, as required by paragraph 32; and
 - (e) Significant judgments relating to the auditor's determination of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated.

⁴⁷ ISA 330, paragraph 9

⁴⁸ ISA 230, *Audit Documentation*, paragraphs 8–11, A6, A7 and A10

⁴⁹ ISA 330, paragraph 28(b)

Application and Other Explanatory Material

Nature of Accounting Estimates (Ref: Para. 2)

Examples of Accounting Estimates

...

Methods

- A2. A method is a measurement technique used by management to make an accounting estimate in accordance with the required measurement basis. For example, one recognized method used to make accounting estimates relating to share-based payment transactions is to determine a theoretical option call price using the Black Scholes option pricing formula. A method is applied using a computational tool or process, sometimes referred to as a model, and involves applying assumptions and data and taking into account a set of relationships between them.

Assumptions and Data

- A3. Assumptions involve judgments based on available information about matters such as the choice of an interest rate, a discount rate, or judgments about future conditions or events. An assumption may be selected by management from a range of appropriate alternatives. Assumptions that may be made or identified by a management's expert become management's assumptions when used by management in making an accounting estimate.

- A4. For purposes of this ISA, data is information that can be obtained through direct observation or from a party external to the entity. Information obtained by applying analytical or interpretive techniques to data is referred to as derived data when such techniques have a well-established theoretical basis and therefore less need for management judgment. Otherwise, such information is an assumption.

- A5. Examples of data include:

- Prices agreed in market transactions;
- Operating times or quantities of output from a production machine;
- Historical prices or other terms included in contracts, such as a contracted interest rate, a payment schedule, and term included in a loan agreement;
- Forward-looking information such as economic or earnings forecasts obtained from an external information source, or
- A future interest rate determined using interpolation techniques from forward interest rates (derived data).

- A6. Data can come from a wide range of sources. For example, data can be:

- Generated within the organization or externally;
- Obtained from a system that is either within or outside the general or subsidiary ledgers;
- Observable in contracts; or
- Observable in legislative or regulatory pronouncements.

Scalability (Ref: Para. 3)

A7. Examples of paragraphs that include guidance on how the requirements of this ISA can be scaled include paragraphs A20–A22, A63, A67, and A84.

Key Concepts of This ISA

Inherent Risk Factors (Ref: Para. 4)

- A8. Inherent risk factors are characteristics of ~~conditions and events~~ orand conditions that ~~may~~ affect ~~the~~ susceptibility ~~of an assertion~~ to misstatement, ~~whether due to fraud or error, of an assertion about a class of transactions, account balance or disclosures, before consideration of controls.~~⁵⁰ Appendix 1 further explains the nature of these inherent risk factors, and their inter-relationships, in the context of making accounting estimates and their presentation in the financial statements.
- A9. ~~In addition to the inherent risk factors of estimation uncertainty, complexity or subjectivity, other inherent risk factors included in ISA 315 (Revised) that the auditor may consider takes into account in identifying and assessing the risks of material misstatement at the assertion level⁵¹, in addition to estimation uncertainty, complexity, and subjectivity, the auditor also takes into account the degree may include the extent to which inherent risk factors included in ISA 315 (Revised), other than estmation uncertainty, complexity, and subjectivity, affect susceptibility to misstatement of assertions about the accounting estimate. Such additional inherent risk facyors include is subject to, or affected by:~~
- Change in the nature or circumstances of the relevant financial statement items, or requirements of the applicable financial reporting framework which may give rise to the need for changes in the method, assumptions or data used to make the accounting estimate.
 - Susceptibility to misstatement due to management bias, or other fraud risk factors insofar as they affect inherent risk, in making the accounting estimate.
 - Uncertainty, other than estimation uncertainty.

Control Risk (Ref: Para. 6)

- A10. ~~An important consideration for the auditor i~~ In assessing control risk at the assertion level in accordance with ISA 315 (Revised), the auditor takes into account ~~is the effectiveness of the design of the controls that whether the auditor intends plans to rely test on the operating effectiveness of controls, and the extent to which the controls address the assessed inherent risks at the assertion level. When the auditor is considering whether to test the operating effectiveness of controls, T~~ the auditor's evaluation that controls are effectively designed and have been implemented supports an expectation, by the auditor, about the operating effectiveness of the controls in ~~determining whether establishing their plan~~ to test them.

⁵⁰ ISA 315 (Revised), paragraph 16(f)

⁵¹ ISA 315 (Revised), paragraph 48

Professional Skepticism (Ref: Para. 8)

....

Concept of "Reasonable" (Ref: Para. 9, 35)

...

Risk Assessment Procedures and Related Activities

Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework, and the Entity's System of Internal Control (Ref: Para. 13)

A19. Paragraphs ~~2311–4324~~ of ISA 315 (Revised) require the auditor to obtain an understanding of certain matters about the entity and its environment, the applicable financial reporting framework and including the entity's system of internal control. The requirements in paragraph 13 of this ISA relate more specifically to accounting estimates and build on the broader requirements in ISA 315 (Revised).

Scalability

A20. The nature, timing, and extent of the auditor's procedures to obtain the understanding of the entity and its environment, including the applicable financial reporting framework, and the entity's system of internal control, related to the entity's accounting estimates, may depend, to a greater or lesser degree, on the extent to which the individual matter(s) apply in the circumstances. For example, the entity may have few transactions or other events ~~and or~~ conditions that give rise to the need for accounting estimates, the applicable financial reporting requirements may be simple to apply, and there may be no relevant regulatory factors. Further, the accounting estimates may not require significant judgments, and the process for making the accounting estimates may be less complex. In these circumstances, the accounting estimates may be subject to, or affected by, estimation uncertainty, complexity, subjectivity, or other inherent risk factors to a lesser degree, and there may be fewer identified controls in the control activities component ~~relevant to the audit~~. If so, the auditor's risk identification and assessment procedures are likely to be less extensive and may be obtained primarily through inquiries of management with appropriate responsibilities for the financial statements, such as ~~and~~ simple walk-throughs of management's process for making the accounting estimate (including when evaluating whether the identified controls in that process are designed effectively and when determining whether the control has been implemented).

A21. By contrast, the accounting estimates may require significant judgments by management, and the process for making the accounting estimates may be complex and involve the use of complex models. In addition, the entity may have a more sophisticated information system, and more extensive controls over accounting estimates. In these circumstances, the accounting estimates may be subject to or affected by estimation uncertainty, subjectivity, complexity or other inherent risk factors to a greater degree. If so, the nature or timing of the auditor's risk assessment procedures are likely to be different, or be more extensive, than in the circumstances in paragraph A20.

A22. The following considerations may be relevant for entities with only simple businesses, which may include many smaller entities:

- Processes relevant to accounting estimates may be uncomplicated because the business activities are simple or the required estimates may have a lesser degree of estimation uncertainty.
- Accounting estimates may be generated outside of the general and subsidiary ledgers, controls over their development may be limited, and an owner-manager may have significant influence over their determination. The owner-manager's role in making the accounting estimates may need to be taken into account by the auditor both when identifying the risks of material misstatement and when considering the risk of management bias.

The Entity and Its Environment

The entity's transactions and other events ~~and~~or conditions (Ref: Para. 13(a))

A23. Changes in circumstances that may give rise to the need for, or changes in, accounting estimates may include, for example, whether:

- The entity has engaged in new types of transactions;
- Terms of transactions have changed; or
- New events or conditions have occurred.

The requirements of the applicable financial reporting framework (Ref: Para. 13(b))

A24. Obtaining an understanding of the requirements of the applicable financial reporting framework provides the auditor with a basis for discussion with management and, where applicable, those charged with governance about how management has applied ~~these~~ requirements of the applicable financial reporting framework relevant to the accounting estimates, and about the auditor's determination of whether they have been applied appropriately. This understanding also may assist the auditor in communicating with those charged with governance when the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework, not to be the most appropriate in the circumstances of the entity.⁵²

A25. In obtaining this understanding, the auditor may seek to understand whether:

- The applicable financial reporting framework:
 - Prescribes certain criteria for the recognition, or methods for the measurement of accounting estimates;
 - Specifies certain criteria that permit or require measurement at a fair value, for example, by referring to management's intentions to carry out certain courses of action with respect to an asset or liability; or
 - Specifies required or suggested disclosures, including disclosures concerning judgments, assumptions, or other sources of estimation uncertainty relating to accounting estimates; and

⁵² ISA 260 (Revised), paragraph 16(a)

- Changes in the applicable financial reporting framework require changes to the entity's accounting policies relating to accounting estimates.

Regulatory factors (Ref: Para. 13(c))

...

The nature of the accounting estimates and related disclosures that the auditor expects to be included in the financial statements (Ref: Para. 13(d))

...

The Entity's System of Internal Control ~~Relevant to the Audit~~

The nature and extent of oversight and governance (Ref: Para. 13(e))

A28. In applying ISA 315 (Revised),⁵³ the auditor's understanding of the nature and extent of oversight and governance that the entity has in place over management's process for making accounting estimates may be important to the auditor's required evaluation of as it relates to whether:

- Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior; ~~and~~
- The ~~strengths in those areas of the entity's control environment elements collectively provides~~ an appropriate foundation for the other components of the system of internal control considering the nature and size of the entity; and whether
- ~~those other components are undermined by~~ Control deficiencies identified in the control environment undermine the other components of the system of internal control.⁵⁴

...

A30. Obtaining an understanding of the oversight by those charged with governance may be important when there are accounting estimates that:

- Require significant judgment by management to address subjectivity;
- Have high estimation uncertainty;
- Are complex to make, for example, because of the extensive use of information technology, large volumes of data or the use of multiple data sources or assumptions with complex interrelationships;
- Had, or ought to have had, a change in the method, assumptions or data compared to previous periods; or
- Involve significant assumptions.

⁵³ ISA 315 (Revised), paragraph 28(a).¹⁴

⁵⁴ ~~ISA 315 (Revised), paragraph 28~~

Management's application of specialized skills or knowledge, including the use of management's experts (Ref: Para. 13(f))

...

The entity's risk assessment process (Ref: Para. 13(g))

A32. Understanding how the entity's risk assessment process identifies and addresses risks relating to accounting estimates may assist the auditor in considering changes in:

- The requirements of the applicable financial reporting framework related to the accounting estimates;
- The availability or nature of data sources that are relevant to making the accounting estimates or that may affect the reliability of the data used;
- The entity's information systems or IT environment; and
- Key personnel.

A33. Matters that the auditor may consider in obtaining an understanding of how management identified and addresses the susceptibility to misstatement due to management bias or ~~fraud~~ ~~fraud~~ ~~other fraud~~ ~~risk factors insofar as they affect inherent risk~~ in making accounting estimates, include whether, and if so how, management:

- Pays particular attention to selecting or applying the methods, assumptions and data used in making accounting estimates.
- Monitors key performance indicators that may indicate unexpected or inconsistent performance compared with historical or budgeted performance or with other known factors.
- Identifies financial or other incentives that may be a motivation for bias.
- Monitors the need for changes in the methods, significant assumptions or the data used in making accounting estimates.
- Establishes appropriate oversight and review of models used in making accounting estimates.
- Requires documentation of the rationale for, or an independent review of, significant judgments made in making accounting estimates.

The entity's information system relating to accounting estimates (Ref: Para. 13(h)(i))

A34. The significant classes of transactions, events and conditions within the scope of paragraph 13(h) are the same as the significant classes of transactions, events and conditions relating to accounting estimates and related disclosures that are subject to paragraphs ~~35618(a) and (d)~~ of ISA 315 (Revised). In obtaining the understanding of the entity's information system as it relates to accounting estimates, the auditor may consider:

- Whether the accounting estimates arise from the recording of routine and recurring transactions or whether they arise from non-recurring or unusual transactions.
- How the information system addresses the completeness of accounting estimates and related disclosures, in particular for accounting estimates related to liabilities.

A35. During the audit, the auditor may identify classes of transactions, events ~~and or~~ conditions that give rise to the need for accounting estimates and related disclosures that management failed to identify. ISA 315 (Revised) deals with circumstances where the auditor identifies risks of material misstatement that management failed to identify, including ~~determining whether there is a significant deficiency or one or more control deficiencies in internal control with regard to considering the implications for the auditor's evaluation of~~ the entity's risk assessment process.⁵⁵

Management's Identification of the Relevant Methods, Assumptions and Sources of Data (Ref: Para. 13(h)(ii)(a))

...

Methods (Ref: Para. 13(h)(ii)(a)(i))

...

Models

A39. Management may design and implement specific controls around models used for making accounting estimates, whether management's own model or an external model. When the model itself has an increased level of complexity or subjectivity, such as an expected credit loss model or a fair value model using level 3 inputs, controls that address such complexity or subjectivity may be more likely to be identified ~~controls in accordance with ISA 315 (Revised)⁵⁶as relevant to the auditbecause the assessments of inherent risk may be higher such that the auditor requires more persuasive audit evidence. The auditor's evaluation of the design of such controls and determination of whether such controls have been implemented contributes to the audit evidence related to higher assessed risks.~~ When complexity in relation to models is present, controls over data integrity are also more likely to ~~be identified controls in accordance with ISA 315 (Revised)relevant to the audit.~~ Factors that may be appropriate for the auditor to consider in obtaining an understanding of the model and ~~of related identified controls activities relevant to the audit~~ include the following:

- How management determines the relevance and accuracy of the model;
- The validation or back testing of the model, including whether the model is validated prior to use and revalidated at regular intervals to determine whether it remains suitable for its intended use. The entity's validation of the model may include evaluation of:
 - The model's theoretical soundness;
 - The model's mathematical integrity; and
 - The accuracy and completeness of the data and the appropriateness of data and assumptions used in the model.
- How the model is appropriately changed or adjusted on a timely basis for changes in market or other conditions and whether there are appropriate change control policies over the model;

⁵⁰ ISA 315 (Revised), paragraph ~~314~~317

⁵⁶ ISA 315 (Revised), paragraph 39(a)

- Whether adjustments, also referred to as overlays in certain industries, are made to the output of the model and whether such adjustments are appropriate in the circumstances in accordance with the requirements of the applicable financial reporting framework. When the adjustments are not appropriate, such adjustments may be indicators of possible management bias; and
- Whether the model is adequately documented, including its intended applications, limitations, key parameters, required data and assumptions, the results of any validation performed on it and the nature of, and basis for, any adjustments made to its output.

Assumptions (Ref: Para. 13(h)(ii)(a)(ii))

...

Data (Ref: Para. 13(h)(ii)(a)(iii))

A44. Matters that the auditor may consider in obtaining an understanding of how management selects the data on which the accounting estimates are based include:

- The nature and source of the data, including information obtained from an external information source.
- How management evaluates whether the data is appropriate.
- The accuracy and completeness of the data.
- The consistency of the data used with data used in previous periods.
- The complexity of IT applications or other aspects of the entity's IT environment ~~the information technology systems~~ used to obtain and process the data, including when this involves handling large volumes of data.
- How the data is obtained, transmitted and processed and how its integrity is maintained.

How management understands and addresses estimation uncertainty (Ref: Para. 13(h)(ii)(b)–13(h)(ii)(c))

...

Identified Controls Activities Relevant to the Audit Over Management's Process for Making Accounting Estimates (Ref: Para 13(i))

A50. The auditor's judgment in identifying controls ~~relevant to the audit~~ in the controls activities component, and therefore the need to evaluate the design of those controls and determine whether they have been implemented, relates to management's process described in paragraph 13(h)(ii). The auditor may not identify ~~relevant controls relevant to the audit activities~~ in relation to all ~~the elements~~ aspects of paragraph 13(h)(ii), ~~depending on the degree to which complexity affects~~ associated with the accounting estimate.

A51. As part of ~~obtaining an understanding of~~ identifying the controls activities relevant to the audit, and evaluating their design and determining whether they have been implemented, the auditor may consider:

- How management determines the appropriateness of the data used to develop the accounting estimates, including when management uses an external information source or data from outside the general and subsidiary ledgers.
- The review and approval of accounting estimates, including the assumptions or data used in their development, by appropriate levels of management and, where appropriate, those charged with governance.
- The segregation of duties between those responsible for making the accounting estimates and those committing the entity to the related transactions, including whether the assignment of responsibilities appropriately takes account of the nature of the entity and its products or services. For example, in the case of a large financial institution, relevant segregation of duties may consist of an independent function responsible for estimation and validation of fair value pricing of the entity's financial products staffed by individuals whose remuneration is not tied to such products.
- The effectiveness of the design of the controls ~~activities~~. Generally, it may be more difficult for management to design controls that address subjectivity and estimation uncertainty in a manner that effectively prevents, or detects and corrects, material misstatements, than it is to design controls that address complexity. Controls that address subjectivity and estimation uncertainty may need to include more manual elements, which may be less reliable than automated controls as they can be more easily bypassed, ignored or overridden by management. The design effectiveness of controls addressing complexity may vary depending on the reason for, and the nature of, the complexity. For example, it may be easier to design more effective controls related to a method that is routinely used or over the integrity of data.

A52. When management makes extensive use of information technology in making an accounting estimate, identified controls relevant to the audit in the control activities component are likely to include general IT controls and ~~application–information processing~~ controls. Such controls may address risks related to:

- Whether the IT applications or other aspects of the IT environment ~~information technology system has~~ have the capability and is appropriately configured to process large volumes of data;
- Complex calculations in applying a method. When diverse IT applications ~~systems~~ are required to process complex transactions, regular reconciliations between the IT applications ~~systems~~ are made, in particular when the IT applications ~~systems~~ do not have automated interfaces or may be subject to manual intervention;
- Whether the design and calibration of models is periodically evaluated;
- The complete and accurate extraction of data regarding accounting estimates from the entity's records or from external information sources;

- Data, including the complete and accurate flow of data through the entity's information system, the appropriateness of any modification to the data used in making accounting estimates, the maintenance of the integrity and security of the data. When using external information sources, risks related to processing or recording the data;
- Whether management has controls around access, change and maintenance of individual models to maintain a strong audit trail of the accredited versions of models and to prevent unauthorized access or amendments to those models; and
- Whether there are appropriate controls over the transfer of information relating to accounting estimates into the general ledger, including appropriate controls over journal entries.

A53. In some industries, such as banking or insurance, the term governance may be used to describe activities within the control environment, the entity's process to monitor the system of internal control ~~monitoring of controls~~, and other components of the system of internal control, as described in ISA 315 (Revised).⁵⁷

A54. For entities with an internal audit function, its work may be particularly helpful to the auditor in obtaining an understanding of:

- The nature and extent of management's use of accounting estimates;
- The design and implementation of controls ~~activities~~ that address the risks related to the data, assumptions and models used to make the accounting estimates;
- The aspects of the entity's information system that generate the data on which the accounting estimates are based; and
- How new risks relating to accounting estimates are identified, assessed and managed.

Reviewing the Outcome or Re-Estimation of Previous Accounting Estimates (Ref: Para. 14)

...

A58. Based on the auditor's previous assessment of the risks of material misstatement, for example, if inherent risk is assessed as higher for one or more risks of material misstatement, the auditor may judge that a more detailed retrospective review is required. As part of the detailed retrospective review, the auditor may pay particular attention, when practicable, to the effect of data and significant assumptions used in making the previous accounting estimates. On the other hand, for example, for accounting estimates that arise from the recording of routine and recurring transactions, the auditor may judge that the application of analytical procedures as risk assessment procedures is sufficient for purposes of the review.

A59. The measurement objective for fair value accounting estimates and other accounting estimates, based on current conditions at the measurement date, deals with perceptions about value at a point in time, which may change significantly and rapidly as the environment in which the entity operates changes. The auditor may therefore focus the review on obtaining information that may be relevant to identifying and assessing risks of material misstatement. For example, in some cases, obtaining an understanding of changes in marketplace participant assumptions that affected the outcome of a

⁵⁷ ISA 315 (Revised) paragraph A98(a).⁷⁷

previous period's fair value accounting estimates may be unlikely to provide relevant audit evidence. In this case, audit evidence may be obtained by understanding the outcomes of assumptions (such as a cash flow projections) and understanding the effectiveness of management's prior estimation process that supports the identification and assessment of the risks of material misstatement in the current period.

- A60. A difference between the outcome of an accounting estimate and the amount recognized in the previous period's financial statements does not necessarily represent a misstatement of the previous period's financial statements. However, such a difference may represent a misstatement if, for example, the difference arises from information that was available to management when the previous period's financial statements were finalized, or that could reasonably be expected to have been obtained and taken into account in the context of the applicable financial reporting framework.⁵⁸ Such a difference may call into question management's process for taking information into account in making the accounting estimate. As a result, the auditor may reassess any plan to test related controls and the related assessment of control risk ~~and or~~ may determine that more persuasive audit evidence needs to be obtained about the matter. Many financial reporting frameworks contain guidance on distinguishing between changes in accounting estimates that constitute misstatements and changes that do not, and the accounting treatment required to be followed in each case.

Specialized Skills or Knowledge (Ref: Para. 15)

...

Identifying and Assessing the Risks of Material Misstatement (Ref: Para. 4, 16)

- A64. Identifying and assessing risks of material misstatement at the assertion level relating to accounting estimates is important for all accounting estimates, including not only those that are recognized in the financial statements, but also those that are included in the notes to the financial statements.
- A65. Paragraph A42 of ISA 200 states that the ISAs ~~do not ordinarily refer to inherent risk and control risk separately~~ typically refer to the "risks of material misstatement" rather than to inherent risk and control risk separately. ~~However, this ISA 315 (Revised) requires a separate assessment of inherent risk and control risk at the assertion level⁵⁹ to provide a basis for designing and performing further audit procedures to respond to the risks of material misstatement at the assertion level⁶⁰, including significant risks, at the assertion level for accounting estimates in accordance with ISA 330.⁶⁴~~
- A66. In identifying the risks of material misstatement and in assessing inherent risk for accounting estimates, in accordance with ISA 315 (Revised),⁶² the auditor is required to take into account the degree to which the accounting estimate is subject to, or affected by, the inherent risk factors described in paragraph 16 of this ISA ~~the inherent risk factors that affect susceptibility to misstatement~~

⁵⁸ ISA 560, Subsequent Events, paragraph 14

⁵⁹ ISA 315 (Revised), paragraphs 48 and 50

⁶⁰ ISA 315 (Revised), paragraphs 48 and 51

⁶⁴ ISA 330, paragraph 7(b)

⁶² ISA 315 (Revised), paragraph 48(a)

~~of assertions, and how they do so estimation uncertainty, complexity, subjectivity, or other inherent risk factors.~~ The auditor's consideration of the inherent risk factors may also provide information to be used in ~~determining~~:

- ~~Assessing the likelihood and magnitude of material misstatement (i.e., where inherent risk is assessed on the spectrum of inherent risk); and~~
- ~~Determining the reasons for the assessment given to the risks of material misstatement at the assertion level, and that the auditor's further audit procedures in accordance with paragraph 18 are responsive to those reasons.~~

The interrelationships between the inherent risk factors are further explained in Appendix 1.

A67. The reasons for the auditor's assessment of inherent risk at the assertion level may result from one or more of the inherent risk factors of estimation uncertainty, complexity, subjectivity or other inherent risk factors. For example:

- (a) Accounting estimates of expected credit losses are likely to be complex because the expected credit losses cannot be directly observed and may require the use of a complex model. The model may use a complex set of historical data and assumptions about future developments in a variety of entity specific scenarios that may be difficult to predict. Accounting estimates for expected credit losses are also likely to be subject to high estimation uncertainty and significant subjectivity in making judgments about future events or conditions. Similar considerations apply to insurance contract liabilities.
- (b) An accounting estimate for an obsolescence provision for an entity with a wide range of different inventory types may require complex systems and processes, but may involve little subjectivity and the degree of estimation uncertainty may be low, depending on the nature of the inventory.
- (c) Other accounting estimates may not be complex to make but may have high estimation uncertainty and require significant judgment, for example, an accounting estimate that requires a single critical judgment about a liability, the amount of which is contingent on the outcome of the litigation.

A68. The relevance and significance of inherent risk factors may vary from one estimate to another. Accordingly, the inherent risk factors may, either individually or in combination, affect simple accounting estimates to a lesser degree and the auditor may identify fewer risks or assess inherent risk at close to the lower end of the spectrum of inherent risk.

A69. Conversely, the inherent risk factors may, either individually or in combination, affect complex accounting estimates to a greater degree, and may lead the auditor to assess inherent risk at the higher end of the spectrum of inherent risk. For these accounting estimates, the auditor's consideration of the effects of the inherent risk factors is likely to directly affect the number and nature of identified risks of material misstatement, the assessment of such risks, and ultimately the persuasiveness of the audit evidence needed in responding to the assessed risks. Also, for these accounting estimates the auditor's application of professional skepticism may be particularly important.

A70. Events occurring after the date of the financial statements may provide additional information relevant to the auditor's assessment of the risks of material misstatement at the assertion level. For example, the outcome of an accounting estimate may become known during the audit. In such cases, the auditor may assess or revise the assessment of the risks of material misstatement at the assertion level,⁶³ regardless of how the inherent risk factors affect susceptibility to misstatement of assertions relating to the degree to which the accounting estimate was subject to, or affected by, estimation uncertainty, complexity, subjectivity or other inherent risk factors. Events occurring after the date of the financial statements also may influence the auditor's selection of the approach to testing the accounting estimate in accordance with paragraph 18. For example, for a simple bonus accrual that is based on a straightforward percentage of compensation for selected employees, the auditor may conclude that there is relatively little complexity or subjectivity in making the accounting estimate, and therefore may assess inherent risk at the assertion level at close to the lower end of the spectrum of inherent risk. The payment of the bonuses subsequent to period end may provide sufficient appropriate audit evidence regarding the assessed risks of material misstatement at the assertion level.

A71. The auditor's assessment of control risk may be done in different ways depending on preferred audit techniques or methodologies. The control risk assessment may be expressed using qualitative categories (for example, control risk assessed as maximum, moderate, minimum) or in terms of the auditor's expectation of how effective the control(s) is in addressing the identified risk, that is, the planned reliance on the effective operation of controls. For example, if control risk is assessed as maximum, the auditor contemplates no reliance on the effective operation of controls. If control risk is assessed at less than maximum, the auditor contemplates reliance on the effective operation of controls.

Estimation Uncertainty (Ref: Para. 16(a))

A72. In taking into account the degree to which the accounting estimate is subject to estimation uncertainty, the auditor may consider:

- Whether the applicable financial reporting framework requires:
 - The use of a method to make the accounting estimate that inherently has a high level of estimation uncertainty. For example, the financial reporting framework may require the use of unobservable inputs.
 - The use of assumptions that inherently have a high level of estimation uncertainty, such as assumptions with a long forecast period, assumptions that are based on data that is unobservable and are therefore difficult for management to develop, or the use of various assumptions that are interrelated.
 - Disclosures about estimation uncertainty.
- The business environment. An entity may be active in a market that experiences turmoil or possible disruption (for example, from major currency movements or inactive markets) and the accounting estimate may therefore be dependent on data that is not readily observable.

⁶³ ISA 315 (Revised), paragraph 5334

- Whether it is possible (or practicable, insofar as permitted by the applicable financial reporting framework) for management:
 - To make a precise and reliable prediction about the future realization of a past transaction (for example, the amount that will be paid under a contingent contractual term), or about the incidence and impact of future events or conditions (for example, the amount of a future credit loss or the amount at which an insurance claim will be settled and the timing of its settlement); or
 - To obtain precise and complete information about a present condition (for example, information about valuation attributes that would reflect the perspective of market participants at the date of the financial statements, to develop a fair value estimate).

A73. The size of the amount recognized or disclosed in the financial statements for an accounting estimate is not, in itself, an indicator of its susceptibility to misstatement because, for example, the accounting estimate may be understated.

A74. In some circumstances, the estimation uncertainty may be so high that a reasonable accounting estimate cannot be made. The applicable financial reporting framework may preclude recognition of an item in the financial statements, or its measurement at fair value. In such cases, there may be risks of material misstatement that relate not only to whether an accounting estimate should be recognized, or whether it should be measured at fair value, but also to the reasonableness of the disclosures. With respect to such accounting estimates, the applicable financial reporting framework may require disclosure of the accounting estimates and the estimation uncertainty associated with them (see paragraphs A112–A113, A143–A144).

A75. In some cases, the estimation uncertainty relating to an accounting estimate may cast significant doubt about the entity's ability to continue as a going concern. ISA 570 (Revised)⁶⁴ establishes requirements and provides guidance in such circumstances.

Complexity or Subjectivity (Ref: Para. 16(b))

The Degree to Which Complexity Affects the Selection and Application of the Method

A76. In taking into account the degree to which the selection and application of the method used in making the accounting estimate are affected by complexity, the auditor may consider:

- The need for specialized skills or knowledge by management which may indicate that the method used to make an accounting estimate is inherently complex and therefore the accounting estimate may have a greater susceptibility to material misstatement. There may be a greater susceptibility to material misstatement when management has developed a model internally and has relatively little experience in doing so, or uses a model that applies a method that is not established or commonly used in a particular industry or environment.
- The nature of the measurement basis required by the applicable financial reporting framework, which may result in the need for a complex method that requires multiple sources of historical and forward-looking data or assumptions, with multiple interrelationships between them. For example, an expected credit loss provision may require judgments about future credit

⁶⁴ ISA 570, (Revised), *Going Concern*

repayments and other cash flows, based on consideration of historical experience data and the application of forward looking assumptions. Similarly, the valuation of an insurance contract liability may require judgments about future insurance contract payments to be projected based on historical experience and current and assumed future trends.

The Degree to Which Complexity Affects the Selection and Application of the Data

A77. In taking into account the degree to which the selection and application of the data used in making the accounting estimate are affected by complexity, the auditor may consider:

- The complexity of the process to derive the data, taking into account the relevance and reliability of the data source. Data from certain sources may be more reliable than from others. Also, for confidentiality or proprietary reasons, some external information sources will not (or not fully) disclose information that may be relevant in considering the reliability of the data they provide, such as the sources of the underlying data they used or how it was accumulated and processed.
- The inherent complexity in maintaining the integrity of the data. When there is a high volume of data and multiple sources of data, there may be inherent complexity in maintaining the integrity of data that is used to make an accounting estimate.
- The need to interpret complex contractual terms. For example, the determination of cash inflows or outflows arising from a commercial supplier or customer rebates may depend on very complex contractual terms that require specific experience or competence to understand or interpret.

The Degree to Which Subjectivity Affects the Selection and Application of the Method, Assumptions or Data

A78. In taking into account the degree to which the selection and application of method, assumptions or data are affected by subjectivity, the auditor may consider:

- The degree to which the applicable financial reporting framework does not specify the valuation approaches, concepts, techniques and factors to use in the estimation method.
- The uncertainty regarding the amount or timing, including the length of the forecast period. The amount and timing is a source of inherent estimation uncertainty, and gives rise to the need for management judgment in selecting a point estimate, which in turn creates an opportunity for management bias. For example, an accounting estimate that incorporates forward looking assumptions may have a high degree of subjectivity which may be susceptible to management bias.

Other Inherent Risk Factors (Ref: Para. 16(b))

A79. The degree of subjectivity associated with an accounting estimate influences the susceptibility of the accounting estimate to misstatement due to management bias or ~~fraud~~other fraud risk factors insofar as they affect inherent risk. For example, when an accounting estimate is subject to a high degree of subjectivity, the accounting estimate is likely to be more susceptible to misstatement due to management bias or fraud and this may result in a wide range of possible measurement outcomes. Management may select a point estimate from that range that is inappropriate in the circumstances,

or that is inappropriately influenced by unintentional or intentional management bias, and that is therefore misstated. For continuing audits, indicators of possible management bias identified during the audit of preceding periods may influence the planning and risk assessment procedures in the current period.

Significant Risks (Ref: Para. 17)

A80. The auditor's assessment of inherent risk, which takes into account the degree to which an accounting estimate is subject to, or affected by estimation uncertainty, complexity, subjectivity or other inherent risk factors, assists the auditor in determining whether any of the risks of material misstatement identified and assessed are a significant risk.

...

When the Auditor Intends to Rely on the Operating Effectiveness of ~~Relevant~~ Controls (Ref: Para: 19)

A85. Testing the operating effectiveness of ~~relevant~~ controls may be appropriate when inherent risk is assessed as higher on the spectrum of inherent risk, including for significant risks. This may be the case when the accounting estimate is subject to or affected by a high degree of complexity. When the accounting estimate is affected by a high degree of subjectivity, and therefore requires significant judgment by management, inherent limitations in the effectiveness of the design of controls may lead the auditor to focus more on substantive procedures than on testing the operating effectiveness of controls.

...

Overall Evaluation Based on Audit Procedures Performed (Ref: Para. 33)

...

Determining Whether the Accounting Estimates are Reasonable or Misstated (Ref: Para. 9, 35)

...

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO. 4.1
Meeting date: 24 October 2019
Subject: Meeting with Felicity Caird, IOD
Date: 11 October 2019
Prepared By: Sylvia van Dyk



Action Required



For Information Purposes Only

Agenda Item Objectives

For the Board to :

RECEIVE an update from Felicity Caird on challenges Directors encountered during the last reporting period;

DISCUSS ways to improve interaction with the Director community about auditing and assurance matters.

Background

During the September meeting the Board requested we invite Felicity Caird to the Oct meeting to provide the Board with an update on challenges Directors encountered during the last reporting period.

The previous meeting Felicity attended was in October 2018.

Matters to Consider

In addition to receiving an update from Felicity, this is a good opportunity to discuss ways to further improve interaction with the Director community about auditing and assurance matters.

For example, we will be reaching out to Directors for views about auditor reporting in our follow up joint review with the FMA to be discussed at agenda 10. It would be good to get feedback from Felicity about the best way to do so.

Material Presented

Agenda item 4.1. Board Meeting Summary Paper

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO. 6.1
Meeting date: 24 October 2019
Subject: NZAuASB Strategic Action Plan
Date: 10 October 2019

☒ **Action Required**

☐ **For Information Purposes Only**

Agenda Item Objectives

To APPROVE:

- the “annual cut” of the NZAuASB Strategic Action Implementation Plan for 2019/20 identifying the specific actions that will be undertaken in this year; and
- the updated NZAuASB Strategic Action Plan document for the five-year period 1 July 2019 to 30 June 2024.

To NOTE

- the progress made to date on the Implementation Plan for the year 1 July 2019 to date.

Background

NZAuASB Strategic Action Plan

1. At its July meeting the NZAuASB considered and provided feedback to the CE on the revised XRB organisation Strategic Plan 2019-2024.
2. At the September meeting the Board provided feedback on the draft NZAuASB Strategic Action Plan document for the five-year period 1 July 2019 to 30 June 2024 (SAP). The updated NZAuASB SAP, showing the mark ups to the version discussed at the September meeting, is available at agenda 6.3 for the Board’s approval.
3. We have also prepared the “annual cut” of the NZAuASB Strategic Action Implementation Plan for 2019/20 identifying the specific actions that will be undertaken in this year. This is available at agenda item 6.2. We have noted the progress to date against the 2019/20 implementation plan.

Action

1. APPROVE the SAP for the five- year period 1 July 2019 to 30 June 2024.

2. CONSIDER and APPROVE the annual cut of the NZAuASB Strategic Action Implementation Plan for 2019/20, identifying the specific actions that will be undertaken in this year.
3. NOTE the progress made to date on the Draft Implementation Plan for the year 1 July 2018 to date.

Material Presented

Agenda item 6.1	Board Meeting Summary Paper
Agenda item 6.2	NZAuASB Strategic Action Implementation Plan 2019/20 DRAFT
Agenda item 6.3	NZAuASB 2019-24 Strategic Action Plan DRAFT marked up

Actual actions against planned actions as at October 2019

Specific Strategy 1: Standards are Fit-for-Purpose

PART A: Business as Usual

Key: Green – ongoing activity and on track Orange – action is work in progress and on track Red – no action taken			
NZAuASB Action 1A.1:	Timing	2019/20 Planned Actions	2019/20 Actual Actions
Contributing to International Auditing and Assurance Standards Due Process			
<i>The NZAuASB will actively contribute to the "due process" activities of the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA). These activities relate to the development or amendment of international standards.</i>			
The Action will comprise:			
a. Ensuring assurance practitioners and relevant users of assurance reports are aware of IAASB and IESBA due process documents and encouraging them to make submissions directly to the international boards and to the NZAuASB;	Ongoing	<ul style="list-style-type: none"> Issue newsletters when international documents issued Organise consultation events as appropriate, with a focus on "why" the change Promote awareness on social media 	Newsletters highlighting consultation documents: <ul style="list-style-type: none"> IESBA ED Role and Mindset (Aug 2019) Events organised: <ul style="list-style-type: none"> Assurance update webinar (Sept 2019) Consultation on less complex entities <ul style="list-style-type: none"> Webinar (Aug 2019) One on one targeted interviews (Aug 2019) Online survey (Aug 2019)
b. Responding, as appropriate, to IAASB and IESBA due process documents (consultation documents, discussion papers and exposure drafts) and doing		<ul style="list-style-type: none"> Prepare comment letters 	Submissions provided to the following International Boards on the following topics:

so in conjunction with the Australian Auditing and Assurance Standards Board (AUASB) and Australian Accounting and Professional Ethical Standards Board (APESB) where appropriate;		<ul style="list-style-type: none"> • Liaise with AUASB in accordance with established protocol before letters finalised • Liaise with APESB to the extent considered appropriate in each case 	IAASB <ul style="list-style-type: none"> • Less complex entities consultation (Sept 2019) IESBA <ul style="list-style-type: none"> • ED Role and Mindset (Oct 2019)
c. Participating, as appropriate, in roundtables and other face-to-face due process related meetings organised by the international boards.		<ul style="list-style-type: none"> • Participate in events in NZ or Australia (or elsewhere on an exceptional basis) 	<ul style="list-style-type: none"> • Senior project manager attended APESB roundtable PJC Inquiry into Regulation of Auditing (Sep 2019)

NZAuASB Action 1A.2:	Timing	2019/20 Planned Actions	2019/20 Actual Actions
Maintaining New Zealand Auditing and Assurance Standards			
<i>The NZAuASB will amend the auditing and assurance standards (auditing standards, review engagement standards, other assurance standards) to ensure that the existing suite of standards are maintained on an on-going basis.</i>			
The Action will comprise:			
a. Incorporating any auditing and assurance standards, or amendments to those standards, issued by the IAASB, to achieve convergence, as appropriate, and including working with the AUASB to ensure any changes are appropriately harmonised; and	Ongoing	<ul style="list-style-type: none"> • Amend standards following due process as documents issued by IAASB • Liaise with AUASB in accordance with harmonisation process protocol 	The following standards/guidance have been approved and issued to NZ constituents following due process <ul style="list-style-type: none"> • ISA (NZ) 315 (Revised) and Conforming Amendments (see agenda item 3)
b. Incorporating any ethical standards for assurance practitioners, or amendments to those standards, issued by IESBA, including liaising with the		<ul style="list-style-type: none"> • Amend standards following due process as documents issued by IESBA 	The following standards/guidance have been approved and issued to NZ constituents following due process

APESB to ensure any changes are appropriately harmonised.		<ul style="list-style-type: none"> • Interact with APESB staff and Chair as appropriate • Observe some APESB meetings to build relationships with staff and the Board • Agree a communications protocol with the APESB • Develop harmonisation process protocol with APESB • Apply APESB harmonisation protocol 	<ul style="list-style-type: none"> • Part 4B 3000 Amendments (to consider in Dec) • Regular ongoing liaison with APESB CEO and staff.
c. Responding as appropriate to any gaps /issues identified with the current suite of standards		<ul style="list-style-type: none"> • Develop an appropriate response where such matters are identified. • Utilisation of research and stakeholder engagement where appropriate. 	<ul style="list-style-type: none"> • No matters identified to date.
d. Incorporating any amendments to international auditing and assurance standards to domestic standards where applicable, including liaising with the AUASB.		<ul style="list-style-type: none"> • Amend standards following due process and agreed policy. 	<ul style="list-style-type: none"> • Consider impact of ISA 315 (Revised) on NZ AS 1, etc.
e. Developing domestic standards, and amendments to standards, as appropriate, including working with the AUASB to ensure, where relevant, domestic standards are appropriately harmonised		<ul style="list-style-type: none"> • Develop or amend domestic standards following due process and agreed policy. 	<ul style="list-style-type: none"> • Amending NZ SRE 2410 for new reporting requirements in progress, in collaboration with the AUASB (see agenda item 5)
f. Liaising with the New Zealand Accounting Standards Board (NZASB) during the development stage of new or amending		<ul style="list-style-type: none"> • Liaise with the NZASB as appropriate 	<ul style="list-style-type: none"> • Senior project managers attended NZASB staff briefing on Intangible Assets

accounting standards and any post-implementation reviews to identify any audit or assurance considerations.		<ul style="list-style-type: none"> NZAuASB staff to attend at least 3 NZASB staff briefing or education sessions during the year to receive and provide update on work plans Invite NZASB Chair and Director to meetings to provide update on NZASB workplan. 	<ul style="list-style-type: none"> Senior project manager attended Sept 2019 NZASB meeting to obtain views on NZ SRE 2410 proposals Director Accounting Standard provided an update to the Board in July 2019 on the accounting framework PIR. Director Assurance Standards provided an update to NZASB in August 2019.
NZAuASB Action 1A.3:	Timing	2019/20 Planned Actions	2019/20 Actual Actions
Monitoring the Assurance Environment			
<p><i>The NZAuASB will monitor the wider assurance environment, liaise with key participants in the financial and non-financial reporting "supply chain", and consider the implications of any developing issues for New Zealand auditing and assurance standards.</i></p> <p>The Action will comprise:</p>			
a. Monitoring issues arising from the implementation of the current suite of standards and responding as appropriate;	Ongoing	Passive monitoring via media, public sources, and relationship contacts, specifically: <ul style="list-style-type: none"> implementation of new auditor reporting for FMC reporting entities implementation of auditing of accounting estimates implementation of the revised and restructured Code of Ethics auditing of SSPs 	<ul style="list-style-type: none"> Ongoing monitoring occurring <ul style="list-style-type: none"> Update to auditors' responsibilities description on XRB website to cover service performance information (Oct 2019) Modified auditor reports update provided in September.

		Monitor modified auditor reports and report half yearly to Board	
b. Monitoring issues or gaps with the current suite of standards and responding as appropriate.	Ongoing	<ul style="list-style-type: none"> Take action as appropriate as matters arise during the year 	<ul style="list-style-type: none"> Ongoing monitoring occurring. Practitioners attended Sept 2019 NZAuASB meeting. Matters identified: <ul style="list-style-type: none"> Consider if guidance is required for KAMs in other assurance engagements (See Action 2.1) FMA issue re ISA 560 Subsequent events. Discussed July 2019 and to complete 2019/20. Refer agenda 11.
c. Tracking local and international research projects, monitoring academic research outputs in both New Zealand and Australia in conjunction with the AUASB and considering the implications for the New Zealand auditing and assurance standards;	Ongoing	<ul style="list-style-type: none"> Monitor projects, including: <ul style="list-style-type: none"> global extended external reporting developments academic research use of data analytics and artificial intelligence in auditing; <u>auditing for SMEs</u> <u>non-assurance services</u> 	<ul style="list-style-type: none"> Ongoing monitoring occurring. Environmental scanning report standard agenda item.
d. Monitoring results from QA reviews conducted locally and internationally and considering the implications for New Zealand auditing and assurance standards;	Ongoing	<ul style="list-style-type: none"> Director continue to participate at FMA Audit Oversight Committee meetings and report as necessary to the Board Analyse results of QA reviews for standards issues. Liaise with FMA on reviews conducted. 	<ul style="list-style-type: none"> Ongoing attendance at Audit Oversight Committee meetings and reporting to the Board as necessary. Ongoing regular liaison with FMA on audit quality review issues and reporting to the Board as necessary. FMA raised issue re SA 560 Subsequent Events (Oct 2018). Considered at July meeting. In progress to complete 2019/20. Refer agenda 11.

			<ul style="list-style-type: none"> Report on FMA QA findings at agenda 9
e. Assisting the XRB to contribute to government policy work relating to auditing and assurance and other related services standards	Ongoing	<ul style="list-style-type: none"> Interact with MBIE and other agencies as requested by them, or as identified as necessary 	<ul style="list-style-type: none"> Ongoing contact with MBIE regarding progress on change in mandate for AUP standard. Bill currently in select committee. Ongoing contact with RBNZ regarding auditor reporting Ongoing contact with MBIE regarding sustainability reporting and assurance
f. Monitoring the XRB EER project, contributing to the development of guidance as appropriate, and work with others to ensure that any assurance gaps are identified, understood, researched if necessary and addressed.		<ul style="list-style-type: none"> Monitor developments and consider if any action is required Collaborate with others in researching innovation in EER assurance engagements 	<ul style="list-style-type: none"> Ongoing monitoring. Ongoing assistance to AUASB on EER survey
g. Monitoring activities and developments in the wider assurance standard setting space, particularly for changes coming out of the Monitoring Group review and major reviews in other jurisdictions, and considering the implications for the New Zealand auditing and assurance standards		<ul style="list-style-type: none"> Monitor developments and consider if any action is required 	<ul style="list-style-type: none"> Ongoing
h. Collaborating with the NZASB on projects where quality issues with accounting standards may have an audit impact, and by supporting the targeted review of the accounting standards framework.			<ul style="list-style-type: none"> Planning for joint NZASB/NZAuASB meeting in progress

Specific Strategy 1: Standards are Fit-for-Purpose

Part B: Address Critical Issues

NZAuASB Action 1B.1:	Timing	2019/20 Planned Actions	2019/20 Actual Actions
Developing an Assurance Standard on the Examination of Prospective financial information			
<i>The NZAuASB will develop an assurance standard for other assurance engagements involving the examination of prospective financial information.</i>			
This action will comprise:			
Developing the standard in accordance with the due process for domestic standards, ensuring harmonisation with the AUASB standard as appropriate.	Whole year.	<ul style="list-style-type: none"> • Approve updated project plan and continue development of standard in accordance with the agreed project plan 	<ul style="list-style-type: none"> • In progress.
NZAuASB Action 1B.2: Consider what further guidance is needed on the use of the XRB auditing and assurance standards and relative assurance products, and develop guidance where identified	Timing	2019/20 Planned Actions	2019/20 Actual Actions
<i>The NZAuASB will consider what further guidance is needed in the New Zealand environment. The action will comprise:</i>			

Considering what further guidance is needed Developing appropriate guidance.	Whole year.	<ul style="list-style-type: none"> Consider if there is a need for further guidance on the use of the assurance standards. Liaise with the AUASB staff when they update/develop guidance and consider if equivalent guidance needed in NZ Develop further guidance in accordance with the approved project plan and in collaboration with the AUASB where applicable Include guidance on website Promote the guidance 	<ul style="list-style-type: none"> Possible guidance to consider as part of NASS collaboration is Guidance on use of Management's Expert.
NZAuASB Action 1B.3: Developing a review standard on service performance information	Timing	2019/20 Planned Actions	2019/20 Actual Actions
<i>The NZAuASB will develop a review standard on service performance information for Public Benefit Entities (PBEs)</i> The action will comprise:			
Developing the standard in accordance with the due process for domestic standards and in collaboration with the AUASB as appropriate.	Commence 2 nd half 2019-20 and complete 2020-21.	<ul style="list-style-type: none"> Approve project plan and commence development of the engagement standard in accordance with the agreed project plan. 	<ul style="list-style-type: none"> Project plan to approve. See agenda 7.

NZAuASB Action 1B.4: Developing an engagement standard/guidance for smaller NFPs	Timing	2019/20 Planned Actions	2019/20 Actual Actions
<i>The NZAuASB will develop an engagement standard/guidance for smaller NFPs not required to have an audit or a review to better meet the needs of users, as informed by research completed in 2016-17.</i>			
The action will comprise:			
Developing the standard/guidance in accordance with the due process for domestic standards and in collaboration with the AUASB as appropriate.	Whole year. – to complete 2020-21.	<ul style="list-style-type: none"> Commence development of the engagement standard/guidance in accordance with the agreed project plan 	<ul style="list-style-type: none"> In progress.
NZAuASB Action 1B.5 Perform a post implementation review of the Compliance Engagement Standard	Timing	<ul style="list-style-type: none"> 2019/20 Planned Actions 	<u>2019/20 Actual Actions</u>
<i>The NZAuASB will perform a post implementation review of the Compliance Engagement standard jointly with the AUASB to determine if further guidance is needed.</i>			
This action will comprise:			
Performing a post implementation review of the Compliance standard jointly with the AUASB. Considering if further application guidance is needed.	Commence 2 nd half 2019-20	<ul style="list-style-type: none"> Liaise with the AUASB and develop a joint project plan for the post implementation review Perform the post implementation review in accordance with the approved project plan Consider the results together with the AUASB 	<ul style="list-style-type: none"> Commenced discussion with AUASB Director re timing.

		and decide whether further application guidance is needed.	
NZAuASB Action 1B.6: Amending NZ SRE 2410 Review of Financial Statements Performed by the Independent Auditor of the Entity	Timing	2019/20 Planned Actions	2019/20 Actual Actions
<p><i>The NZAuASB will amend NZ SRE 2410 for the new auditor reporting requirements.</i></p> <p>This action will comprise:</p>			
Amending the standard in collaboration with the AUASB and in accordance with the due process for domestic standards	Complete first half 2019/20.	<ul style="list-style-type: none"> Amend the standard in accordance with the approved project plan 	<ul style="list-style-type: none"> In progress. Refer agenda 5.
NZAuASB Action 1B.7 Perform a review of the compelling reason test and the harmonisation policy jointly with the AUASB	Timing	2019/20 Planned Actions	<u>2019/20 Actual Actions</u>
<p><i>The NZAuASB will perform a review of the compelling reason test, in collaboration with the AUASB, to determine if it remains fit for purpose in the current auditing and assurance environment globally and in the two jurisdictions</i></p> <p>This action will comprise:</p>			
Performing a review of the compelling reason test and the harmonisation policy together with the AUASB about any changes that may be needed	Commence 2 nd half 2019-20	<ul style="list-style-type: none"> Staff to liaise with AUASB staff and to prepare a joint issues paper for the 2 Boards to consider at concurrent meetings. Both Boards to consider outcome of the 	<ul style="list-style-type: none"> Commenced discussion with AUASB Director re timing.

		respective meetings, and staff to jointly prepare an update for Boards to approve at subsequent meetings.	
NZAuASB Action 1B.8 Perform a follow up joint review with the FMA on auditor reporting in New Zealand The Action will comprise:	Timing	<ul style="list-style-type: none"> • 2019/20 Planned Actions 	<u>2019/20 Actual Actions</u>
a. Developing and issuing a follow up joint report with the FMA on auditor reporting and issuing a joint report	Whole year	<ul style="list-style-type: none"> • Staff to liaise with the FMA and prepare a project plan • Prepare a joint draft report for the Board's comments • Issue the report jointly with the FMA 	<ul style="list-style-type: none"> • Project plan at agenda 10.
b. Considering if further guidance is needed on auditor reporting	As needed	<ul style="list-style-type: none"> • Consider if there is a need for further guidance 	
NZAuASB Action 1B.10 Considering and addressing the implications of the XRB mandate The action will comprise:	Timing	2019/20 Planned Actions	<u>2019/20 Actual Actions</u>
Addressing issues arising as a result of the XRB's mandate and any changes to the mandate	Whole year	Consider issues arising as a result of the XRB's legal mandate on the	<ul style="list-style-type: none"> • In progress

		professional and ethical standards	
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Specific Strategy 2: Standards are Evidenced-Informed as to User Needs

NZAuASB Action 2.1:	Timing	2019/20 Planned Actions	2019/20 Actual Actions
<p>The NZAuASB will undertake, organised research into needs of the various users of NZAuASB standards as a basis for considering enhancements to the NZAuASB's standards in the future, and to help inform efforts to influence the work of the international standard setting boards.</p> <p>This action will comprise:</p>			
a. Identifying and performing applicable user needs research to undertake where appropriate.	Whole year.	<p>The NZAuASB has identified the following in house research projects:</p> <ul style="list-style-type: none"> Discuss with Commerce Commission and research if there is a need to develop guidance on KAMs for other assurance reports Perform survey on extent and type of EER assurance engagements performed in NZ in collaboration with AUASB. 	<ul style="list-style-type: none"> Discussion with Commerce Commission not yet commenced. Draft survey on EER being developed in conjunction with AUASB.
b. Considering output of research available (including in liaison with the AUASB) and	Ongoing	<ul style="list-style-type: none"> Monitor outputs of research projects 	<ul style="list-style-type: none"> Ongoing

how this can best contribute to the quality of standard setting work.		conducted on assurance matters <ul style="list-style-type: none"> Perform search to identify available research on current IAASB, IESBA and NZAuASB projects and consider relevance of research output to the projects 	
NZAuASB Action 2.2: Developing relationships with academia and other “think tanks”	Timing	2019/20 Planned Actions	2019/20 Actual Actions
<i>The focus of the NZAuASB specific actions will be to develop relationships with academia and other ‘think tanks’ to direct user needs research to contribute to the standard setting process.</i> This action will comprise:			
a. Leveraging collaboration between academic members of the NZAuASB and the AUASB;			<ul style="list-style-type: none"> Ongoing
b. Meeting with academic constituent groups on a rolling basis as part of the NZAuASB’s regular meetings;		Invite representatives from academia (lecturers and researches) to a Board meeting to explore ways to best engage.	<ul style="list-style-type: none"> Liaison schedule planned meeting
c. <u>Taking opportunities to meet with academics in other fora, including at events hosted by them.</u>		<ul style="list-style-type: none"> <u>Present a seminar at least at one university about the audit environment.</u> 	

NZAuASB Action 2.3:	Timing	2019/20 Planned Actions	2019/20 Actual Actions
Promoting an evidence informed standard setting strategy			
a. <u>Reviewing the AUASB's strategy and refining the NZAuASB's approach under this strategy.</u>			<ul style="list-style-type: none"> Not yet commenced

Specific Strategy 3: High Quality Global Standards Applicable in New Zealand

NZAuASB Action 3.1:	Timing	2019/20 Planned Actions	2019/20 Actual Actions
Building Relationships with the IAASB			
<i>The NZAuASB will seek to build and maintain relationships with IAASB members and staff.</i> The Action will comprise:			
a. Attending relevant meetings and events (including National Standard Setters meetings);	Ongoing	<ul style="list-style-type: none"> Chair and Director to attend NSS meetings Director to attend IAASB meetings as Technical Advisor (TA) to Lyn Provost Chair to observe IAASB meetings in conjunction with NSS meeting or otherwise as appropriate 	<ul style="list-style-type: none"> Ongoing attendance by Director at all IAASB meetings, and report provided to the Board on each meeting.
b. Taking opportunities to meet with IAASB members and staff;		<ul style="list-style-type: none"> Interact with key staff and Chair as appropriate NZAuASB representative and staff to attend the 	<ul style="list-style-type: none"> Ongoing interaction at staff level.

		NSS meeting in May 2020.	
c. Fostering relationships with and providing support to Australasian representatives on the IAASB and those who are involved in relevant working groups;		<ul style="list-style-type: none"> Support Lyn Provost as IAASB member (see 3,3) and interact regularly with Fiona Campbell at IAASB meetings and on specific topics as required Work with AUASB at chair and staff level to influence international agenda. 	<ul style="list-style-type: none"> Ongoing support provided to Lyn Provost Ongoing liaison with Fiona Campbell at IAASB meetings.
d. Hosting IAASB members and staff in visits to New Zealand as appropriate.		<ul style="list-style-type: none"> Host IAASB members and staff as appropriate 	<ul style="list-style-type: none"> No visit identified to date.
e. Responding as appropriate to requests for information from the IAASB and any other relevant working groups		<ul style="list-style-type: none"> Respond to requests for information as appropriate 	
NZAuASB Action 3.2: Increasing the International Visibility of the NZAuASB	Timing	2019/20 Planned Actions	2019/20 Actual Actions
<p><i>The NZAuASB will take advantage of opportunities to increase its visibility in the international arena so as to illustrate its ability to contribute to the work of the IAASB in a constructive and high quality way.</i></p> <p>The Action will comprise:</p>			
a. Volunteering to present at the NSS meetings on New Zealand projects or with the AUASB/APESB and/or other NSS on joint projects; and	Ongoing	<ul style="list-style-type: none"> Identify possible topic to present on at NSS in May 2020 	

b. Identifying appropriate, mutually beneficial IAASB and IESBA projects and contributing technical resources in support of those projects.	Ongoing	<ul style="list-style-type: none"> Contribute resources to mutual beneficial projects as opportunities arise 	<ul style="list-style-type: none"> Director participating as task force member on IAASB ISA 540 Implementation project. Senior project manager assisted IAASB staff with QA review on proposed amendment t to ISAs for changes to the Code (September).
NZAuASB Action 3.3: Supporting Lyn Provost in her role as IAASB member	Timing	2019/20 Planned Actions	2019/20 Actual Actions
<p><i>The NZAuASB will provide support to Lyn Provost in her role as IAASB member.</i></p> <p>The Action will comprise:</p>			
a. Inviting Lyn Provost to Board meetings and providing high level support for her role (and monitoring the inputs of the Technical Advisory group)	Ongoing	<ul style="list-style-type: none"> Invite Lyn Provost to Board meetings Providing high level support for Lyn's role and monitoring the inputs of the Technical Advisory Group Arrange high-level discussions between Lyn Provost and the NZAuASB when appropriate 	<ul style="list-style-type: none"> Ongoing meetings occurring with technical advisory group before each IAASB meeting, with report back to the Board.
b. The Director Assurance Standards attending IAASB meetings as Technical Advisor (TA) to Lyn Provost.		<ul style="list-style-type: none"> Director to attend IAASB meetings as Technical Advisor (TA) to Lyn Provost 	<ul style="list-style-type: none"> Ongoing attendance at all IAASB meetings, and report back to the Board.
NZAuASB Action 3.4:	Timing	2019/20 Planned Actions	2019/20 Actual Actions

Building Relationships with the IESBA			
<p><i>The NZAuASB will seek to build relationships with IESBA members and staff.</i></p> <p>The Action will comprise:</p>			
a. Attending relevant meetings and events (including NSS meetings);	Ongoing	<ul style="list-style-type: none"> Chair and Director to attend NSS meeting in May 2020. Chair to observe IESBA meetings in conjunction with NSS meeting or otherwise as appropriate 	
b. Taking opportunities to meet with IESBA members and staff; and		<ul style="list-style-type: none"> Interact with key staff and Chair as appropriate 	
c. Fostering relationships with Australian representatives on the IESBA.		<ul style="list-style-type: none"> Build relationship with Australian IESBA member – Invite to a NZAuASB meeting. 	
d. Hosting IESBA members and staff in visits to New Zealand as appropriate.		<ul style="list-style-type: none"> Host IESBA members and staff as appropriate 	
e. Responding, as appropriate, to requests for information from the IESBA and any other relevant working group.		Respond to requests for information as appropriate	
<p>NZAuASB Action 3.5:</p> <p>Working with the IESBA and CA ANZ, as appropriate, to explore transfer of the eCode to New Zealand</p> <p>The Action will comprise:</p>	Timing	2019/20 Planned Actions	2019/20 Actual Actions

a. Contributing technical resource to the next phase of the IESBA project	Whole year	<ul style="list-style-type: none"> Senior project manager to assist with the project 	<ul style="list-style-type: none"> Ongoing
b. Assisting IESBA with testing the E-Code application adjusted for jurisdictional provisions in New Zealand		<ul style="list-style-type: none"> Test the eCode in New Zealand 	<ul style="list-style-type: none"> Not yet commenced
NZAuASB Action 3.6: Collaborating with other NASSs to ensure global standards are fit for purpose at jurisdictional levels. The Action will comprise:	Timing	2019/20 Planned Actions	2019/20 Actual Actions
a. Leading the exploration internationally of how NASSs can work more collaboratively with each other to address issues associated with current and recently released IAASB standards (e.g. the impact of technology on the audit, SMP/LCE audit issues, and the implementation of new or updated standards).		<ul style="list-style-type: none"> Jointly develop and agree a NASS Vision with the lead group of 4. Agree Vision with the wider NASS group at the NSS meeting in May 2020 Have quarterly phone calls with the NASS G4 group, and in-person meetings alongside the IAASB meetings. Establish and maintain a NASS communications network Share work plans and identify specific projects amongst NASS G4 group to collaborate on. 	<ul style="list-style-type: none"> In progress. Work plans have been shared with NASS G4 group to be discussed at quarterly conference call on 18 Oct.

<p>b. Identifying and exploring opportunities for the IAASB and National Assurance Standard Setters (NASS) to work collaboratively to enable more impactful support for the IAASB in progressing its current and future work.</p>		<ul style="list-style-type: none"> • Liaise with the IAASB staff on NSS matters to work collaboratively on. • Contribute to planning NSS meetings. • Develop relationship with the new IAASB Chair. 	<ul style="list-style-type: none"> • In progress • Chair has had discussions with the new IAASB Chair (Sept)
<p>c. Continuing to develop an understanding of how NASS as a stakeholder group can better inform the implementation of the IAASB's current and future strategies, through global and regional actions that increase the value and perception of the audit.</p>		<ul style="list-style-type: none"> • Participate in NASS meetings • Build relationships with other NASS in the ASIA PACIFIC region. • Develop a database of NASS contacts and invite them to join the NASS communications network. • Obtain support for a wider participation at annual NASS meetings 	<ul style="list-style-type: none"> • In progress
<p>d. Work with the IAASB and the IESBA in support of their joint project to foster "quadrilogue" and project specific collaboration between the two boards and their respective NSS groups</p>		<ul style="list-style-type: none"> • Continue dialogue with the IAASB and IESBA Chairs and Directors to identify joint projects. • Plan and host the joint Boards' session at the NSS meeting in May 2020. • Liaise with APESB and the Canadian Ethics Standards Board to establish a 	<ul style="list-style-type: none"> • In progress

		communications network for national ethic standard setters.	
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Specific Strategy 4: Standards Developed Collaboratively with Constituency

NZAuASB Action 4.1:	Timing	2019/20 Planned Actions	2019/20 Actual Actions
Enhancing Auditing and Assurance Standards Due Process Consultation			
<p><i>The NZAuASB will seek to enhance consultation with major assurance practitioners and user constituent groups on specific issues relating to the auditing and assurance standards, especially consultation relating to due process documents.</i></p> <p>The Action will comprise:</p>			
a. Identifying and implementing innovative, targeted consultation methods with a focus on “why” the change, that are high value-added but relatively low-effort from the constituents’ point of view; and	Ongoing	<ul style="list-style-type: none"> Continue current due process engagement methods Develop new communications & engagement approach that reflects different target groups and helps to explain “why” changes are needed. 	<ul style="list-style-type: none"> Targeted interviews on LCEs (Sep 2019) Online surveys (LCEs, 2410 revision) (Sep 2019) Blog (2410 revision) (Sep 2019)
b. Proactively engaging with relevant constituent groups about specific technical issues or matters being considered domestically or internationally.		<ul style="list-style-type: none"> Present updates on Auditing and Assurance standards to accounting, auditing, legal, and director community audiences Promote other Topics as arise Identify and engage with relevant groups 	

		about major new exposure drafts and standards.	
NZAuASB Action 4.2: Undertaking On-Going Dialogue	Timing	2019/20 Planned Actions	2019/20 Actual Actions
<p><i>The NZAuASB will undertake an on-going dialogue with relevant constituent groups across all sectors on general matters relating to auditing & assurance standards, including changes resulting from the evolving nature of the audit market.</i></p> <p>The Action will comprise:</p>			
a. Meeting with major constituent groups on a rolling basis as part of the NZAuASB's regular meetings;	Ongoing	<ul style="list-style-type: none"> Update and include liaison schedule as a standard agenda item Organise regular meetings with key stakeholders identified on the liaison schedule - 	<ul style="list-style-type: none"> Ongoing. Liaison schedule standard agenda item. Assurance practitioners attended Sept 2019 meeting.
b. Taking opportunities to meet with major constituent groups in other fora, including at events hosted by those groups; and	Ongoing	<ul style="list-style-type: none"> Organise seminars & round tables Attend other fora Attend mid-tier forum 	<ul style="list-style-type: none"> Planning underway for consultations with stakeholders on auditor reporting implementation for joint report with the FMA. Refer agenda 10.
c. Maintaining strong working relationships at the operational level with key constituent groups.	Ongoing	<ul style="list-style-type: none"> Built relationships with key groups identified. 	
NZAuASB Action 4.3: Promoting understanding of the auditing and assurance standards and engagements	Timing	2019/20 Planned Actions	2019/20 Actual Actions
<p><i>The NZAuASB will undertake activities throughout the life-cycle of developing standards to promote an increased understanding of the auditing and assurance standards</i></p> <p>The Action will comprise:</p>			

<p>a. Conducting seminars, presentations, speaking engagements and other awareness raising activities as appropriate that help raise awareness of:</p> <ul style="list-style-type: none"> assurance practitioners about new and revised auditing and assurance standards users (where relevant) about auditing and assurance standards and the benefits of and options for enhancing credibility 		<ul style="list-style-type: none"> Speaking engagements as opportunities arise Targeted meetings with users Journal articles Targeted newsletters Social media notifications 	<ul style="list-style-type: none"> Assurance update webinar (Sept 2019) Australian Accounting Review "International Code of Ethics for Professional Accountants: A behind the Scenes look at the eCode" (Sept 2019) Perspectives Article ISA 315 (Revised)
<p>b. Promoting awareness of the IAASB and the IESBA implementation support activities.</p>		<ul style="list-style-type: none"> Targeted newsletters Social media notifications 	<ul style="list-style-type: none"> Ongoing

NZAuASB Action 4.5: Support the XRB to Promote Understanding of the factors that Affect Audit Quality	Timing	2019/20 Planned Actions	2019/20 Actual Actions
<p><i>The focus of the NZAuASB's specific actions will be to work with other key organisations to enhance audit quality</i></p> <p>This action will comprise:</p>			

a. Actively supporting the XRB in its work with regulators and other stakeholders to promote an understanding of the factors that affect audit quality	Ongoing	<ul style="list-style-type: none"> Promote the audit quality framework as opportunities arise Liaise with IOD to do an awareness raising session as part of the director education series 	<ul style="list-style-type: none"> IOD guest at October meeting. Refer agenda 4.
b. Conducting seminars, presentations, speaking engagements and other awareness raising activities as appropriate that inform assurance users and those charged with governance about the factors that affect audit quality		<ul style="list-style-type: none"> Speaking engagements as opportunities arise XRBrief article Promote guidance developed. 	

*"A User-Needs Framework
Contributing to New Zealand's
Sustainable and Inclusive
Economic Goals"*

Strategic Action Plan

**For the five-year period
1 July 2019 to 30 June 2024**

September 2019

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1. ~~Overview of the NZAuASB~~Introduction

The New Zealand Auditing and Assurance Standards Board (NZAuASB) is a Committee of the External Reporting Board (XRB) established under schedule 5 of the Crown Entities Act.

The NZAuASB has delegated authority from the XRB Board to develop or adopt and issue auditing and assurance standards (including professional and ethical standards for assurance practitioners). In doing so the NZAuASB must operate within the financial reporting strategy established by the XRB Board.

The NZAuASB also issues "Other Assurance Standards" in accordance with an [authority provided](#) by the Minister of Commerce issued under section 24 (1) (b) (v) of the Financial Reporting Act 1993.

1.1 NZAuASB's Strategic Objective

The XRB's strategies aim to contribute to building trust and confidence in the reporting by New Zealand organisations across all sectors¹. The NZAuASB's strategic objective, which reflects that goal, is:

To establish auditing and assurance standards ~~(including ethical standards)~~ [in the public interest](#) which will encourage assurance practitioners to ~~provide~~ [perform](#) assurance [engagements](#) in a manner that engenders confidence in New Zealand financial reporting, assists [New Zealand](#) entities to compete internationally, and enhances entities' accountability to [their](#) stakeholders.

Commented [MP1]: The Board asked for these words in September

Commented [MP2]: Do not provide assurance ...move away from assurance providers. Suggest "perform assurance engagements in a manner..."

The ~~provision-performance~~ of high quality assurance [engagements](#) that provides users with confidence about the fair presentation of the information presented in financial reports is vital to the achievement of the XRB's strategies. Consistent with those strategies, the NZAuASB maintains the existing suite of auditing and assurance standards and issues such standards or guidance as it considers necessary from time to time.

1.2 Role and Responsibilities of the NZAuASB

The primary responsibility of the NZAuASB is to develop or adopt, expose, finalise and promulgate:

- auditing and assurance standards for use in audit or assurance engagements required by statute;
- professional and ethical standards to be applied by assurance practitioners undertaking statutory assurance engagements; and
- other assurance standards within the scope of any "additional assurance standards" approval provided by the Responsible Minister in accordance with the Financial Reporting Act 2013.

consistent with its strategic objective.

¹ The underlying foundations of the XRB's strategic plan are set out in detail in the XRB's [Strategic Plan 1 July 2014 to 30 June 2019](#) and in subsequent Strategic Plans. The strategies are summarised in the Appendix to this Plan.

To meet that responsibility, the NZAuASB:

- ensures that the auditing and assurance standards are consistent with the XRB's financial reporting strategy, including:
 - adoption of international standards, subject only to compelling reasons to enhance those standards in New Zealand and with the objective of harmonising New Zealand and Australian standards
 - development of standards jointly with Australia; or
 - development of New Zealand specific standards as may be required by the strategy;
- develops and promulgates guidance material to support the application and implementation of issued standards;
- undertakes or commissions research relating to auditing and assurance or matters concerning professional and ethical conduct;
- liaises with and influences other stakeholders in the auditing and assurance dimensions of the XRB's financial reporting strategy, including ~~the auditing profession, regulators and~~ all participants in the financial and non-financial reporting "supply chain";
- collaborates with the Australian Auditing and Assurance Standards Board (AUASB), through reciprocal membership and liaison, and occasional joint meetings, to promote cooperation and the harmonisation of New Zealand and Australian auditing and assurance standards;
- collaborates with the Accounting Professional and Ethical Standards Board of Australia (APESB), through liaison and observing APESB meetings, to promote cooperation and harmonisation of New Zealand and Australian professional and ethical standards for assurance practitioners;
- on behalf of the XRB as New Zealand's national standard setter, participates in the activities ~~of~~ the international standard setting bodies responsible for auditing and assurance and professional and ethical standards;
- maintains and enhances ~~s~~ relationships with other national auditing and assurance and ethical standard setters (N~~A~~SSs) and collaborates on matters of mutual interest; and
- contributes to the development and implementation of the XRB's Strategic Plan, acting as thought leaders on assurance issues in support of the XRB's mandate and strategic objectives.

2. Introduction to the NZAuASB's Strategic Action Plan

2.1 The NZAuASB's Strategic Action Plan

This Strategic Action Plan outlines the specific actions that the NZAuASB will take in the 2019/20 financial year and subsequent years to give effect to its strategic objective.

The NZAuASB updates and revises this Strategic Action Plan annually during the five-year period covered by the overarching strategic plan. This enables the Strategic Action Plan to be a dynamic document that reflects achievements to date and new strategies and actions.

3. Strategic Context and Priorities for the 2019-2024 period

Strategic Context

Auditing and assurance standards are a significant element of the financial reporting “supply chain”. Assurance standards are also increasingly important in non-financial reporting, including emerging forms of [extended](#) external reporting (EER).

Currently, there is considerable international and domestic activity examining trust and confidence in financial reporting, including audit quality, the independence of [auditors](#) and audit firms, and competition in the audit market.

Internationally both the style and format of international auditing and assurance standards and the structures for auditing and assurance standard setting (including those for ethics) are a matter of debate and controversy.

These are in addition to other disruptions like developments in artificial intelligence, other technology advances, and changes in the professional accounting market place.

In the period from 1 July 2019 to 30 June 2024 the NZAuASB plans to continue to actively monitor such disruptions and consider the implications for the New Zealand auditing and assurance standards.

Overarching priorities

Domestic priorities

Responding to that strategic context, and consistent with the XRB’s strategic priorities, the NZAuASB will continue to strengthen its core work by ensuring that New Zealand auditing and assurance standards remain fit-for-purpose and are capable of serving the public interest – both in relation to regulated audits and more broadly. It will do so by:

- liaising with ~~regulators and the profession~~ [key participants in the financial and non-financial reporting “supply chain”](#), and being responsive to emerging user needs;
- undertaking targeted outreach with practitioners and users in relation to standards under international revision;
- continuing its strong collaboration with the AUASB and the APESB;
- [reviewing the compelling reason test to ensure it remains fit-for-purpose](#); and
- promoting an evidence ~~informed-based~~ approach to its standard setting work.

The NZAuASB will actively support XRB initiatives that are relevant to its responsibilities or have auditing and assurance implications, including:

- Monitoring the XRB's EER project (which aims to take an active role in leading the development of EER in New Zealand as it relates to users of "corporate" reports), contributing to the development of guidance as appropriate. The NZAuASB will work with others to ensure any assurance gaps are identified, understood, researched if necessary and addressed.
- Actively supporting (including through its own outreach and liaison activities) the XRB's work with regulators and other stakeholders to promote an understanding of the factors that affect audit quality.

The NZAuASB will also enhance its collaboration with the New Zealand Accounting Standards Board (NZASB), including through joint projects and by providing any necessary support to the targeted review of the New Zealand accounting standards framework.

International priorities

Recognising that New Zealand and Australia are primarily international "standard takers", the NZAuASB will continue to seek ways to leverage its international influence in the international auditing and assurance standard setting (including the ethical standard setting) context. This will include:

- progressing the initiatives being undertaken jointly with the AUASB and the Canadian Auditing and Assurance Standards Board, and with the IAASB ~~and the IESBA~~, to enhance cooperation between the international boards and the [national assurance standard setters \(NASSs\)](#);
- [progressing the initiatives being undertaken jointly with the IAASB and the IESBA to enhance cooperation between the international boards and the national assurance standard setters and national ethical standard setters \(NSSs\)](#); and
- (jointly with the AUASB) supporting the contributions of the New Zealand and Australian members of the IAASB.

Commented [SvD3]: Clarifying the acronyms – NASSs and NSSs.

As a contingency, the NZAuASB will enhance its regional (within Asia-Pacific in particular) relationships in the event that ~~N~~A~~S~~Ss need to return to a higher level of national standard setting following possible changes to the international system.

Specific strategies

The NZAuASB's strategic objective in the period 2019-2024 will be achieved through the following specific strategies.

Overarching Strategy – Broad strategic approach

- Maintaining and enhancing the existing suite of auditing and assurance standards (including professional and ethical standards for assurance practitioners);
- Continuing the convergence and harmonisation approach (where relevant) for auditing and assurance standards;

- Working to ensure that New Zealand’s auditing and assurance standards are understood and applied in accordance with the NZAuASB’s strategic objective; and
- Responding to the changing international environment and external reporting landscape and leveraging New Zealand’s international influence.

Specific Strategy 1: Standards are Fit-for-Purpose

The purpose of this strategy is to ensure that the existing suites of standards are maintained and enhanced on an on-going basis so that they are of a high quality, fully converged with international standards and harmonised with Australian standards, where appropriate, at all times, and retain local relevance and acceptance.

The actions required under this strategy are those necessary to ensure convergence and harmonisation is maintained, including actively monitoring any issues emerging from the implementation of standards, and responding to those issues where appropriate.

The underlying actions in Specific Strategy 1 are grouped into two main areas of planned activities:

Part A: Business as Usual Activities

Part B: Address critical issues.

Specific Strategy 1: Standards are Fit-for-Purpose

Part A: Business as Usual Activities

This section outlines the “business as usual” activities that the NZAuASB will undertake during the strategic period. These activities comprise the actions required to maintain the existing suites of standards in accordance with the overarching strategy (convergence with international standards, and harmonisation with Australian standards where appropriate). To a large extent these activities are a continuation of the activities undertaken by the NZAuASB during the previous strategic period.

Specific action	This action will comprise...
Action 1A.1: Contributing to International Due Process	<p>Actively contributing to the “due process” activities of the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA), by:</p> <ol style="list-style-type: none"> Ensuring assurance practitioners and relevant users of assurance reports are aware of the IAASB and the IESBA due process documents and encouraging them to make submissions directly to the international boards and to the NZAuASB; Responding, as appropriate, to the IAASB and the IESBA due process documents (consultation documents, discussion papers and exposure drafts) and doing so in conjunction with the AUASB and the APESB where appropriate; Participating, as appropriate, in roundtables and other face-to-face due process related meetings organised by the international boards.
Action 1A.2: Maintaining New Zealand Standards	Amending the auditing and assurance standards (auditing standards, review engagement standards, other assurance

	<p>standards) to ensure that the existing suites of standards are maintained on an on-going basis, by:</p> <ul style="list-style-type: none"> a. Incorporating any auditing and assurance standards, or amendments to those standards, issued by the IAASB, to achieve convergence, as appropriate, and including working with the AUASB to ensure any changes are appropriately harmonised. b. Incorporating any ethical standards, or amendments to those standards, issued by the IESBA, including liaising with the Australian Professional Ethical Standards Board (APESB) to ensure any changes are appropriately harmonised. c. Responding as appropriate to any gaps /issues identified with the current suite of standards. d. Incorporating any amendments to international auditing and assurance standards to domestic standards where applicable, including liaising with the AUASB. e. Developing domestic standards, and amendments to standards, as appropriate, including working with the AUASB to ensure, where relevant, domestic standards are appropriately harmonised. f. Liaising with the New Zealand Accounting Standards Board during the development stage of new or amending accounting standards and any post-implementation reviews, to identify any audit or assurance considerations.
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Action 1A.3: Monitoring the Assurance Environment	<p>Monitoring the wider assurance environment, liaising with key stakeholders including the auditing profession, regulators and all key participants in the financial and non-financial reporting "supply chain", and considering the implications of any developing issues for New Zealand auditing and assurance standards.</p> <ol style="list-style-type: none"> Monitoring issues arising from the implementation of the current suite of standards and responding as appropriate. Monitoring issues or gaps with the current suite of standards and responding as appropriate. Tracking local and international research projects, monitoring academic research outputs in both New Zealand and Australia in conjunction with the AUASB and APESB considering the implications for the New Zealand auditing and assurance standards. Monitoring results from QA reviews conducted locally and internationally and considering the implications for New Zealand auditing and assurance standards. Assisting the XRB to contribute to government policy work relating to auditing and assurance standards. Monitoring the XRB EER project, contributing to the development of reporting guidance as appropriate, and work with others to ensure any assurance gaps are identified, understood, researched if necessary and addressed. Monitoring activities and developments in the wider assurance standard setting space, particularly for changes coming out of the Monitoring Group review and major reviews in other jurisdictions, and considering the implications for the New Zealand auditing and assurance standards. Collaborating with the NZASB on projects where quality issues with accounting standards may have an audit impact, and by supporting the targeted review of the accounting standards framework.
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Specific Strategy 1: Standards are Fit-for-Purpose

Part B: Address critical issues

This section outlines the new specific strategic actions that the NZAuASB intends to carry out during the period of the strategic plan. These strategic actions comprise activities that would not normally be undertaken as part of the business as usual actions outlined in section 3.

They also relate to issues or matters not addressed (or addressed in any detail) by the NZAuASB previously.

The purpose of this strategy is to address any deficiencies or gaps in existing standards that are critical to user-needs and the quality of financial reporting. The actions required under this strategy are to (a) identify critical issues; and (b) undertake appropriate actions to address

those critical issues within a reasonable timeframe.

The NZAuASB's primary focus is on promulgating auditing and assurance standards. The Board spent the 2009-2014 period developing and issuing amended standards to give effect to the new Auditing & Assurance Standards Framework. Many of these new standards became effective during the 2014-2016 period and critical issues may emerge that need to be addressed. The Board will do so should this occur.

In addition, the NZAuASB is aware of a small number of critical issues with the existing standards and policies that it plans to address during the 2019-2024 period:

Specific action	This action will comprise...
Action 1B.1: Developing an Assurance Standard on the Examination of Prospective Information	Developing the standard in accordance with the due process for domestic standards and in collaboration with the AUASB as appropriate.
Action 1 B2: Consider what further guidance is needed on the use of the XRB auditing and assurance standards and relevant assurance products and develop guidance where identified.	<ul style="list-style-type: none"> a. Considering what further guidance is needed in the New Zealand environment. b. Developing appropriate guidance.
Action 1 B3: Developing a Review Standard on Service Performance Information	Developing a review standard on service performance information for Public Benefit Entities (PBEs) in accordance with the due process for domestic standards and in collaboration with the AUASB as appropriate.
Action 1 B4: Developing an Engagement Standard/Guidance for smaller NFPs	Developing an engagement standard/guidance for smaller NFPs, not required by statute to have an audit or review, to better meet the needs of users, as informed by research completed in 2016-17, in accordance with the due process for domestic standards and in collaboration with the AUASB as appropriate.
Action 1 B5: Performing a post implementation review jointly with the AUASB on the Compliance Engagement Standard	Performing a post implementation review on the Compliance Engagement Standard jointly with the AUASB to determine if further guidance is needed.
Action 1 B6: Amending NZ SRE 2410 Review of Financial Statements Performed by the Independent Auditor of the Entity	Amending the standard in collaboration with the AUASB and in accordance with the due process for domestic standards.
Action 1 B7: Reviewing the compelling reason test and the	<ul style="list-style-type: none"> a. Performing a review of the compelling reason test and the harmonisation policy, in collaboration with the AUASB, to determine if it remains fit for purpose in the

harmonisation policy jointly with the AUASB	<p>current auditing and assurance environment both globally and in the two jurisdictions.</p> <p>b. Liaising with the AUASB about any changes that may be needed.</p>
Action 1 B8: Performing a follow up joint review with the FMA on auditor reporting in New Zealand	<p>a. Developing and issuing a follow up joint report with the FMA on auditor reporting.</p> <p>b. Considering if further guidance is needed on auditor reporting.</p>
Action 1 B9: Performing a post implementation review of NZ AS 1 The audit of Service Performance Information three years post implementation (2023/2024)	Performing a post implementation review of NZ AS 1- The Audit of Service Performance Information.
Action 1 B10: Considering and addressing the implications of the XRB mandate	<p>Addressing issues arising as a result of the XRB's legal mandate and any changes to the mandate and the implications (if any) on the professional and ethical standards:</p> <ul style="list-style-type: none"> • The quality management standards • The Code of Ethics

Specific Strategy 2: Standards are Evidenced-Informed as to User Needs

A key objective of the XRB is to ensure that auditing and assurance standards are based on a user-needs approach i.e. the assurance reports required by those standards provide the level of assurance and information required by users of those assurance reports for accountability and decision-making purposes. This strategy involves undertaking organised research into needs of the various users of NZAuASB standards as a basis for considering enhancements to the NZAuASB's standards in the future, to help inform efforts to influence the work of the international standard setting boards, to respond to developments in corporate-reporting and to provide thought leadership.

Specific action	This action will comprise...
Action 2.1 Undertaking and considering user needs research as appropriate	<p>a. Identifying and performing applicable user needs research to undertake where appropriate.</p> <p>b. Considering output of research available (including in liaison with the AUASB) and how this can best contribute to the quality of standard setting work.</p>
Action 2.2 Developing relationships with academia and other "think tanks"	<p>Developing relationships to direct user needs research to contribute to the standard setting process, by</p> <p>a. Leveraging collaboration between the academic members of the NZAuASB and the AUASB</p> <p>b. Meeting with academic constituent groups on a rolling basis as part of the NZAuASB's regular meetings;</p> <p>c. Taking opportunities to meet with academics in other</p>

	fora, including at events hosted by them.
Action 2.3 Considering the development of Promoting an evidence informed standard setting strategy	Reviewing the AUASB's strategy and refining the NZAuASB's approach under this Specific Strategy
Specific Strategy 3: High Quality Global Standards Applicable in New Zealand A key aspect of the overarching strategy contained in the XRB Strategic Plan is the international convergence approach. Implicit in this approach is the need for the NZAuASB to mostly be a "standard-taker" i.e. to use the international standards as the base for New Zealand standards. For those standards to be appropriate in New Zealand, it is important for the NZAuASB to seek to influence international standards during appropriate stages of standards development to ensure high quality global standards that are both applicable in New Zealand and in the public interest. The purpose of Specific Strategy 3 is to seek to influence the work of the international boards during the early stages of standards development through the establishment of "influencing strategies" specific to each international board. The NZAuASB's specific strategic actions relating to Specific Strategy 3 reflects the Board's responsibilities for promulgating auditing and assurance standards. Its influencing strategies are therefore targeted at the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA). This includes collaborating with other NSSs to ensure the global standards are high quality and fit-for-purpose in national jurisdictions.	
Action 3.1: Building Relationships with the IAASB	<ul style="list-style-type: none"> a. Attending relevant meetings and events (including NSS meetings); b. Taking opportunities to meet with IAASB members and staff; c. Fostering relationships with and providing support to Australasian representatives on the IAASB and those who are involved in relevant working groups; d. Hosting IAASB members and staff in visits to New Zealand as appropriate; e. Responding, as appropriate, to requests for information from the IAASB and any other relevant working groups.
Action 3.2: Increasing the International Visibility of the NZAuASB	<ul style="list-style-type: none"> a. Volunteering to present at the NSS meetings on New Zealand projects or with the AUASB/APESB and/or other NSS on joint projects; and b. Identifying appropriate, mutually beneficial IAASB and IESBA projects and contributing technical resources in support of those projects.
Action 3.3: Supporting Lyn Provost in her role as IAASB member	<ul style="list-style-type: none"> a. Inviting Lyn Provost to Board meetings and providing high level support for her role (and monitoring the inputs of the Technical Advisory Group); b. The Director Assurance Standards attending IAASB meetings as Technical Advisor (TA) to Lyn Provost.

Action 3.4: Building Relationships with the IESBA	<ul style="list-style-type: none"> a. Attending relevant meetings and events (including NSS meetings); b. Taking opportunities to meet with IESBA members and staff; c. Fostering relationships with Australian representatives on the IESBA; d. Hosting IESBA members and staff in visits to New Zealand; e. Responding, as appropriate, to requests for information from the IAASB and any other relevant working groups.
Action 3.5: Working with the IESBA to explore transfer of the eCode to New Zealand	<ul style="list-style-type: none"> a. Working with the IESBA and CA ANZ, as appropriate, to ensure NZ specific provisions can be incorporated into the eCode by: <ul style="list-style-type: none"> • Contributing technical resource to the next phase of the IESBA project; and • Assisting IESBA with testing the eCode application adjusted for jurisdictional provisions in New Zealand.
Action 3.6: Collaborating with other NSSs to ensure global standards are fit for purpose at jurisdictional level	<ul style="list-style-type: none"> a. Be an active participant in the NASS collaboration project with the the AUASB, Canadian and Netherlands NASSs, including: <ul style="list-style-type: none"> i. Leading the exploration internationally of how NASS can work more collaboratively with each other to address issues associated with current and recently released IAASB standards (e.g. the impact of technology on the audit, SMP/LCE audit issues, and the implementation of new or updated standards). ii. Identifying and exploring opportunities for the IAASB and national auditing and assurance standard setters (NASS) to work collaboratively to enable more impactful support for the IAASB in progressing its current and future work. iii. Continuing to develop an understanding of how NASS as a stakeholder group can better inform the implementation of the IAASB's current and future strategies, through global and regional actions that increase the value and perception of the audit. b. Working with the IAASB and the IESBA in support of their joint project to foster "quadrilogue" and project specific collaboration between the two boards and their respective NSS groups.

Specific Strategy 4: Standards Developed Collaboratively with Constituency	
<p>Another key aspect of the NZAuASB's standard setting strategy is to ensure that standards are developed in collaboration with the constituency. This is reflected in Specific Strategy 4 which has three elements:</p> <p>Constituent engagement, awareness raising activities and sector facilitation.</p>	
Specific action	This action will comprise...
<i>Constituent Engagement: establish ways for the NZAuASB to enhance the level and quality of constituent engagement.</i>	
Action 4.1: Enhancing Due Process Consultation	<p>Enhancing due process consultation with major user constituent groups² and all participants in the financial and non-financial reporting "supply chains" on specific issues relating to the auditing and assurance standards, especially consultation relating to due process documents, by:</p> <ol style="list-style-type: none"> Identifying and implementing innovative, targeted consultation methods <u>with a focus on detailing the</u> "why" the change, that are high value-added but relatively low-effort from the constituents' point of view; and Proactively engaging with relevant constituent groups about specific technical issues or matters being considered domestically or internationally.
Action 4.2: Undertaking On-Going Dialogue	<p>Undertaking an on-going dialogue with relevant constituent groups across all sectors on general matters relating to auditing and assurance standards, including changes resulting from the evolving nature of the audit and assurance market by:</p> <ol style="list-style-type: none"> Meeting with major constituent groups on a rolling basis as part of the NZAuASB's regular meetings; Taking opportunities to meet with major constituent groups in other fora, including at events hosted by those groups; and Maintaining strong working relationships at the operational level with key constituent groups.
Action 4.3: Improving engagement with assurance practitioners in small firms.	<p><u>Seeking to improve engagement with assurance practitioners that are small firms and sole practitioners, by:</u></p> <p><u>Specifically targeting this group when consulting about relevant standards using customised consulting approaches.</u></p>
<i>Awareness raising activities: ensuring assurance practitioners and assurance users (where relevant) understand the auditing and assurance standards that apply when performing assurance engagements required by law.</i>	
Action 4.4 promoting understanding of the auditing and assurance standards and	<p>Undertake activities throughout the life-cycle of developing standards to promote an increased understanding of auditing and assurance standards by:</p>



² CAANZ, CPA, FMA, IOD, NZX and others


Commented [SvD4]: The Board requested this action to be retained.



engagements	<p>a. Conducting seminars, presentations, speaking engagements and other awareness raising activities as appropriate that help raise awareness:</p> <ul style="list-style-type: none"> • of assurance practitioners about new and revised auditing and assurance standards; • of assurance users (where relevant) about auditing and assurance standards and the benefits of and options for enhancing credibility; <p>b. Promoting awareness of the IAASB and the IESBA implementation support activities.</p>
<i>Sector facilitation: encouraging, facilitating and supporting other relevant organisations to provide appropriate training and professional development activities relating to financial reporting; and working with other agencies to ensure the linkages between the work of relevant agencies in the financial reporting area are identified and gaps addressed.</i>	
Action 4.5: Support the XRB to promote Understanding of the Factors that Affect Audit Quality	<p>a. Actively supporting the XRB in its work with regulators and other stakeholders to promote an understanding of the factors that affect audit quality;</p> <p>b. Conducting seminars, presentations, speaking engagements and other awareness raising activities as appropriate that inform all participants in the external reporting supply chain about the factors that affect audit quality.</p>

4. NZAuASB Strategic Action Plan Summary

The NZAuASB's planned strategic actions are summarised in the table below.

	Specific Strategy	Action
	<p>Specific Strategy 1: Standards are Fit-for-Purpose – Part A: Maintain Existing Suites of Standards (Business as Usual)</p> <p>The primary responsibility of the NZAuASB is to maintain and enhance the existing suite of auditing and assurance standards (including professional and ethical standards for assurance practitioners); and</p> <p>to continue the convergence and harmonisation approach (where relevant) for auditing and assurance standards.</p>	Action 1A.1: Contributing to International Due Process
		Action 1A.2: Maintaining New Zealand Standards
		Action 1A.3: Monitoring the Assurance Environment
	<p>Specific Strategy 1: Standards are Fit-for-Purpose – Part B: Address Critical Issues</p> <p>This strategy is to address any</p>	Action 1B.1: Developing an Assurance Standard on the Examination of Prospective Information

	<p>deficiencies or gaps in existing standards that are critical to user-needs and the quality of financial reporting.</p> <p>The actions required under this strategy are to (a) identify critical issues; and (b) undertake appropriate actions to address those critical issues within a reasonable timeframe.</p>	Action 1B.2: Consider what further guidance is needed on the use of the XRB auditing and assurance standards and relevant assurance products and develop guidance where identified
		Action 1B.3: Developing a Review Standard on Service Performance Information
		Action 1B.4: Developing an Engagement Standard/Guidance for smaller NFPs
		Action 1B.5: Performing a post implementation review jointly with the AUASB on the Compliance Engagement Standard
		Action 1B.6: Amending NZ SRE 2410 <i>Review of Financial Statements Performed by the Independent Auditor of the Entity</i>
		Action 1 B7: Reviewing the compelling reason test and the harmonisation policy jointly with the AUASB
		Action 1 B8: Performing a follow up joint review with the FMA on auditor reporting in New Zealand
		Action 1B.9: Performing a post implementation review of NZ AS 1 <i>The Audit of Service Performance Information</i> three years post implementation
		Action 1 B.10: Considering and addressing the implications of the XRB mandate
	<p>Specific Strategy 2: Standards are Evidenced-Informed as to User Needs</p> <p>A key objective of the XRB is to ensure that auditing and assurance standards are based on a user-needs approach i.e. the assurance reports required by those standards provide the level of assurance and information required by users of those assurance reports for accountability and decision-making</p>	Action 2.1: Undertaking and considering user needs research as appropriate
		Action 2.2: Developing relationships with academia and other "think tanks"
		Action 2.3: Considering the development of Promoting an evidence informed standard setting strategy

	<p>purposes.</p> <p>This strategy involves undertaking organised research into needs of the various users of NZAuASB standards as a basis for considering enhancements to the NZAuASB's standards in the future, and to help inform efforts to influence the work of the international standard setting boards, to respond to developments in corporate reporting and to provide thought leadership.</p>	
	<p>Specific Strategy 3: High Quality Standards Applicable in New Zealand</p> <p>The NZAuASB strategy is to seek to influence the work of the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA) during the early stages of standards development, through the establishment of "influencing strategies" specific to each international board.</p>	Action 3.1: Building Relationships with the IAASB
		Action 3.2: Increasing the International Visibility of the NZAuASB
		Action 3.3: Supporting Lyn Provost in her role as IAASB member.
		Action 3.4: Building Relationships with the IESBA
		Action 3.5: Working with the IESBA to explore implementation of the ECode in New Zealand
		Action 3.6 Collaborating with other NSSs to ensure global standards are fit for purpose at jurisdictional levels.
	<p>Specific Strategy 4: Standards developed Collaboratively with Constituency</p> <p>A key aspect of the NZAuASB's standard setting strategy is to ensure that standards are developed with constituents in a collaborative manner, through outreach, awareness raising activities and sector facilitation. This strategy also includes maintaining relationships with major user constituent groups³ and all participants in the financial "reporting process" groups to monitor any emerging issues.</p>	Action 4.1: Enhancing Due Process Consultation
		Action 4.2: Undertaking On-Going Dialogue
		Action 4.3: Improving engagement with assurance practitioners in small firms.
		Action 4.4: Promoting understanding of the auditing and assurance standards and engagements
		Action 4.5: Supporting the XRB in Promoting Understanding of the Factors that Affect Audit Quality

³ CAANZ, CPA, FMA, IOD, NZX and others

APPENDIX A: Summary of the XRB's Strategic Priorities for the 2019-2024 Period

The XRB's strategies aim to contribute to building trust and confidence in the reporting by New Zealand organisations across all sectors⁴.

In the period from 1 July 2019 to 30 June 2024, the XRB plans to further develop the standards frameworks (including accounting and auditing & assurance standards⁵) to ensure they continue to be fit-for-purpose for the future. The XRB will focus on developing the User-needs Framework to ensure it is *A User-needs Framework for New Zealand's Wellbeing* and that the XRB's standards frameworks (and standards) meet user-needs and continue to:

- engender confidence in New Zealand financial reporting;
- assist New Zealand entities to compete; and
- enhance entities' accountability to New Zealand stakeholders,

thereby contributing to sustainable and inclusive economic goals and the wellbeing of New Zealanders.

Strategic Priorities – 2019-2024

The XRB's outcome goal in the period 2019-2024 will be achieved through several specific strategies, as set out below:

Overarching Strategy – Broad strategic approach	
<ul style="list-style-type: none">• Maintaining the existing financial reporting strategy including the two-sector, multi-standards, multi-tier Accounting Standards Framework• Continuing, as appropriate, the convergence and harmonisation approach for both accounting and auditing & assurance standards• Responding to the changing international environment and external reporting landscape	
Specific Strategy	To be achieved by....
Specific Strategy 1: Standards are Fit-for-Purpose	<p>Enduring policy of sector-specific standards and Tier Structure.</p> <p>Maintaining a financial reporting strategy and standards frameworks that are:</p> <ul style="list-style-type: none">• Reliable and require infrequent changes;• Consistent with NZ's legislative frameworks; and• Responsive to legislative changes and stakeholder feedback (including the Targeted Review of Accounting Standards Frameworks) <p>Appropriate policy of international convergence/harmonisation.</p> <p>Maintaining existing accounting and auditing & assurance standards (and associated pronouncements) so that:</p> <ul style="list-style-type: none">• They are of high quality;• They remain consistent with international standards, as appropriate; and• There is local relevance and acceptance. <p>Enhancing existing accounting and auditing & assurance standards (and associated pronouncements) by:</p> <ul style="list-style-type: none">• Identifying and addressing any New Zealand-specific

⁴ The underlying foundations of the XRB's strategic plan are set out in detail in the XRB's [Strategic Plan 1 July 2014 to 30 June 2019](#) and in subsequent Strategic Plans.

⁵ Auditing & assurance standards, including ethics standards.

	<p>deficiencies or gaps; and</p> <ul style="list-style-type: none"> Expanding, where necessary, the XRB's legal mandate in relation to the issue of standards.,. <p>Ensuring transparent due process and consultation. Reviewing the existing "standard taker" policy, understanding the ramifications of change and discussing with policy makers.</p>
Specific Strategy 2: Standards are Evidenced-Informed as to User Needs	<p>Undertaking organised research into the financial and non-financial information needs of users of our standards:</p> <ul style="list-style-type: none"> as a basis for enhancing the financial reporting framework or specific standards; to inform efforts to influence the work of the international standard setting boards; to respond to developments in corporate reporting; and to provide thought leadership. <p>Undertaking a Targeted Review of the accounting standards frameworks in the period 2019-2020</p>
Specific Strategy 3: High Quality Global Standards Applicable in New Zealand	<p>Seeking to influence the work of the international boards during appropriate stages of standards development to ensure high quality global standards that are both applicable in New Zealand and in the public interest:</p> <ul style="list-style-type: none"> Using targeted "influencing strategies" specific to each international board; and By participating, building relationships, and, where appropriate, being represented on international boards. <p>Monitoring and responding to major disruptions and developments in the international standard setting structures and environment, particularly in the audit market, and ensuring that stakeholders are well informed. The XRB remains alert to the need for any resultant changes in strategies and/or actions.</p> <p>Maintaining and enhancing regional relationships with like-minded countries, as a contingency plan in the event of a return to national standard setting or a move away from principles-based standards.</p> <p>Re-considering the most effective investment of resources in respect of our influencing strategies, whether this be at the commencement of the standard setting process, the end of the standard setting process or working more closely with regional groups. This activity needs to be sustainable and in the public interest in a constrained resource environment. A prioritisation exercise may be needed and domestic influencing re-considered.</p>
Specific Strategy 4: Standards Developed Collaboratively with Constituency	<p>Developing standards in a collaborative manner with the constituency by:</p> <ul style="list-style-type: none"> Implementing new engagement strategies to enhance the depth and breadth of constituency engagement (including all participants in the financial "reporting process"); and Increasing awareness raising activities across all participants of the financial "reporting process" throughout the life-cycle of developing standards including detailing "why" the change. <p>Promoting the awareness, understanding and implementation of EER among New Zealand constituents by:</p> <ul style="list-style-type: none"> maintaining a proactive leadership approach to EER, considering investor versus broader stakeholder requirements; continuing a strategy for EER in response to user demands; and

	<ul style="list-style-type: none"> increasing the collaborative approach with other key stakeholders to EER. <p>Working with other agencies, including other standard-setters, to ensure any external reporting and assurance gaps are identified, understood, researched if necessary and addressed.</p> <p>The XRB and the technical boards working together to create the power of “one voice” and the full utilisation of our “levers” in the constituent’s awareness of the legislative nature of the standards ensuring consistent, timely and effective implementation.</p> <p>Providing a thought leadership role involving bold thinking, being proactive and facilitating meetings with key stakeholders to make a difference.</p> <p>Encouraging, facilitating and supporting other relevant organisations to provide appropriate training and professional development activities relating to external reporting.</p>
Specific Strategy 5: Capable, High-Performing and Financially Prudent Organisation	<p>Maintaining a high-performance culture to achieve the XRB’s outcome goals in a rapidly changing environment.</p> <p>Operating in a financially prudent manner.</p> <p>Maintaining the level of capability needed to deliver the outputs.</p> <p>Strengthening, widening and improving the relationship matrix.</p> <p>Actively seeking the involvement of a digital specialist capability or specialised advisory group to provide timely and expert advice on technological improvements to XRB’s output work.</p>

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO. 7.1
Meeting date: 24 October 2019
Subject: Review standard for SPI
Date: 11 October 2019
Prepared By: Sylvia van Dyk

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Agenda Item Objectives

For the Board to CONSIDER and APPROVE the project plan to develop a standard to apply when engaged to review a Performance Report that includes service performance information.

Background

1. The NZAuASB issued NZ AS 1 *The Audit of Service Performance Information* in February 2019. The Board has previously agreed to develop a review standard and to withdraw EG AU 9 *Guidance on the Audit or Review of the Performance Report of Tier 3 Not-For-Profit Public Benefit Entities*.
2. Under the Charities Act, Registered Charities with operating expenditure between \$500k and \$1 million is required to have the general purpose financial report either audited or reviewed.
3. Anecdotally, we understand that some charities are having their Performance Report reviewed.
4. NZ AS 1 is effective for periods beginning on or after 1 January 2021. It would be ideal to withdraw EG Au9 before the mandatory effective date of NZ AS 1.

Matters to Consider

5. The draft project plan is available at agenda 7.2

Recommendations

6. We recommend that the Board approve the project plan to develop a standard to apply when engaged to review a Performance Report that includes service performance information.

Material Presented

Agenda item 7.1	Board Meeting Summary Paper
Agenda item 7.2	Draft project plan

Project Plan

Project Title:	Review of Service Performance Information
Project Objective(s):	Develop a standard to apply when engaged to review service performance information
Priority:	High
Issue/Reason:	NZ AS 1 has been finalised and there is a legal option for Tier 3 entities to have their Performance Report Reviewed but no equivalent to NZ AS 1
Date Prepared:	30 September 2019
Date Approved:	
Date Updated: (if applicable)	

Project Objectives

1. To develop a standard to apply when engaged to review a Performance Report that includes service performance information.

Background

1. The NZAuASB issued NZ AS 1 *The Audit of Service Performance Information* in February 2019. The Board has previously agreed to develop a review standard and to withdraw EG AU 9 *Guidance on the Audit or Review of the Performance Report of Tier 3 Not-For-Profit Public Benefit Entities*.
2. Under the Charities Act, Registered Charities with operating expenditure between \$500k and \$1 million is required to have the general purpose financial report either audited or reviewed.
3. Anecdotally, we understand that some charities are having their Performance Report reviewed.
4. NZ AS 1 is effective for periods beginning on or after 1 January 2021. It would be ideal to withdraw EG Au9 before the mandatory effective date of NZ AS 1.

International

2. The most relevant international standard that would apply to the review of service performance information would be ISAE 3000 (Revised) *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*. The IAASB's project to develop guidance on the assurance challenges for Extended External Reporting (EER) assurance engagements may also address the differences between limited and reasonable assurance engagements.

Australia

3. The AUASB have no equivalent standard but played an active role in monitoring and contributing to the development of NZ AS 1.

Risks/Issues

4. Issues or risks to the development of the standard include the following:
 - 4.1. The number of entities that elect to have their Performance Report reviewed may be relatively few;
 - 4.2. The need to align with the International Assurance Framework may meet with resistance in practice (i.e. the work effort related to the suitability of criteria is the same regardless of the level of assurance).
5. Key areas identified for consideration in the project include:
 - 5.1. Develop a separate standard (similar to the approach adopted in developing NZ AS 1) or update ISRE (NZ) 2400 (Revised) to cover service performance information? This same question was posed at the commencement of the project to develop NZ AS 1. The structure and application of ISRE (NZ) 2400 (Revised) differs from the ISAs (NZ) and therefore may result in a different approach for this project.
 - 5.2. Exploring the key differences between an audit and a review and developing requirements and application material that differs from NZ AS 1 as appropriate.
 - 5.3. Exploring key areas that are the same regardless of the level of assurance (Limited or reasonable) in accordance with International Assurance principles and replicating requirements and application material from NZ AS 1, as appropriate, including:
 - 5.3.1. Suitability of criteria
 - 5.3.2. Materiality

Action Plan

6. The project will involve the following key steps:
 1. Identifying members to assist on a sub-committee of the Board to develop the draft standard to meet as required.
 2. Developing a reference group (if considered necessary by the Board) to assist with the project by identifying key issues to be addressed and field-testing ideas as they develop. The reference group would meet as required. Such reference group would include broad representation.
 3. Develop recommendations to the key issues identified to inform the development of the standard.
 4. Develop a first draft of a standard, based on the direction approved by the Board.
 5. Further refine the standard following the Board's feedback.
 6. Expose a draft standard.
 7. Obtain and collate comments, and obtain the Board's approval of amendments to address comments.
 8. Final approval obtained from the Board to issue a new standard.
 9. Quality assurance to be conducted prior to issuing.
 10. Release standard with Communique alert and any other explanatory statements as required.
 11. Consider the need for further awareness sessions and implementation guidance once the final standard is released.

Timetable

7. It is anticipated that it will take about 15 months to develop and finalise the standard. Indicative timings are as follows:

Description	Proposed Date
NZAuASB approves project plan at Board meeting	24 October 2019
Establishment and meeting of a sub-committee of the NZAuASB to assist in developing ideas and recommendations to present to the NZAuASB	Meet to determine recommendations to the key areas identified above
NZAuASB to provide feedback on the sub-committee's recommendations	April 2020
NZAuASB to provide feedback on developing exposure draft	June 2020
Approval of NZAuASB exposure draft	July 2020
Exposure draft open for comment	July – Oct 2020
Consideration of submissions	Oct 2020
Approval of standard	Dec 2020

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	8.1
Meeting date:	24 October 2019
Subject:	Conforming Amendments to Auditing and Assurance Standards
Date:	7 October 2019
Prepared By:	Sharon Walker

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Agenda Item Objectives

1. To approve the draft ITC and Exposure Draft NZAuASB 2019-2 New Zealand Specific Amendments to the Auditing and Assurance Standards: Implications of the Revised Professional and Ethical Standard 1¹, on the NZAuASB's Standards.

Background

2. The IAASB's international standards refer to the IESBA Code in various ways ranging from simple references to the title to detailed references to specific paragraphs in the IESBA Code as it existed before April 2018.
3. A project to update the IAASB's international standards for the revised and restructured IESBA Code is necessary to address inconsistencies between the international standards and the IESBA Code. The purpose of making the revisions is solely to align the extant wording with the revised and restructured IESBA Code and not to re-evaluate or re-discuss the merits of each reference, thus ensuring that the IAASB's international standards can continue to be applied effectively together with the IESBA Code.
4. A concurrent project is necessary in New Zealand to capture necessary changes to the New Zealand specific paragraphs and the NZAuASB's domestic standards, as these are outside the scope of the IAASB's project.
5. The [IAASB project plan](#) sets out the categories of proposed changes as well as the project time line. The IAASB expects to approve its exposure draft at a teleconference on 7 November. The ED is expected to be issued on or around 15 November with a 45- day comment period.

¹ Professional and Ethical Standard 1, *International Code of Ethics for Assurance Practitioners (including International Independence Standards)* (New Zealand)

NZ Approach

6. The Board considered and agreed the proposed changes to the NZ specific paragraphs and domestic standards at its July 2019 meeting. These included the proposed change to the way the relevant ethical standards are referred to in the auditor's report and updates to references to Professional and Ethical Standard 1.
7. We propose that draft ED NZAuASB 2019-2 be exposed concurrent with the IAASB's exposure draft. EG Au2² indicates shorter comment periods are used only for urgent or minor matters and will never be less than 30 days. Given the nature of the proposed changes we consider 30 days to be an appropriate comment period.

Recommendation

8. We recommend that the Board APPROVE the draft ITC and ED NZAuASB 2019-2 subject to possible changes arising from the IAASB discussions.

Material Presented

Agenda item 8.1	Board Meeting Summary Paper
Agenda item 8.2	Draft ITC and ED NZAuASB 2019-2

² EG Au2, *Overview of the Auditing and Assurance Standard Setting Process*, paragraph 32



NZ AUDITING
AND ASSURANCE
STANDARDS BOARD

EXPOSURE DRAFT

NEW ZEALAND SPECIFIC AMENDMENTS TO AUDITING AND ASSURANCE STANDARDS: IMPLICATIONS OF THE REVISED PROFESSIONAL AND ETHICAL STANDARD 1 ON THE NZAuASB'S STANDARDS

ED NZAuASB 2019-2

Invitation to Comment

November 2019

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Information for Respondents

Invitation to Comment

The New Zealand Auditing and Assurance Standards Board (NZAuASB)¹ is seeking comments on the specific matters raised in this Invitation to Comment. We will consider all comments before finalising *New Zealand Specific Amendments to the Auditing and Assurance Standards: Implications of the Revised Professional and Ethical Standard 1 on the NZAuASB's Standards*.

If you want to comment, please supplement your opinions with detailed comments, whether supportive or critical of the proposals, as both supportive and critical comments are essential to a balanced view.

Comments are most useful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for an alternative. Feel free to provide comments only for those questions or issues that are relevant to you.

Comments should be submitted electronically using our 'Open for comment' page at

[\[insert link\]](#)

The closing date for submissions is [\[date\]](#)

Publication of Submissions, the Official Information Act and the Privacy Act

We intend publishing all submissions on the XRB website (xrb.govt.nz), unless the submission may be defamatory. If you have any objection to publication of your submission, we will not publish it on the internet. However, it will remain subject to the Official Information Act 1982 and may, therefore, be released in part or full. The Privacy Act 1993 also applies.

If you have an objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission be withheld, and the grounds under the Official Information Act 1982 for doing so (e.g. that it would be likely to unfairly prejudice the commercial position of the person providing the information).

¹ The NZAuASB is a sub-Board of the External Reporting Board and is responsible for setting auditing and assurance standards.

List of Abbreviations

The following abbreviations are used in this Invitation to Comment.

ED	Exposure Draft
IAASB	International Auditing and Assurance Standards Board
IESBA	International Ethics Standards Board for Accountants
ISAs	International Standards on Auditing
ISAs (NZ)	International Standards on Auditing (New Zealand)
ITC	Invitation to comment
NZAuASB	New Zealand Auditing and Assurance Standards Board
PES	Professional and Ethical Standard
XRB	External Reporting Board

Summary of Questions for Respondents

1. Do you agree with the proposed amendments to the auditing and assurance standards to align with the revised Professional and Ethical Standard 1?
2. Do you have any other comments on ED NZAuASB 2019-2 *New Zealand Specific Amendments to the Auditing and Assurance Standards: Implications of the Revised Professional and Ethical Standard 1 on the NZAuASB's Standards* (please be specific)?
3. Do you agree that a lengthy transition period is not required given the limited nature of the proposed changes? If not, please explain why not.

1. Introduction

1.1 Purpose of this Invitation to Comment

1. The purpose of this Invitation to Comment is to seek feedback on the proposed amendments to standards issued by the NZAuASB.

1.2 Background

2. In December 2018, the NZAuASB issued a revised code of ethics, Professional and Ethical Standard (PES) 1, *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)*, based on the International Ethics Standards Board for Accountants' (IESBA), *International Code of Ethics for Professional Accountants (including International Independence Standards)*.
3. The International Auditing and Assurance Standards Board (IAASB) has proposed amendments to its auditing, assurance and related services standards to address inconsistencies between the extant international standards and the revised IESBA Code.
4. This Invitation to Comment and Exposure Draft proposes amendments to the auditing and assurance standards, including Professional and Ethical Standard 3 (Amended)² issued by the NZAuASB that are not otherwise captured by the amendments proposed by the IAASB. This includes amendments to New Zealand specific paragraphs within ISAs (NZ), ISAEs (NZ) and ISREs (NZ) and to domestic standards.
5. The New Zealand exposure draft should be considered in conjunction with the IAASB's conforming amendments package. This exposure draft does not mark up the changes to the international standards, as made by the IAASB. These are explained in the IAASB's explanatory memorandum. Stakeholders are advised to read this Invitation to Comment and the attached exposure draft together with the IAASB explanatory memorandum and exposure draft to fully understand the impact of the changes.

Commented [SW1]: Link to IAASB website, updating title of IAASB ED once known.

1.3 Reasons for Issuing this Exposure Draft

6. This exposure draft considers the implications of the revised PES 1 on the NZAuASB's auditing and assurance standards, including Professional and Ethical Standard 3 (Amended). The amendments affect numerous standards issued by the NZAuASB as identified in the Exposure Draft.

1.4 Timeline and Next Steps

7. Submissions on ED 2019-2 are due by [date]. Information on how to make submissions is provided on page 4 of this Invitation to Comment.

² Professional and Ethical Standard 3 (Amended), *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements*

8. The NZAuASB will consider the submissions received immediately after the consultation period ends. Subject to the content of that feedback, the NZAuASB expects to issue the *Standard New Zealand Specific Amendments to the Auditing and Assurance Standards: Implications of the revised Professional and Ethical Standard 1 on the NZAuASB's Standards* in early 2020.
9. The effective date for the final conforming amendments is a matter for the NZAuASB to determine. However, it is anticipated that, given the limited nature of the amendments proposed, the amendments can go into effect almost immediately.

Commented [SW2]: Align wording with IAASB

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2. Overview of Exposure Draft New Zealand Specific Amendments to the Auditing and Assurance Standards: Implications of the Revised Professional and Ethical Standard 1 on the NZAuASB's Standards

2.1 Matters Addressed in this Exposure Draft

10. The exposure draft considers the implications of the revised Professional and Ethical Standard 1, *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)*, on standards issued by the NZAuASB.
11. The purpose of making the revisions is solely to align the extant wording with the revised PES 1 and not to re-evaluate or discuss the merits of each reference, thus ensuring that the auditing and assurance standards can continue to be applied effectively together with the revised PES 1.
12. The IAASB has proposed amendments to its auditing, assurance and related services standards to address inconsistencies between the extant international standards and the revised *International Code of Ethics for Professional Accountants (including International Independence Standards)* issued by the IESBA.

2.2 Proposed Amendments to ISA (NZ) 700 (Revised)

13. The NZAuASB proposes to amend the independence statement in the "basis for opinion" paragraph in the auditor's report by replacing the reference to Professional and Ethical Standard 1 with a reference to the ethical requirements that are relevant to the audit of financial statements in New Zealand.
14. As part of the restructure and revision of the IESBA Code, the applicability of Part 2, *Professional Accountants in Business*, was clarified and enhanced to apply also to professional accountants in public practice. This increased emphasis on the applicability of Part 2 to professional accountants in public practice raises the question as to whether an assurance practitioner can assert compliance with the ethical requirements that are at least as stringent as the IESBA Code if Professional and Ethical Standard 1 does not incorporate these provisions.
15. As the NZAuASB's mandate relates to professional and ethical standard for assurance practitioners, to address the applicability issue, PES 1 states, "When dealing with an ethics issue, the assurance practitioner shall consider the context in which the issue has arisen or might arise. Where an individual who is an assurance practitioner is performing assurance services pursuant to the assurance practitioner's relationship with the firm, whether as a contractor, employee or owner, the individual shall comply with any other ethical standards that apply to these circumstances."³ [emphasis added]

³ Professional and Ethical Standard 1, paragraphs NZ R120.4.1 and NZ R300.5

16. Given the reference in PES 1 to “any other ethical standards”, the NZAuASB is of the view that a generic reference to ethical requirements relevant to the audit financial Statements is appropriate. Accordingly, the requirement to refer to Professional and Ethical Standard 1 in the auditor’s report is amended. The proposed wording references ethical standards that are relevant to an audit of financial statements in New Zealand.

Questions for Respondents

1. Do you agree with the proposed amendments to the auditing and assurance standards to align with the revised Professional and Ethical Standard 1?
2. Do you have any other comments on ED 2019-2, *New Zealand Specific Amendments to the Auditing and Assurance Standards: Implications of the Revised Professional and Ethical Standard 1 on the NZAuASB’s Standards* (please be specific)?

2.3 Effective Date

17. The NZAuASB does not consider that a lengthy transition period is required given the extent of the change is limited in nature.

Commented [SW3]: Align with IAASB wording

Questions for Respondents

3. Do you agree that a lengthy transition period is not required given the limited nature of the proposed changes? If not, please explain why not.

EXPOSURE DRAFT NZAuASB 2019-2

New Zealand Specific Amendments to the Auditing and Assurance Standards: *Implications of the Revised Professional and Ethical Standard 1 on the NZAuASB's Standards*

CONTENTS

A: INTRODUCTION

B: PROPOSED AMENDMENTS TO NZ SPECIFIC PARAGRAPHS

C: PROPOSED AMENDMENTS TO DOMESTIC STANDARDS

D: EFFECTIVE DATE

A: INTRODUCTION

This document sets out proposed amendments to the auditing and assurance standards, including professional and ethical standards arising from the issuance of Professional and Ethical Standard 1, *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)*

Amended paragraphs are shown with new text underlined and deleted text struck through.

The footnote numbers within these amendments do not align with the ISAs (NZ) and other pronouncements that are amended, and reference should be made to those ISAs (NZ) and other pronouncements.

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B: Proposed Amendments to NZ specific paragraphs

B.1 Professional and Ethical Standard 3 (Amended) *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements*

Amend paragraphs NZ12.9 and NZA14.1 to replace reference to Professional and Ethical Standard 1 (Revised) with Professional and Ethical Standard 1. Footnote references to PES 1 are updated. A new footnote is added following the first reference to PES 1 to add its title.

NZ12.9 Relevant ethical requirements – Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise Professional and Ethical Standard 1⁴ ~~(Revised)~~, and other applicable law or regulation.

NZA14.1 Professional and Ethical Standard 1 ~~(Revised)~~ recognises that the familiarity threat is particularly relevant in the context of financial statement audits of public interest entities. For these audits, Professional and Ethical Standard 1 ~~(Revised)~~ requires the rotation of the key audit partner⁵ after a pre-defined period, normally no more than seven years, and provides related standards and guidance⁶.

B.2 ISA (NZ) 210 *Agreeing the Terms of Audit Engagements*

Amend paragraph NZ21.1 and related footnote to reflect the new title of Professional and Ethical Standard 1.

NZ21.1 Professional and Ethical Standard 1 ~~(Revised)~~,⁷ requires assurance practitioners to comply with Auditing Standards; therefore auditors shall not sign an audit report that does not conform to the requirements of this ISA (NZ). In the extremely rare situation described in paragraph 21, the auditor shall attach a separate report that conforms to the requirements of this ISA (NZ).

B.3 ISA (NZ) 700 (Revised) *Forming an Opinion and Reporting on Financial Statements*

In paragraphs NZ28(c) and NZ50(e)(1) the reference to Professional and Ethical Standard 1 (Revised) is replaced with a reference to “ethical requirements that are relevant to the audit of financial statements in New Zealand”. This change is necessary to reflect the structural changes

⁴ Professional and Ethical Standard 1, *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)*

⁵ Professional and Ethical Standard 1 ~~(Revised)~~, Definitions:

⁶ ~~Paragraph 290.151 of Professional and Ethical Standard 1, section 540, Long Association of Personnel (including Partner Rotation) with an Audit or Review Client – (Revised)~~

⁷ Professional and Ethical Standard 1 ~~(Revised)~~, *“International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand) (Compiled)”*.

to Professional and Ethical Standard 1 and the revised applicability of Professional and Ethical Standard 1. The illustrative reports are also amended accordingly.

Basis for Opinion

28. The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that: (Ref: Para. A32)
- (a) States that the audit was conducted in accordance with International Standards on Auditing (New Zealand); (Ref: Para. A33)
 - (b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the ISAs (NZ);
 - (c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall identify the jurisdiction of origin of the relevant ethical requirements or refer to the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code); and (Ref: Para. A34-A39)
- NZ28(c) In New Zealand, the statement required by paragraph 28(c) shall refer to ethical requirements that are relevant to the audit of financial statements in New Zealand. Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board. ~~Professional and Ethical Standard 1 (Revised) is at least as restrictive as Parts A and B of the IESBA Code related to an audit of financial statements.~~
- (d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

Auditor's Report Prescribed by Law or Regulation

50. If the auditor is required by law or regulation of a specific jurisdiction to use a specific layout, or wording of the auditor's report, the auditor's report shall refer to International Standards on Auditing (New Zealand) only if the auditor's report includes, at a minimum, each of the following elements: (Ref: Para. A70-A71)
- (a) A title.
 - (b) An addressee, as required by the circumstances of the engagement.
 - (c) An Opinion section containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements (including identifying the jurisdiction of origin of the financial reporting framework that is not International Financial Reporting Standards or International Public Sector Accounting Standards, see paragraph 26).
- NZ50(c)(1) The opinion paragraph shall identify the applicable financial reporting requirements issued by the New Zealand Accounting Standards Board used to prepare the financial statements.

- (d) An identification of the entity's financial statements that have been audited.
 - (e) A statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall identify the jurisdiction of origin of the relevant ethical requirements or refer to the IESBA Code.
- NZ50(e)(1) In New Zealand, the independence statement shall refer to ethical requirements that are relevant to the audit of financial statements in New Zealand, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the ~~New Zealand Auditing and Assurance Standards Board~~.
- (f) Where applicable, a section that addresses, and is not inconsistent with, the reporting requirements in paragraph 22 of ISA (NZ) 570 (Revised).
 - (g) Where applicable, a Basis for Qualified (or Adverse) Opinion section that addresses, and is not inconsistent with, the reporting requirements in paragraph 23 of ISA (NZ) 570 (Revised).
 - (h) Where applicable, a section that includes the information required by ISA (NZ) 701, or additional information about the audit that is prescribed by law or regulation and that addresses, and is not inconsistent with, the reporting requirements in that ISA (NZ).⁸ (Ref: Para. A72–A73)
 - (i) Where applicable, a section that addresses the reporting requirements in paragraph 24 of ISA (NZ) 720 (Revised)⁹.
 - (j) [Amended by the NZAuASB].
- NZ50(j)(1) A description of the responsibilities of those charged with governance for the preparation of the financial statements that addresses, and is not inconsistent with, the requirements in paragraphs 33–36.
- (k) A reference to International Standards on Auditing (New Zealand) and the law or regulation, and a description of the auditor's responsibilities for an audit of the financial statements that addresses, and is not inconsistent with, the requirements in paragraphs 37–40. (Ref: Para. A54–A55)
 - (l) [Amended by the NZAuASB].
- NZ50(l)(1) For audits of complete sets of general purpose financial statements of FMC reporting entities considered to have a higher level of public accountability, the name of the engagement partner unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat.
- (m) The auditor's signature.
 - (n) The auditor's address.
 - (o) The date of the auditor's report.

⁸ ISA (NZ) 701, paragraphs 11–16

⁹ ISA (NZ) 720 (Revised), paragraph 24-

...

[NZ] Illustration 1 – Auditor's Report on Financial Statements of a FMC Reporting Entity Considered to have a Higher Level of Public Accountability Prepared in Accordance with a Fair Presentation Framework (for example NZ IFRS)

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a FMC reporting entity considered to have a higher level of public accountability using a fair presentation framework. The audit is not a group audit (i.e., ISA (NZ) 600 does not apply).
- The financial statements are prepared by management of the entity in accordance with NZ IFRS (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 ~~(Revised)~~ *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* and any other ethical provisions that apply to these circumstances¹⁰. ~~comprises all of the relevant ethical requirements that apply to the audit.~~ The auditor has also chosen to refer to the International Ethics Standards Board for Accountants *International Code of Ethics for Professional Accountants (including International Independence Standards)*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- Key audit matters have been communicated in accordance with ISA (NZ) 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR'S REPORT

...

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in

¹⁰ For example, the New Zealand Institute of Chartered Accountants "Code of Ethics" including Part 2, *Members in Business*

accordance with the ethical requirements that are relevant to our audit of financial Statements in New Zealand ~~Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners~~ issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the Company.

...

[NZ] Illustration 2 – Auditor’s Report on Consolidated Financial Statements of a FMC Reporting Entity Considered to have a Higher Level of Public Accountability Prepared in Accordance with a Fair Presentation Framework (for example, NZ IFRS)

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of a FMC reporting entity considered to have a higher level of public accountability using a fair presentation framework. The audit is a group audit of an entity with subsidiaries (i.e., ISA (NZ) 600 applies).
- The consolidated financial statements are prepared by management of the entity in accordance with NZ IFRS (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the consolidated financial statements in ISA (NZ) 210.
- The auditor has concluded an unmodified (i.e., “clean”) opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 (Revised) *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* and any other ethical provisions that apply to these circumstances.¹¹ ~~comprises all of the relevant ethical requirements that apply to the audit.~~
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- Key audit matters have been communicated in accordance with ISA (NZ) 701.
- The auditor has obtained all of the other information prior to the date of the auditor’s report and has not identified a material misstatement of the other information.
- In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR’S REPORT

...

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial Statements in New Zealand Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit

¹¹ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Company or any of its subsidiaries.

...

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[NZ] Illustration 3 – Auditor’s Report on Financial Statements of a Public Benefit Entity that is not a FMC Reporting Entity Considered to have a Higher Level of Public Accountability Prepared in Accordance with a Fair Presentation Framework (for example, Public Benefit Entity Standards)

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a public benefit entity that is not a FMC reporting entity considered to have a higher level of public accountability using a fair presentation framework. The audit is not a group audit (i.e., ISA (NZ) 600 does not apply).
- The financial statements are prepared by management of the entity in accordance with Public Benefit Entity Standards¹² (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.
- The auditor has concluded an unmodified (i.e., “clean”) opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 (Revised) *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* and any other ethical provisions that apply to these circumstances.¹³ ~~comprises all of the relevant ethical requirements that apply to the audit.~~
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with ISA (NZ) 701.
- The auditor has obtained all of the other information prior to the date of the auditor’s report and has not identified a material misstatement of the other information.
- The auditor has no other reporting responsibilities required under local law.

¹² The use of Public Benefit Entity Standards is used for the purposes of illustration. The appropriate financial reporting standards to be applied by an entity will be determined by the tier structure established in XRB A1 *Application of the Accounting Standards Framework*. The Auditor’s Report would identify one of the following:

- New Zealand equivalents to International Financial Reporting Standards. (This may also include compliance with International Financial Reporting Standards)
- New Zealand equivalents to International Financial Reporting Standards Reduced Disclosure Regime
- Public Benefit Entity Standards
- Public Benefit Entity Standards Reduced Disclosure Regime
- Public Benefit Entity Simple Format Reporting – Accrual (Public Sector)
- Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit).

¹³ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

- The auditor elects to refer to the description of the auditor’s responsibility included on the website of the XRB.

INDEPENDENT AUDITOR’S REPORT

...

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the [entity] in accordance with the ethical requirements that are relevant to our audit of financial Statements in New Zealand ~~Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners~~ issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

[NZ] Illustration 4 – Auditor’s Report on Financial Statements of an Entity Other than a FMC Reporting Entity Considered to have a Higher Level of Public Accountability Prepared in Accordance with a General Purpose Compliance Framework

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an entity other than a FMC reporting entity considered to have a higher level of public accountability required by law or regulation. The audit is not a group audit (i.e., ISA (NZ) 600 does not apply).
- The financial statements are prepared by management of the entity in accordance with the Financial Reporting Framework (XYZ Law) of Jurisdiction X (that is, a financial reporting framework, encompassing law or regulation, designed to meet the common financial information needs of a wide range of users, but which is not a fair presentation framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.
- The auditor has concluded an unmodified (i.e., “clean”) opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 (Revised) International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand) and any other ethical provisions that apply to these circumstances.¹⁴ ~~comprises all of the relevant ethical requirements that apply to the audit.~~
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with ISA (NZ) 701.
- The auditor has obtained all of the other information prior to the date of the auditor’s report and has not identified a material misstatement of the other information.
- The auditor has no other reporting responsibilities required under local law.

INDEPENDENT AUDITOR’S REPORT

...

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of financial statements in New Zealand ~~Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board~~, and we have fulfilled our other

¹⁴ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Company.

B.4 ISA (NZ) 705 *Modifications to the Opinion in the Independent Auditor's Report*

Amend illustrative reports [NZ] Illustration 1 through [NZ] Illustration 5 to reflect changes to the wording in the auditor's report as required by ISA (NZ) 700 (Revised).

Appendix

(Ref: Para. A17-A18, A25)

Illustrations of Auditor's Reports with Modifications to the Opinion

- [NZ] Illustration 1: An auditor's report containing a qualified opinion due to a material misstatement of the financial statements.
- [NZ] Illustration 2: An auditor's report containing an adverse opinion due to a material misstatement of the consolidated financial statements.
- [NZ] Illustration 3: An auditor's report containing a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence regarding a foreign associate.
- [NZ] Illustration 4: An auditor's report containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the consolidated financial statements.
- [NZ] Illustration 5: An auditor's report containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements.

[NZ] Illustration 1 – Qualified Opinion due to a Material Misstatement of the Financial Statements

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a FMC reporting entity considered to have a higher level of public accountability using a fair presentation framework. The audit is not a group audit (i.e., ISA (NZ) 600¹⁵ does not apply).
- The financial statements are prepared by management of the entity in accordance with NZ IFRS (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.¹⁶
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements (i.e., a qualified opinion is appropriate).
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 (Revised) *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* and any other ethical provisions that apply to these circumstances.¹⁷ ~~comprises all of the relevant ethical requirements that apply to the audit.~~
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- Key audit matters have been communicated in accordance with ISA (NZ) 701.
- The auditor has obtained all of the other information prior to the date of the auditor’s report and the matter giving rise to the qualified opinion on the consolidated financial statements also affects the other information.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements¹⁸

Qualified Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the

¹⁵ ISA (NZ) 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

¹⁶ ISA (NZ) 210, *Agreeing the Terms of Audit Engagements*

¹⁷ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

¹⁸ The sub-title “Report on the Audit of the Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion* section of our report, the accompanying financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

Basis for Qualified Opinion

The Company’s inventories are carried in the statement of financial position at xxx. Management has not stated the inventories at the lower of cost and net realisable value but has stated them solely at cost, which constitutes a departure from NZ IFRS. The Company’s records indicate that, had management stated the inventories at the lower of cost and net realisable value, an amount of xxx would have been required to write the inventories down to their net realisable value. Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders’ equity would have been reduced by xxx, xxx and xxx, respectively.

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial Statements in New Zealand, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the Company.

...

[NZ] Illustration 2 – Adverse Opinion due to a Material Misstatement of the Consolidated Financial Statements

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of a FMC reporting entity considered to have a higher level of public accountability using a fair presentation framework. The audit is a group audit of an entity with subsidiaries (i.e., ISA (NZ) 600 applies).
- The consolidated financial statements are prepared by management of the entity in accordance with NZ IFRS (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the consolidated financial statements in ISA (NZ) 210.
- The consolidated financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. The effects of the misstatement on the consolidated financial statements have not been determined because it was not practicable to do so (i.e., an adverse opinion is appropriate).
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 (Revised) *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* and any other ethical provisions that apply to these circumstances.¹⁹ ~~comprises all of the relevant ethical requirements that apply to the audit.~~
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- ISA (NZ) 701 applies; however, the auditor has determined that there are no key audit matters other than the matter described in the Basis for Adverse Opinion section.
- The auditor has obtained all of the other information prior to the date of the auditor’s report and the matter giving rise to the adverse opinion on the consolidated financial statements also affects the other information.
- In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Consolidated Financial Statements²⁰

¹⁹ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

²⁰ The sub-title “Report on the Audit of the Consolidated Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

Adverse Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at December 31, 20X1, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, because of the significance of the matter discussed in the *Basis for Adverse Opinion* section of our report, the accompanying consolidated financial statements do not present fairly (or *do not give a true and fair view of*) the consolidated financial position of the Group as at December 31, 20X1, and (of) its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

Basis for Adverse Opinion

As explained in Note X, the Group has not consolidated subsidiary XYZ Company that the Group acquired during 20X1 because it has not yet been able to determine the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under NZ IFRS, the Company should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had XYZ Company been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the group financial Statements in New Zealand, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Company or any of its subsidiaries.

...

[NZ] Illustration 3 – Qualified Opinion due to the Auditor’s Inability to Obtain Sufficient Audit Evidence Regarding a Foreign Associate

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of a FMC reporting entity considered to have a higher level of public accountability using a fair presentation framework. The audit is a group audit of an entity with subsidiaries (i.e., ISA (NZ) 600 applies).
- The consolidated financial statements are prepared by management of the entity in accordance with NZ IFRS (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the consolidated financial statements in ISA (NZ) 210.
- The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the consolidated financial statements (i.e., a qualified opinion is appropriate).
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 (Revised) *International Code of Ethics for Assurance Practitioners (including International Independence Standards (New Zealand))* and any other ethical provisions that apply to these circumstances.²¹ ~~comprises all of the relevant ethical requirements that apply to the audit.~~
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- Key audit matters have been communicated in accordance with ISA (NZ) 701.
- The auditor has obtained all of the other information prior to the date of the auditor’s report and the matter giving rise to the qualified opinion on the consolidated financial statements also affects the other information.
- In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Consolidated Financial Statements²²

Qualified Opinion

²¹ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

²² The sub-title “Report on the Audit of the Consolidated Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at December 31, 20X1, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, except for the possible effects of the matter described in the *Basis for Qualified Opinion* section of our report, the accompanying consolidated financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of the Group as at December 31, 20X1, and (of) its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

Basis for Qualified Opinion

The Group's investment in XYZ Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the consolidated statement of financial position as at December 31, 20X1, and ABC's share of XYZ's net income of xxx is included in ABC's income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC's investment in XYZ as at December 31, 20X1 and ABC's share of XYZ's net income for the year because we were denied access to the financial information, management, and the auditors of XYZ. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the group financial Statements in New Zealand, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Company or any of its subsidiaries.

...

[NZ] Illustration 4 – Disclaimer of Opinion due to the Auditor’s Inability to Obtain Sufficient Appropriate Audit Evidence about a Single Element of the Consolidated Financial Statements

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of an entity other than a FMC reporting entity considered to have a higher level of public accountability using a fair presentation framework. The audit is a group audit of an entity with subsidiaries (i.e., ISA (NZ) 600 applies).
- The consolidated financial statements are prepared by management of the entity in accordance with NZ IFRS (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the consolidated financial statements in ISA (NZ) 210.
- The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the consolidated financial statements. That is, the auditor was also unable to obtain audit evidence about the financial information of a joint venture investment that represents over 90% of the entity’s net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the consolidated financial statements (i.e., a disclaimer of opinion is appropriate).
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 (Revised) *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* and any other ethical provisions that apply to these circumstances.²³ ~~comprises all of the relevant ethical requirements that apply to the audit.~~
- A more limited description of the auditor’s responsibilities section is required.
- In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Consolidated Financial Statements²⁴

Disclaimer of Opinion

We were engaged to audit the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at December 31, 20X1, and the consolidated statement of comprehensive income, consolidated statement of changes in equity

²³ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

²⁴ The sub-title “Report on the Audit of the Consolidated Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

We do not express an opinion on the accompanying consolidated financial statements of the Group. Because of the significance of the matter described in the *Basis for Disclaimer of Opinion* section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated financial statements.

Basis for Disclaimer of Opinion

The Group's investment in its joint venture XYZ Company is carried at xxx on the Group's consolidated statement of financial position, which represents over 90% of the Group's net assets as at December 31, 20X1. We were not allowed access to the management and the auditors of XYZ Company, including XYZ Company's auditors' audit documentation. As a result, we were unable to determine whether any adjustments were necessary in respect of the Group's proportional share of XYZ Company's assets that it controls jointly, its proportional share of XYZ Company's liabilities for which it is jointly responsible, its proportional share of XYZ's income and expenses for the year, and the elements making up the consolidated statement of changes in equity and the consolidated cash flow statement.

Directors' Responsibilities for the Consolidated Financial Statements²⁵

[Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 2 in ISA (NZ) 700 (Revised).]

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our responsibility is to conduct an audit of the Group's consolidated financial statements in accordance with International Standards on Auditing (New Zealand) and to issue an auditor's report. However, because of the matter described in the *Basis for Disclaimer of Opinion* section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated financial statements.

We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in New Zealand, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Company or any of its subsidiaries.

Report on Other Legal and Regulatory Requirements

[Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 2 in ISA (NZ) 700 (Revised).]

[Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate]

[Auditor Address]

[Date]

²⁵ Or other terms that are appropriate in the context of the legal framework of the entity

[NZ] Illustration 5 – Disclaimer of Opinion due to the Auditor’s Inability to Obtain Sufficient Appropriate Audit Evidence about Multiple Elements of the Financial Statements

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an entity other than a FMC reporting entity considered to have a higher level of public accountability using a fair presentation framework. The audit is not a group audit (i.e., ISA (NZ) 600, does not apply).
- The financial statements are prepared by management of the entity in accordance with NZ IFRS (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.
- The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements, that is, the auditor was also unable to obtain audit evidence about the entity’s inventories and accounts receivable. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 (Revised) *International Code of Ethics for Assurance Practitioners (including International Independence Standards)* (New Zealand) and any other ethical provisions that apply to these circumstances.²⁶ ~~comprises all of the relevant ethical requirements that apply to the audit.~~
- A more limited description of the auditor’s responsibilities section is required.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements²⁷

Disclaimer of Opinion

We were engaged to audit the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

We do not express an opinion on the accompanying financial statements of the Company. Because of

²⁶ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

²⁷ The sub-title “Report on the Audit of the Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

the significance of the matters described in the *Basis for Disclaimer of Opinion* section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for Disclaimer of Opinion

We were not appointed as auditors of the Company until after December 31, 20X1 and thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at December 31, 20X0 and 20X1, which are stated in the statements of financial position at xxx and xxx, respectively. In addition, the introduction of a new computerised accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable. As of the date of our report, management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the statement of financial position at a total amount of xxx as at December 31, 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the statement of comprehensive income, statement of changes in equity and statement of cash flows.

Directors' Responsibilities for the Financial Statements²⁸

[Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 1 in ISA (NZ) 700 (Revised).]

Auditor's Responsibilities for the Audit of the Financial Statements

Our responsibility is to conduct an audit of the Company's financial statements in accordance with International Standards on Auditing (New Zealand) and to issue an auditor's report. However, because of the matters described in the *Basis for Disclaimer of Opinion* section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial Statements in New Zealand, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Other than in our capacity as auditor we have no relationship with, or interests in, the Company.

Report on Other Legal and Regulatory Requirements

[Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 1 in ISA (NZ) 700 (Revised).]

[Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate]

[Auditor Address]

[Date]

²⁸ Or other terms that are appropriate in the context of the legal framework of the entity

B.5 ISA (NZ) 720 *The Auditor's Responsibilities Relating to Other Information*

Amend Appendix 2, [NZ] Illustration 1 through [NZ] Illustration 7 to reflect changes to the wording in the auditor's report as required by ISA (NZ) 700 (Revised).

Appendix 2

(Ref: Para. 21–22, A53)

Illustrations of Auditor's Reports Relating to Other Information

- [NZ] Illustration 1: An auditor's report of any entity, whether a FMC reporting entity considered to have a higher level of public accountability or not, containing an unmodified opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- [NZ] Illustration 2: An auditor's report of a FMC reporting entity considered to have a higher level of public accountability containing an unmodified opinion when the auditor has obtained part of the other information prior to the date of the auditor's report, has not identified a material misstatement of the other information, and expects to obtain other information after the date of the auditor's report.
- [NZ] Illustration 3: An auditor's report of an entity other than a FMC reporting entity considered to have a higher level of public accountability containing an unmodified opinion when the auditor has obtained part of the other information prior to the date of the auditor's report, has not identified a material misstatement of the other information, and expects to obtain other information after the date of the auditor's report.
- [NZ] Illustration 4: An auditor's report of a FMC reporting entity considered to have a higher level of public accountability containing an unmodified opinion when the auditor has obtained no other information prior to the date of the auditor's report but expects to obtain other information after the date of the auditor's report.
- [NZ] Illustration 5: An auditor's report of any entity, whether a FMC reporting entity considered to have a higher level of public accountability or not, containing an unmodified opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and has concluded that a material misstatement of the other information exists.
- [NZ] Illustration 6: An auditor's report of any entity, whether a FMC reporting entity considered to have a higher level of public accountability or not, containing a qualified opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and there is a limitation of scope with respect to a material item in the consolidated financial statements which also affects the other information.
- [NZ] Illustration 7: An auditor's report of any entity, whether a FMC reporting entity considered to have a higher level of public accountability or not, containing an adverse opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and the adverse opinion on the consolidated financial statements also affects the other information.

[NZ] Illustration 1 – An auditor’s report of any entity, whether a FMC reporting entity considered to have a higher level of public accountability or not, containing an unmodified opinion when the auditor has obtained all of the other information prior to the date of the auditor’s report and has not identified a material misstatement of the other information.

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of financial statements of any entity, whether a FMC reporting entity considered to have a higher level of public accountability or not, using a fair presentation framework. The audit is not a group audit (i.e., ISA (NZ) 600²⁹ does not apply).
- The financial statements are prepared by management of the entity in accordance with NZ IFRS (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.
- The auditor has concluded an unmodified (i.e., “clean”) opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 ~~(Revised)~~ *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* and any other ethical provisions that apply to these circumstances.³⁰
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).³¹
- Key audit matters have been communicated in accordance with ISA (NZ) 701.³²
- The auditor has obtained all of the other information prior to the date of the auditor’s report and has not identified a material misstatement of the other information.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements³³

Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income,

²⁹ ISA (NZ) 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

³⁰ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

³¹ ISA (NZ) 570 (Revised), *Going Concern*

³² ISA (NZ) 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*. The Key Audit Matters section is required for FMC reporting entities considered to have a higher level of public accountability only.

³³ The sub-title “Report on the Audit of the Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor's*

Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial Statements in New Zealand, ~~Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners~~ issued by the New Zealand Auditing and Assurance Standards Board, and we

have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the Company.

...

[NZ] Illustration 2 – An auditor’s report of a FMC reporting entity considered to have a higher level of public accountability containing an unmodified opinion when the auditor has obtained part of the other information prior to the date of the auditor’s report, has not identified a material misstatement of the other information, and expects to obtain other information after the date of the auditor’s report.

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a FMC reporting entity considered to have a higher level of public accountability using a fair presentation framework. The audit is not a group audit (i.e., ISA (NZ) 600 does not apply).
- The financial statements are prepared by management of the entity in accordance with NZ IFRS (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.
- The auditor has concluded an unmodified (i.e., “clean”) opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 ~~(Revised)~~ International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand) and any other ethical provisions that apply to these circumstances.³⁴
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- Key audit matters have been communicated in accordance with ISA (NZ) 701.
- The auditor has obtained part of the other information prior to the date of the auditor’s report, has not identified a material misstatement of the other information, and expects to obtain other information after the date of the auditor’s report.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements³⁵

Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, (or *give a*

³⁴ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

³⁵ The sub-title “Report on the Audit of the Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

true and fair view of the financial position of the Company as at December 31, 20X1, and *(of)* its financial performance and its cash flows for the year then ended in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial Statements in New Zealand, Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the Company.

[NZ] Illustration 3 – An auditor’s report of an entity other than a FMC reporting entity considered to have a higher level of public accountability containing an unmodified opinion when the auditor has obtained part of the other information prior to the date of the auditor’s report, has not identified a material misstatement of the other information, and expects to obtain other information after the date of the auditor’s report.

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an entity other than a FMC reporting entity considered to have a higher level of public accountability using a fair presentation framework. The audit is not a group audit (i.e., ISA (NZ) 600 does not apply).
- The financial statements are prepared by management of the entity in accordance with NZ IFRS (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.
- The auditor has concluded an unmodified (i.e., “clean”) opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 ~~(Revised)~~ International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand) and any other ethical provisions that apply to these circumstances.³⁶
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with ISA (NZ) 701.
- The auditor has obtained part of the other information prior to the date of the auditor’s report, has not identified a material misstatement of the other information, and expects to obtain other information after the date of the auditor’s report.
- The auditor has no other reporting responsibilities required under law or regulation.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

³⁶ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial Statements in New Zealand, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the Company.

...

[NZ] Illustration 4 – An auditor’s report of a FMC reporting entity considered to have a higher level of public accountability containing an unmodified opinion when the auditor has obtained no other information prior to the date of the auditor’s report but expects to obtain other information after the date of the auditor’s report.

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a FMC reporting entity considered to have a higher level of public accountability using a fair presentation framework. The audit is not a group audit (i.e., ISA (NZ) 600 does not apply).
- The financial statements are prepared by management of the entity in accordance with NZ IFRS (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.
- The auditor has concluded an unmodified (i.e., “clean”) opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 ~~(Revised)~~ International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand) and any other ethical provisions that apply to these circumstances.³⁷
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- Key audit matters have been communicated in accordance with ISA (NZ) 701.
- The auditor has obtained no other information prior to the date of the auditor’s report but expects to obtain other information after the date of the auditor’s report.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements³⁸

Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with New Zealand

³⁷ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

³⁸ The sub-title “Report on the Audit of the Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

equivalents to International Financial Reporting Standards (NZ IFRS).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial Statements in New Zealand, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the Company.

[NZ] Illustration 5 – An auditor’s report of any entity, whether a FMC reporting entity considered to have a higher level of public accountability or not, containing an unmodified opinion when the auditor has obtained all of the other information prior to the date of the auditor’s report and has concluded that a material misstatement of the other information exists.

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of financial statements of any entity, whether a FMC reporting entity considered to have a higher level of public accountability or not, using a fair presentation framework. The audit is not a group audit (i.e., ISA (NZ) 600 does not apply).
- The financial statements are prepared by management of the entity in accordance with NZ IFRS (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.
- The auditor has concluded an unmodified (i.e., “clean”) opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 ~~(Revised)~~ International Code of Ethics for Assurance Practitioners (including International Independence Standards (New Zealand) and any other ethical provisions that apply to these circumstances.³⁹
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- Key audit matters have been communicated in accordance with ISA (NZ) 701.
- The auditor has obtained all of the other information prior to the date of the auditor’s report and has concluded that a material misstatement of the other information exists
- The auditor has no other reporting responsibilities required under law or regulation.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

³⁹ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial Statements in New Zealand, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the Company.

...

[NZ] Illustration 6 – An auditor’s report of any entity, whether a FMC reporting entity considered to have a higher level of public accountability or not, containing an qualified opinion when the auditor has obtained all of the other information prior to the date of the auditor’s report and there is a limitation of scope with respect to a material item in the consolidated financial statements which also affects the other information.

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of any entity, whether a FMC reporting entity considered to have a higher level of public accountability or not, using a fair presentation framework. The audit is a group audit (i.e., ISA (NZ) 600 applies).
- The consolidated financial statements are prepared by management of the entity in accordance with NZ IFRS (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the consolidated financial statements in ISA (NZ) 210.
- The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the consolidated financial statements (i.e., a qualified opinion is appropriate).
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 ~~(Revised)~~ *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* and any other ethical provisions that apply to these circumstances.⁴⁰
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- Key audit matters have been communicated in accordance with ISA (NZ) 701.
- The auditor has obtained all of the other information prior to the date of the auditor’s report and the matter giving rise to the qualified opinion on the consolidated financial statements also affects the other information.
- The auditor has no other reporting responsibilities required under law or regulation.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Qualified Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at December 31, 20X1, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

⁴⁰ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

In our opinion, except for the possible effects of the matter described in the *Basis for Qualified Opinion* section of our report, the accompanying consolidated financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of the Group as at December 31, 20X1, and (of) its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

Basis for Qualified Opinion

The Group's investment in XYZ Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the consolidated statement of financial position as at December 31, 20X1, and ABC's share of XYZ's net income of xxx is included in ABC's income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC's investment in XYZ as at December 31, 20X1 and ABC's share of XYZ's net income for the year because we were denied access to the financial information, management, and the auditors of XYZ. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the group financial Statements in New Zealand, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Company or any of its subsidiaries.

...

[NZ] Illustration 7 – An auditor’s report of any entity, whether a FMC reporting entity considered to have a higher level of public accountability or not, containing an adverse opinion when the auditor has obtained all of the other information prior to the date of the auditor’s report and the adverse opinion on the consolidated financial statements also affects the other information.

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of any entity, whether a FMC reporting entity considered to have a higher level of public accountability or not, using a fair presentation framework. The audit is a group audit (i.e., ISA (NZ) 600 applies).
- The consolidated financial statements are prepared by management of the entity in accordance with NZ IFRS (a general purpose framework).
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the consolidated financial statements in ISA (NZ) 210.
- The consolidated financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. The effects of the misstatement on the consolidated financial statements have not been determined because it was not practicable to do so (i.e., an adverse opinion is appropriate).
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 (~~Revised~~) *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* and any other ethical provisions that apply to these circumstances.⁴¹
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- Key audit matters have been communicated in accordance with ISA (NZ) 701.
- The auditor has obtained all of the other information prior to the date of the auditor’s report and the matter giving rise to the adverse opinion on the consolidated financial statements also affects the other information.
- The auditor has no other reporting responsibilities required under law or regulation.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Adverse Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at December 31, 20X1, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

⁴¹ For example, the New Zealand Institute of Chartered Accountants “Code of Ethics” including Part 2, *Members in Business*

In our opinion, because of the significance of the matter discussed in the *Basis for Adverse Opinion* section of our report, the accompanying consolidated financial statements do not present fairly (or *do not give a true and fair view of*) the consolidated financial position of the Group as at December 31, 20X1, and (of) its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

Basis for Adverse Opinion

As explained in Note X, the Group has not consolidated subsidiary XYZ Company that the Group acquired during 20X1 because it has not yet been able to determine the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under NZ IFRS, the Group should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had XYZ Company been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in New Zealand jurisdiction, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Company or any of its subsidiaries.

...

B.6 ISA (NZ) 800 *Special Considerations – Audits of Financial Statements Prepared Accordance with Special Purpose Frameworks*

Amend Appendix 1, [NZ] Illustration 1 through [NZ] Illustration 3 to reflect changes to the wording in the auditor's report as required by ISA (NZ) 700 (Revised).

Appendix 1 (Ref: Para. A14)

Illustrations of Independent Auditor's Reports on Special Purpose Financial Statements

- [NZ] Illustration 1: An auditor's report on a complete set of financial statements of an entity other than a FMC reporting entity considered to have a higher level of public accountability prepared in accordance with the financial reporting provisions of a contract (for purposes of this illustration, a compliance framework).
- [NZ] Illustration 2: An auditor's report on a complete set of financial statements of an entity other than a FMC reporting entity considered to have a higher level of public accountability prepared in accordance with the tax basis of accounting (for purposes of this illustration, a compliance framework).
- [NZ] Illustration 3: An auditor's report on a complete set of financial statements of a FMC reporting entity considered to have a higher level of public accountability prepared in accordance with the financial reporting provisions established by a regulator (for purposes of this illustration, a fair presentation framework).

[NZ] Illustration 1: An auditor's report on a complete set of financial statements of an entity other than a FMC reporting entity considered to have a higher level of public accountability prepared in accordance with the financial reporting provisions of a contract (for purposes of this illustration, a compliance framework).

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- The financial statements have been prepared by management of the entity in accordance with the financial reporting provisions of a contract (that is, a special purpose framework). Management does not have a choice of financial reporting frameworks.
- The applicable financial reporting framework is a compliance framework.
- An auditor's report on the complete set of general purpose financial statements was not issued.
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise of Professional and Ethical Standard 1 (~~Revised~~) International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand) and any other ethical provisions that apply to these circumstances.⁴²~~issued by the New Zealand Auditing and Assurance Standards Board.~~
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- Distribution and use of the auditor's report are restricted.
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with ISA (NZ) 701.
- The auditor has determined that there is no other information (i.e., the requirements of ISA (NZ) 720 (Revised) do not apply).
- The auditor has no other reporting responsibilities required under local law or regulation.

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements of the Company for the year ended December 31, 20X1 are prepared, in all material respects, in accordance with the financial reporting provisions of Section Z of the contract dated January 1, 20X1 between the Company and

⁴² For example, the New Zealand Institute of Chartered Accountants "Code of Ethics" including Part 2, *Members in Business*

DEF Company (“the contract”). [Opinion section positioned first as required in ISA (NZ) 700 (Revised)]

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial Statements in New Zealand, ~~Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners~~ issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. [The first and last sentences in this section used to be in the Auditor’s Responsibility section. Also, the Basis for Opinion section is positioned immediately after the Opinion section as required in ISA (NZ) 700 (Revised).]

Other than in our capacity as auditor we have no relationship with, or interests in, the Company.

...

[NZ] Illustration 2: An auditor's report on a complete set of financial statements of an entity other than a FMC reporting entity considered to have a higher level of public accountability prepared in accordance with the tax basis of accounting in New Zealand (for purposes of this illustration, a compliance framework).

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements that have been prepared by management of a partnership in accordance with the tax basis of accounting in New Zealand (that is, a special purpose framework) to assist the partners in preparing their individual income tax returns. Management does not have a choice of financial reporting frameworks.
- The applicable financial reporting framework is a compliance framework.
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 (~~Revised~~) International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand) and any other ethical provisions that apply to these circumstances.⁴³.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- Distribution of the auditor's report is restricted.
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with ISA (NZ) 701.
- The auditor has determined that there is no other information (i.e., the requirements of ISA (NZ) 720 (Revised) do not apply).
- The auditor has no other reporting responsibilities required under local law or regulation.

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Opinion

We have audited the financial statements of ABC Partnership (the Partnership), which comprise the balance sheet as at December 31, 20X1 and the income statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements of the Partnership for the year ended December 31, 20X1 are prepared, in all material respects, in accordance with *[describe the*

⁴³ For example, the New Zealand Institute of Chartered Accountants "Code of Ethics" including Part 2, *Members in Business*

applicable income tax law] of New Zealand. [Opinion section positioned first as required in ISA (NZ) 700 (Revised)]

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Partnership in accordance with the ethical requirements that are relevant to our audit of the financial Statements in New Zealand, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. [The first and last sentences in this section used to be in the Auditor's Responsibility section. Also, the Basis for Opinion section is positioned immediately after the Opinion section as required in ISA (NZ) 700 (Revised).]

Other than in our capacity as auditor we have no relationship with, or interests in, the Partnership.

...

[NZ] Illustration 3: An auditor's report on a complete set of financial statements of a FMC reporting entity considered to have a higher level of public accountability prepared in accordance with the financial reporting provisions established by a regulator (for purposes of this illustration, a fair presentation framework).

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a FMC reporting entity considered to have a higher level of public accountability that have been prepared by management of the entity in accordance with the financial reporting provisions established by a regulator (that is, a special purpose framework) to meet the requirements of that regulator. Management does not have a choice of financial reporting frameworks.
- The applicable financial reporting framework is a fair presentation framework.
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 ~~(Revised)~~ International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand) and any other ethical provisions that apply to these circumstances.⁴⁴
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised). The disclosure of the material uncertainty in the financial statements is adequate.
- Distribution or use of the auditor's report is not restricted.
- The auditor is required by the regulator to communicate key audit matters in accordance with ISA (NZ) 701.
- The auditor has determined that there is no other information (i.e., the requirements of ISA (NZ) 720 (Revised) do not apply).
- The auditor has no other reporting responsibilities required under local law or regulation.

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Company [or Appropriate Addressee]

Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of the Company as at December 31, 20X1, and

⁴⁴ For example, the New Zealand Institute of Chartered Accountants "Code of Ethics" including Part 2, *Members in Business*

(of) its financial performance and its cash flows for the year then ended in accordance with the financial reporting provisions of Section Y of Regulation Z. [Opinion section positioned first as required in ISA (NZ) 700 (Revised)]

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial Statements in New Zealand, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. [The first and last sentences in this section used to be in the Auditor's Responsibility section. Also, the Basis for Opinion section is positioned immediately after the Opinion section as required in ISA (NZ) 700 (Revised).]

Other than in our capacity as auditor we have no relationship with, or interests in, the Company.

...

B.7 ISA (NZ) 805 *Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*

Amend Appendix 2, [NZ] Illustration 1 through [NZ] Illustration 3 to reflect to reflect changes to the wording in the auditor's report as required by ISA (NZ) 700 (Revised).

Appendix 2
(Ref: Para. A16)

Illustrations of Independent Auditor's Reports on a Single Financial Statement and on a Specific Element of a Financial Statement

- [NZ] Illustration 1: An auditor's report on a single financial statement of an entity other than a FMC reporting entity considered to have a higher level of public accountability prepared in accordance with a general purpose framework (for purposes of this illustration, a fair presentation framework).
- [NZ] Illustration 2: An auditor's report on a single financial statement of an entity other than a FMC reporting entity considered to have a higher level of public accountability prepared in accordance with a special purpose framework (for purposes of this illustration, a fair presentation framework).
- [NZ] Illustration 3: An auditor's report on a specific element of a financial statement of a FMC reporting entity considered to have a higher level of public accountability prepared in accordance with a special purpose framework (for purposes of this illustration, a compliance framework).

[NZ] Illustration 1: An auditor's report on a single financial statement of an entity other than a FMC reporting entity considered to have a higher level of public accountability prepared in accordance with a general purpose framework (for purposes of this illustration, a fair presentation framework)

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a balance sheet (that is, a single financial statement) of an entity other than a FMC reporting entity considered to have a higher level of public accountability.
- The balance sheet has been prepared by management of the entity in accordance with the requirements of the applicable financial reporting framework issued by the New Zealand Accounting Standards Board relevant to preparing a balance sheet.
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.
- The applicable financial reporting framework is a fair presentation framework designed to meet the common financial information needs of a wide range of users.
- The auditor has determined that it is appropriate to use the phrase "presents fairly, in all material respects," in the auditor's opinion.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 (Revised) *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* and any other ethical provisions that apply to these circumstances.⁴⁵
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised). The disclosure of the material uncertainty in the single financial statement is adequate.
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with ISA (NZ) 701 in the context of the audit of the balance sheet.
- The auditor has determined that there is no other information (i.e., the requirements of ISA (NZ) 720 (Revised) do not apply).
- The auditor has no other reporting responsibilities required under local law or regulation.

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Opinion

We have audited the balance sheet of ABC Company (the Company) as at December 31, 20X1 and notes to the financial statement, including a summary of significant accounting policies (together "the financial statement").

In our opinion, the accompanying financial statement presents fairly, in all material respects, the financial position of the Company as at December 31, 20X1 in accordance with those requirements of the [applicable financial reporting framework issued by the New Zealand

⁴⁵ For example, the New Zealand Institute of Chartered Accountants "Code of Ethics" including Part 2, *Members in Business*

Accounting Standards Board] relevant to preparing such a financial statement. [Opinion section positioned first as required in ISA (NZ) 700 (Revised)]

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statement* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial Statements in New Zealand, ~~Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners~~ issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. [The first and last sentences in this section used to be in the Auditor's Responsibility section. Also, the Basis for Opinion section is positioned immediately after the Opinion section as required in ISA (NZ) 700 (Revised).]

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Company.

...

[NZ] Illustration 2: An auditor's report on a single financial statement of an entity other than a FMC reporting entity considered to have a higher level of public accountability prepared in accordance with a special purpose framework.

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a statement of cash receipts and disbursements (that is, a single financial statement) of an entity other than a FMC reporting entity considered to have a higher level of public accountability.
- An auditor's report on the complete set of financial statements was not issued.
- The financial statement has been prepared by management of the entity in accordance with the cash receipts and disbursements basis of accounting to respond to a request for cash flow information received from a creditor. Management has a choice of financial reporting frameworks.
- The applicable financial reporting framework is a fair presentation framework designed to meet the financial information needs of specific users.⁴⁶
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The auditor has determined that it is appropriate to use the phrase "presents fairly, in all material respects," in the auditor's opinion.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 (Revised) *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* and any other ethical provisions that apply to these circumstances.⁴⁷ ~~comprises all of the relevant ethical requirements that apply to the audit.~~
- Distribution or use of the auditor's report is not restricted.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with ISA (NZ) 701 in the context of the audit of the statement of cash receipts and disbursements.
- The auditor has determined that there is no other information (i.e., the requirements of ISA (NZ) 720 (Revised) do not apply).
- The auditor has no other reporting responsibilities required under local law or regulation.

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Opinion

⁴⁶ ISA (NZ) 800 (Revised) contains requirements and guidance on the form and content of financial statements prepared in accordance with a special purpose framework.

⁴⁷ For example, the New Zealand Institute of Chartered Accountants "Code of Ethics" including Part 2, *Members in Business*

We have audited the statement of cash receipts and disbursements of ABC Company (the Company) for the year ended December 31, 20X1 and notes to the statement of cash receipts and disbursements, including a summary of significant accounting policies (together “the financial statement”).

In our opinion, the accompanying financial statement presents fairly, in all material respects, the cash receipts and disbursements of the Company for the year ended December 31, 20X1 in accordance with the cash receipts and disbursements basis of accounting described in Note X.

[Opinion section positioned first as required in ISA (NZ) 700 (Revised)]

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statement* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial Statements in New Zealand, ~~Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board~~, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. [The first and last sentences in this section used to be in the Auditor’s Responsibility section. Also, the Basis for Opinion section is positioned immediately after the Opinion section as required in ISA (NZ) 700 (Revised).]

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Company.

...

[NZ] Illustration 3: An auditor's report on a specific element of a financial statement of a FMC reporting entity considered to have a higher level of public accountability prepared in accordance with a special purpose framework.

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of an accounts receivable schedule (that is, element, account or item of a financial statement).
- The financial information has been prepared by management of the entity in accordance with the financial reporting provisions established by a regulator to meet the requirements of that regulator. Management does not have a choice of financial reporting frameworks.
- The applicable financial reporting framework is a compliance framework designed to meet the financial information needs of specific users.⁴⁸
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the financial statements in ISA (NZ) 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 (Revised) *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* and any other ethical provisions that apply to these circumstances.⁴⁹ ~~comprises all of the relevant ethical requirements that apply to the audit.~~
- Distribution of the auditor's report is restricted.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- The auditor is not required, and has otherwise not decided to communicate key audit matters in accordance with ISA (NZ) 701 in the context of the audit of the accounts receivable schedule.
- The auditor has determined that there is no other information (i.e., the requirements of ISA (NZ) 720 (Revised) do not apply).

The auditor has no other reporting responsibilities required under local law or regulation.

INDEPENDENT AUDITOR'S REPORT

[To the Shareholders of ABC Company or Other Appropriate Addressee]

Opinion

We have audited the accounts receivable schedule of ABC Company (the Company) as at December 31, 20X1 ("the schedule").

⁴⁸ ISA (NZ) 800 (Revised) contains requirements and guidance on the form and content of financial statements prepared in accordance with a special purpose framework.

⁴⁹ For example, the New Zealand Institute of Chartered Accountants "Code of Ethics" including Part 2, *Members in Business*

In our opinion, the financial information in the schedule of the Company as at December 31, 20X1 is prepared, in all material respects, in accordance with [describe the financial reporting provisions established by the regulator]. [Opinion section positioned first as required ISA (NZ) 700 (Revised)]

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Schedule* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial Statements in New Zealand, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. [The first and last sentences in this section used to be in the Auditor's Responsibility section. Also, the Basis for Opinion section is positioned immediately after opinion section as required in ISA (NZ) 700 (Revised).]

Other than in our capacity as auditor we have no relationship with, or interests in, the Company.

...

C: Proposed Amendments to domestic standards

C.1: External Reporting Board Standard Au1 *Application of Auditing and Assurance Standards*

Amend Appendix 1 to update the title of PES 1.

Appendix 1

Professional and Ethical Standards

This appendix is an integral part of the Standard.

This appendix lists the Professional and Ethical Standards to be applied in preparing for and conducting all assurance engagements.

PES 1 (~~Revised~~) International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)

PES 3 (Amended) Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements

C.2 New Zealand Auditing Standard 1 *The Audit of Service Performance Information*

Add a footnote to paragraph A18(a) to include the title of Professional and Ethical Standard 1. The illustrative auditor's reports in Appendix 6 and Appendix 7 are amended to reflect changes to the wording in the auditor's report as required by ISA (NZ) 700 (Revised).

A18 The service performance information may include information upon which another practitioner may have expressed an opinion. The auditor may decide to use the evidence on which that other practitioner's opinion is based to provide evidence regarding the service performance information included in the general purpose financial report. The work of another practitioner may be used in relation to service performance information that falls outside the boundary of the reporting entity. Such practitioners are not part of the engagement team. Relevant considerations when the engagement team plans to use the work of another auditor may include:

- (a) Whether the auditor understands and complies with the requirements of Professional and Ethical Standard 1⁵⁰.
- (b) The other practitioner's professional competence.
- (c) The extent of the engagement teams' involvement in the work of the other practitioner.

⁵⁰ Professional and Ethical Standard 1, *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)*

Appendix 6

(Ref: Para. A66)

Illustrative Auditor's Report Including Service Performance Information

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a general purpose financial report/performance report of a public benefit entity that is not a FMC reporting entity considered to have a higher level of public accountability using a fair presentation framework⁵¹. The audit is not a group audit (i.e., ISA (NZ) 600 does not apply).
- The general purpose financial report/performance report is prepared by management of the entity in accordance with a general purpose framework.
- The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the general purpose financial report/performance report in ISA (NZ) 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise Professional and Ethical Standard 1 (Revised) *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* and any other ethical provisions that apply to these circumstances.⁵² ~~comprises all of the relevant ethical requirements that apply to the audit.~~
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with ISA (NZ) 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- The auditor has no other reporting responsibilities required under local law.

INDEPENDENT AUDITOR'S REPORT

To Appropriate Addressee

Opinion

We have audited the [general purpose financial report/performance report] of ABC [entity], which comprise the financial statements on pages x to xx, the [service performance information/statement

⁵¹ The general purpose financial report may be referred to as a performance report and include entity information, according to the requirements of the applicable financial reporting framework.

⁵² For example, the New Zealand Institute of Chartered Accountants "Code of Ethics" including Part 2, *Members in Business*

of service performance] on pages x to xx [and the entity information on page x]. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the [statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity], statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion the accompanying [general purpose financial report/performance report] presents fairly, in all material respects, (or gives a true and fair view of):

- [the entity information as at December 31, 20X1];
- the financial position of the [entity] as at December 31, 20X1, and (of) its financial performance, and its cash flows for the year then ended; and
- the service performance for the year ended December 31, 20X1 in accordance with the entity's service performance criteria

in accordance with [Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)] issued by the New Zealand Accounting Standards Board.

[For a long-form report, include a separate section, under an appropriate heading, for example:

- Underlying facts and information about the entity's process to select what service performance to report on (e.g., the maturity of the entity's process compared to others in the industry).
- The source of the service performance criteria, and whether they are externally established. (e.g., established in section xxx of applicable legislation or externally established performance frameworks).
- Any significant interpretations made in selecting or applying the entity's service performance criteria in the circumstances.
- Whether there have been any changes in the service performance criteria (e.g., changes in the performance measures used).
- Findings or recommendations for improvements to the service performance information.
- Any other matters the auditor considers necessary to assist intended users in making decisions based on the service performance information.]

Basis for Opinion

We conducted our audit of the [financial statements] in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs and New Zealand Auditing Standard (NZ AS) 1 *The Audit of Service Performance Information* (NZ). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report] section of our report. We are independent of the [entity] in accordance with the ethical requirements that are relevant to our audit of the [general purpose financial report/performance report/financial statements] in New Zealand, ~~Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners~~ issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].
...

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Appendix 7

(Ref: Para. A76)

Illustrations of Auditor's Reports with Modifications to the Opinion with Respect to the Service Performance Information

- Illustration 1: An auditor's report containing an unmodified opinion on the financial statements and a qualified opinion due to a material misstatement of the service performance information.
- Illustration 2: An auditor's report containing an unmodified opinion on the financial statements and an adverse opinion due to a material misstatement of the service performance information.
- Illustration 3: An auditor's report containing an unmodified opinion on the financial statements and a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the service performance information.
- Illustration 4: An auditor's report containing a qualified opinion on both the financial statements and the service performance information due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the financial statements.

Illustration 1: An auditor's report containing an unmodified opinion on the financial statements and a qualified opinion due to a material misstatement of the service performance information

INDEPENDENT AUDITOR'S REPORT

To [Appropriate Addressee]

Opinions

We have audited the *[general purpose financial report/performance report]* of ABC [entity], which comprise the financial statements on pages *x to xx*, the *[service performance information/statement of service performance]* on pages *x to xx* *[and the entity information on page x]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity]*, statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Opinion on the [Entity Information and] Financial Statements

In our opinion, the accompanying *[general purpose financial report/performance report]* presents fairly, in all material respects, (or *gives a true and fair view of*) the *[entity information and the]* financial position of the [entity] as at December 31, 20X1, and (of) its, financial performance and its cash flows for the year then ended in accordance with *[Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Qualified Opinion on the Service Performance Information

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion on the Service Performance Information* section of our report the accompanying *[general purpose financial report/performance report]* presents fairly, in all material respects (or *gives a true and fair view of*) the service performance of the [entity] for the year ended December 31, 20X1 in accordance with the entity's service performance criteria and with *[Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Basis for Qualified Opinion on the Service Performance Information

[As reported in the service performance information on page *xx*, the entity has identified its service performance as *[describe improvements reported or description of the difference that the entity has made]* and measured this performance by *[list performance measures and/or descriptions reported]* to report its service performance. The entity has not been able to provide evidence of its role in those particular improvements and therefore should not have reported this improvement.]

We conducted our audit of the *[financial statements]* in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs (NZ) and New Zealand Auditing Standard 1 *The Audit of Service Performance Information*. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report]* section of our report. We are independent of the [entity] in accordance with the ethical requirements that

are relevant to our audit of the [*General Purpose Financial Report/Performance Report*] in New Zealand, ~~Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners~~ issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

...

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Illustration 2: An auditor's report containing an unmodified opinion on the financial statements and an adverse opinion due to a material misstatement of the service performance information

INDEPENDENT AUDITOR'S REPORT

To [Appropriate Addressee]

Opinions

We have audited the *[general purpose financial report/performance report]* of ABC [entity], which comprise the financial statements on pages *x to xx*, the *[service performance information/statement of service performance]* on pages *x to xx [and the entity information on page x]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity]*, statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Opinion on the [Entity Information and] Financial Statements

In our opinion, the accompanying *[general purpose financial report/performance report]* presents fairly, in all material respects, (or *gives a true and fair view of*) the *[entity information and the]* financial position of the [entity] as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with *[Public Benefit Entity Standards Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Adverse Opinion on the Service Performance Information

In our opinion, because of the significance of the matter discussed in the *Basis for Adverse Opinion on the Service Performance Information* section of our report the accompanying *[general purpose financial report/ performance report]* does not present fairly (or *does not give a true and fair view of*) the service performance of the [entity] *[on pages x to xx]* for the year ended December 31, 20X1 in accordance with the entity's service performance criteria and with *[Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Basis for Adverse Opinion on the Service Performance Information

[As reported in the service performance information on pages ..., the entity has identified its service performance to include [list appropriate goods and services] and measured and evaluated this performance with reference to [describe performance measures and/or descriptions reported] to report its service performance. We do not consider that these performance measures will enable a meaningful assessment of the service performance of the entity for the year ended December 31, 20X1 to be made. Had the entity identified more meaningful performance measures, the service performance information would have been materially affected, reporting performance measures including xxx and linking to its responsibility for yyyy.]

We conducted our audit of the *[financial statements]* in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs (NZ) and New Zealand Auditing Standard 1 *The Audit of Service Performance Information*. Our responsibilities under those standards are further described in the

Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report] section of our report. We are independent of the [entity] in accordance with the ethical requirements that are relevant to our audit of the [General Purpose Financial Report/Performance Report] in New Zealand, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

...

DRAFT

Illustration 3: An auditor's report containing an unmodified opinion on the financial statements and a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the service performance information

INDEPENDENT AUDITOR'S REPORT

To [Appropriate Addressee]

Opinions

We have audited the *[general purpose financial report/performance report]* of ABC [entity], which comprise the financial statements on pages *x to xx*, the *[service performance information/statement of service performance]* on pages *x to xx [and the entity information on page x]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity]*, statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Opinion on the [Entity Information and] Financial Statements

In our opinion, the accompanying *[general purpose financial report/performance report]* presents fairly, in all material respects, (or *gives a true and fair view of*) the *[entity information and the]* financial position of the [entity] as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with *[Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Qualified Opinion on the Service Performance Information

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion on the Service Performance Information* section of our report the accompanying *[general purpose financial report/performance report]* presents fairly, in all material respects (or *gives a true and fair view of*) the service performance of the [entity] for the year ended December 31, 20X1 in accordance with the entity's service performance criteria and with *[Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Basis for Qualified Opinion on the Service Performance Information

[Some significant performance measures of the entity, rely on information from third parties, such as (give examples). The entity's control over much of this information is limited, and there are no practical audit procedures to determine the effect of this limited control. For example, *[describe performance measure and explain where information comes from that we are unable to independently test.]*]

We conducted our audit of the *[financial statements]* in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs (NZ) and New Zealand Auditing Standard 1 *The Audit of Service Performance Information*. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report]* section of our report. We are independent of the [entity] in accordance with the ethical requirements that

are relevant to our audit of the [*General Purpose Financial Report/Performance Report*] in New Zealand, ~~Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners~~ issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

...

DRAFT

Illustration 4: Qualified opinion on both the financial statements and the service performance information due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the financial statements

INDEPENDENT AUDITOR'S REPORT

To [Appropriate Addressee]

Qualified Opinion on the [General Purpose Financial Report/Performance Report/

We have audited the [general purpose financial report/performance report] of ABC [entity], which comprise the financial statements on pages *x to xx*, the [service performance information/statement of service performance] on pages *x to xx* [and the entity information on page *x*]. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the [statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity], statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion* section of our report the accompanying [general purpose financial report/performance report] presents fairly, in all material respects (or *gives a true and fair view of*):

- [the entity information as at December 31, 20X1];
- the financial position of the [entity] as at December 31, 20X1, and (of) its financial performance, and its cash flows for the year then ended; and
- the service performance for the year ended December 31, 20X1 in accordance with the entity's service performance criteria

in accordance with [Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – *Accrual (Not-for-profit)*] issued by the New Zealand Accounting Standards Board.

Basis for Qualified Opinion

[As outlined on page *xx* of the [general purpose financial report/ performance report], [entity] has not applied the requirements of the [Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – *Accrual (Not-for-profit)*] to its grant expenditure. We have been unable to obtain sufficient audit evidence to quantify the effects of this limitation. As a result of this matter, we were unable to quantify the adjustments that are necessary in respect of grant expenditure in the [statement of comprehensive revenue and expenses]; assets, liabilities and equity in the statement of financial position, [total comprehensive revenue and expense] and opening and closing equity in the [statement of changes in equity] and grants expense reported in the [service performance information/statement of service performance].]

We conducted our audit of the [financial statements] in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs (NZ) and New Zealand Auditing Standard 1 *The Audit of Service Performance Information*. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report]* section of our report. We are independent of the [entity] in accordance with the ethical requirements that

are relevant to our audit of the [*General Purpose Financial Report/Performance Report*] in New Zealand, ~~Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners~~ issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

...

C.3 SAE 3100 Assurance Engagements on Compliance

Amend paragraphs 9, 19, 46, A19 and A65 to reflect the new title of PES 1. The footnote in paragraph A65 is amended with the new section reference.

9. Compliance with ISAE (NZ) 3000 (Revised) requires, among other things, that the assurance practitioner comply with Professional and Ethical Standard 1 ~~(Revised)~~⁵³ or other professional requirements, or requirements in law or regulation, that are at least as demanding related to assurance engagements⁵⁴. It also requires the lead assurance practitioner⁵⁵ to be a member of a firm that applies Professional and Ethical Standard 3 (Amended)⁵⁶ or requirements in law or regulation, that are at least as demanding related to assurance engagements.
19. As required by ISAE (NZ) 3000 (Revised), the assurance practitioner shall comply with Professional and Ethical Standard 1 ~~(Revised)~~⁵⁷, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding. (Ref: Para. A6)
46. If the assurance practitioner becomes aware of information concerning an instance of non-compliance or suspected non-compliance with respect to laws and regulations, the assurance practitioner shall comply with Professional and Ethical Standard 1 ~~(Revised)~~, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding. (Ref. Para. A65)
- A19. Where relevant, the terms of the engagement could also include a reference to, and description of, the auditor's responsibility in accordance with:
 - Professional and Ethical Standard 1 ~~(Revised)~~; and/or
 - applicable law or regulation, and

⁵³ Professional and Ethical Standard 1 ~~(Revised)~~ *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)*.

⁵⁴ See ISAE (NZ) 3000 (Revised), paragraphs 3(a) and 20:

⁵⁵ The term "lead assurance practitioner" is referred to in Professional and Ethical Standard 1 ~~(Revised)~~ and Professional and Ethical Standard 3 (Amended) as the "engagement partner".

⁵⁶ See ISAE (NZ) 3000 (Revised), paragraphs 3(b) and 31(a):

⁵⁷ See ISAE (NZ) 3000 (Revised), paragraph 20:

- obligations to report identified or suspected matters of non-compliance with laws and regulations to an appropriate authority outside the entity is required or appropriate in the circumstances.

A65. Professional and Ethical Standard 1 ~~(Revised)~~⁵⁸, sets out the approach to be taken by an assurance practitioner who encounters or is made aware of matter(s) of non-compliance or suspected matter(s) of non-compliance with laws or regulations.⁵⁹ In these circumstances, the assurance practitioner shall consider the appropriate response to the identified matter(s) of non-compliance with laws and regulations in accordance with Professional and Ethical Standard 1 ~~(Revised)~~.

C.4 SAE 3150 Assurance Engagements on Controls

Amend paragraphs 9, 19, and A124, to update the title of PES 1. In addition, the footnote to paragraph 19 is replaced with a reference to the applicable requirement in ISAE (NZ) 3000 ~~(Revised)~~.

Paragraph 88(l) and the illustrative assurance practitioner's reports in Appendix 8 are amended consistent with the changes to the wording in the auditor's report as required by ISA (NZ) 700 ~~(Revised)~~.

9. Compliance with ISAE (NZ) 3000 ~~(Revised)~~ requires, among other things, that the assurance practitioner complies with Professional and Ethical Standard 1 ~~(Revised)~~⁵⁹ or other professional requirements, or requirements in law or regulation, that are at least as demanding related to assurance engagements⁶⁰. It also requires the lead assurance practitioner⁶¹ to be a member of a firm that applies Professional and Ethical Standard 3 (Amended) or requirements in law or regulation, that are at least as demanding related to assurance engagements.⁶²
 19. As required by ISAE (NZ) 3000 ~~(Revised)~~, the assurance practitioner shall comply with Professional and Ethical Standard 1 ~~(Revised)~~⁶³ or other professional requirements, or requirements in law or regulation, that are at least as demanding related to assurance engagements. (Ref: Para. A10)
- 88(l) a statement that the assurance practitioner complies with the independence and other

⁵⁸ See Professional and Ethical Standard 1 ~~(Revised)~~, Section 225360, Responding to Non-Compliance with Laws and Regulations

⁵⁹ Professional and Ethical Standard 1 ~~(Revised)~~, International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)

⁶⁰ ISAE (NZ) 3000 ~~(Revised)~~, paragraphs 3(a) and 20-

⁶¹ The term "lead assurance practitioner" is referred to in Professional and Ethical Standard 1 ~~(Revised)~~ and Professional and Ethical Standard 3 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements* (Amended) as the "engagement partner".

⁶² ISAE (NZ) 3000 ~~(Revised)~~, paragraphs 3(b) and 31(a)-

⁶³ ~~Professional and Ethical Standard 1 (Revised), Code of Ethics for Assurance Practitioners. See ISAE (NZ) 3000 (Revised), paragraph 20~~

relevant ethical requirements related to assurance engagements; of Professional and Ethical Standard 1 (Revised), or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding as Professional and Ethical Standard 1 (Revised);

- A124. Professional and Ethical Standard 1 (Revised) or other professional requirements, or requirements in law or regulation, that are at least as demanding require that an assurance practitioner not be associated with information where the assurance practitioner believes that the information:
- (a) contains a materially false or misleading statement;
 - (b) contains statements or information furnished recklessly; or
 - (c) omits or obscures information required to be included where such omission or obscurity would be misleading.

Appendix 8

(Ref: Para. A139)

EXAMPLE ASSURANCE REPORTS ON CONTROLS

Example 1: Limited Assurance Report on Design and Description of the Entity's Controls as at a Specified Date

Example 2: Reasonable Assurance Report on the Design, Description and Operating Effectiveness of the Entity's Controls throughout the Period

Example 3: Reasonable Assurance Report on the Design and Implementation of the Entity's Controls as at a Specified Date

Example 4: Reasonable Assurance Report on the Design and Operating Effectiveness of the Entity's Controls throughout the Period

The following examples of reports are for guidance only and are not intended to be exhaustive or applicable to all situations. They can be applied to both attestation and direct engagements. These examples are short-form reports but may be converted to long-form reports by inclusion of additional information as indicated.

Example 1: Limited Assurance Report on Design and Description of the Entity's Controls as at a Specified Date

Independent Assurance Practitioner's Report

[Appropriate Addressee]

Scope

We have undertaken a limited assurance engagement on the design of controls within ABC's [type or name of] system (the controls), comprising [identify system by distinguishing features, boundaries and control components]⁶⁴, as at [date] relevant to [[list overall objectives]/ the following control objectives: [list or reference specific control objectives⁶⁵]] and ABC's description of its [type or name of] system at pages [bb-cc] (the description)⁶⁶. The scope of our limited assurance engagement does not include whether the controls were implemented as designed or operated effectively.

ABC's Responsibilities

ABC is responsible for:

- (a) the [functions or services] within the [type/name of] system;
- (b) identifying the control objectives;
- (c) identifying the risks that threaten achievement of the control objectives;
- (d) designing controls to mitigate those risks, so that those risks will not prevent achievement of the identified control objectives; and
- (e) preparing the description⁶⁷ [and Statement] at page [aa], including the completeness, accuracy and method of presentation of the description [and Statement].

Our Independence and Quality Control

We have complied with the relevant ethical requirements relating to assurance engagements, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners or other professional requirements, or requirements in law or regulation, that are at least as demanding, which include independence and other requirements founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

In accordance with Professional and Ethical Standard 3 (Amended) *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements* or other professional requirements, or requirements in law or regulation, that are at least as demanding, [name of firm] maintains a comprehensive system of quality control including documented policies

⁶⁴ Identify system by function or service provided and entity, facility or location. If the scope of the engagement is restricted to certain control components, identify those components. Components may include: the control environment, risk assessment, control activities, information and communication or monitoring activities, or equivalent components defined by control framework applied.

⁶⁵ Control objectives are listed if they are not detailed in the entity's description

⁶⁶ If some elements of the description are not included in the scope of the engagement, this is made clear in the assurance report.

⁶⁷ Insert for attestation engagements if a responsible party's or evaluator's Statement is provided to users.

and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

...

DRAFT

Example 2: Reasonable Assurance Report on the Design, Description, and Operating Effectiveness of the Entity's Controls throughout the Period Independent Assurance Practitioner's Report

[Appropriate Addressee]

Scope

We have undertaken a reasonable assurance engagement on the design of controls within ABC's [type/name of] system (the controls), comprising [identify system by distinguishing features, boundaries and control components]⁶⁸, throughout the period [date] to [date] relevant to [[list overall control objectives]/ the following control objectives: [list or reference the control objectives]], ABC's description of its [type or name of] system at pages [bb-cc] (the description)⁶⁹, and the operating effectiveness of those controls.

ABC's Responsibilities

ABC is responsible for:

- (a) the [functions or services] within the [type/name of] system;
- (b) identifying the control objectives;
- (c) identifying the risks that threaten achievement of the control objectives;
- (d) designing controls to mitigate those risks, so that those risks will not prevent achievement of the identified control objectives;
- (e) preparing the description [and Statement]⁷⁰ at page [aa], including the completeness, accuracy and method of presentation of the description [and Statement]⁷¹; and
- (f) operating those controls effectively as designed throughout the period.

Our Independence and Quality Control

We have complied with relevant ethical requirements relating to assurance engagements, the Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners or other professional ethical requirements, or requirements in law or regulation, that are at least as demanding, which include independence and other requirements founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

In accordance with Professional and Ethical Standard 3 (Amended) *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements* or other professional requirements, or requirements in law or regulation, that are at least as demanding,

⁶⁸ Identify the system by function or service provided and entity, facility or location. If the scope of the engagement is restricted to certain control components, identify those components. Components may include: the control environment, risk assessment, control activities, information and communication or monitoring activities, or equivalent components defined by control framework applied.

⁶⁹ If some elements of the description are not included in the scope of the engagement, this is made clear in the assurance report.

⁷⁰ Insert for attestation engagements if the responsible party's or evaluator's Statement is provided to users.

⁷¹ Insert for attestation engagements if the opinion is phrased in terms of the Statement.

[*name of firm*] maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

...

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Example 3: Reasonable Assurance Report on the Design and Implementation of the Entity's Controls as at a Specified Date

Independent Assurance Practitioner's Report

[Appropriate Addressee]

Scope

We have undertaken a reasonable assurance engagement on the design and implementation of controls within ABC's [type/name of] system (the controls), comprising [identify system by distinguishing features, boundaries and control components⁷²] as at [date] relevant to [[list overall objectives]/ the following control objectives: [List or reference the control objectives⁷³]]

ABC's Responsibilities

ABC is responsible for:

- (a) the [functions or services] within the [type/name of] system;
- (b) identifying the control objectives;
- (c) identifying the risks that threaten achievement of the control objectives;
- (d) designing and implementing controls to mitigate those risks, so that those risks will not prevent achievement of the identified control objectives;
- (e) implementing the controls as designed; and
- (f) [preparing the accompanying Statement at page [aa], including the completeness, accuracy and method of presentation of the Statement.]⁷⁴

Our Independence and Quality Control

We have complied with relevant ethical requirements relating to assurance engagements, the Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners or other professional ethical requirements, which include independence and other requirements founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

In accordance with Professional and Ethical Auditing Standard 3 (Amended) *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements* or other professional requirements, or requirements in law or regulation, that are at least as demanding, [name of firm] maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

⁷² Identify the system by function or service provided and entity, facility or location. If the scope of the engagement is restricted to certain control components, identify those components. Components may include: the control environment, risk assessment, control activities, information and communication or monitoring activities, or equivalent components defined by control framework applied.

⁷³ Either list overall control objectives or list specified control objectives depending on scope of engagement.

⁷⁴ Insert for attestation engagements if the responsible party's or evaluator's Statement is provided to users.

...

Example 4: Reasonable Assurance Report on the Design and Operating Effectiveness of the Entity's Controls throughout the Period

Independent Assurance Practitioner's Report

[Appropriate Addressee]

Scope

We have undertaken a reasonable assurance engagement on the design and the operating effectiveness of controls within ABC's *[type/name of]* system (the controls), comprising *[identify system by distinguishing features, boundaries and control components^{75]}*, throughout the period *[date]* to *[date]* relevant to *[[list overall objectives]/ the following control objectives: [List or reference the control objectives^{76]}*

ABC's Responsibilities

ABC is responsible for:

- (a) the *[functions or services]* within the *[type/name of]* system;
- (b) identifying the control objectives;
- (c) identifying the risks that threaten achievement of the control objectives;
- (d) designing controls to mitigate those risks, so that those risks will not prevent achievement of the identified control objectives;
- (e) operating effectively the controls as designed throughout the period; and
- (f) *[preparing the accompanying Statement at page [aa], including the completeness, accuracy and method of presentation of the Statement.^{77]}*

Our Independence and Quality Control

We have complied with relevant ethical requirements relating to assurance engagements, Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners or other professional ethical requirements, or requirements in law or regulation, that are at least as demanding, which include independence and other requirements founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

In accordance with Professional and Ethical Auditing Standard 3 (Amended) *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements* or other professional requirements, or requirements in law or regulation, that are at least as demanding, *[name of firm]* maintains a comprehensive system of quality control including

⁷⁵ Identify the system by function or service provided and entity, facility or location. If the scope of the engagement is restricted to certain control components, identify those components. Components may include: the control environment, risk assessment, control activities, information and communication or monitoring activities, or equivalent components defined by control framework applied.

⁷⁶ Either list overall control objectives or list specified control objectives depending on scope of engagement.

⁷⁷ Insert for attestation engagements if the responsible party's or evaluator's Statement is provided to users.

documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

C.5 ISRE (NZ) 2400 Assurance Engagements on Controls

Amend paragraph NZA95.1 to reflect the new title of PES 1. In the footnotes, paragraph references to PES 1 have been updated. New text is underlined and deleted text is struck through.

NZA95.1 In some cases the relevant ethical requirements may require the assurance practitioner to report or to consider whether reporting identified or suspected fraud or non-compliance with laws and regulations to an appropriate authority outside the entity is an appropriate action in the circumstances. For example, Professional and Ethical Standard 1 ~~(Revised)~~ requires the assurance practitioner to take steps to respond to identified or suspected non-compliance with laws and regulations, and determine whether further action is needed, which may include reporting to an appropriate authority outside the entity.⁷⁸ Professional and Ethical Standard 1 ~~(Revised)~~ explains that such reporting would not be considered a breach of the duty of confidentiality under Professional and Ethical Standard 1 ~~(Revised)~~.⁷⁹

D. Effective Date

The effective date for the final conforming amendments is a matter for the NZAuASB to determine. However, it is anticipated that, given the limited nature of the amendments proposed, the amendments can go into effect almost immediately.

Commented [SW4]: Align with IAASB wording.

⁷⁸ See, for example, paragraph 360.21 A1 ~~Section 225.29~~ of Professional and Ethical Standard 1 ~~(Revised)~~
⁷⁹ See, for example, ~~Section paragraphs R114.1(d) and R360.26140.7 and Section 225.35~~ of Professional and Ethical Standard 1 ~~(Revised)~~.

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO. 10.1

Meeting date: 24 October 2019

Subject: Follow up joint report with the FMA on auditor reporting

Date: 4 October 2019

Prepared by: Misha Pieters

☒ **Action Required**

☐ **For Information Purposes Only**

Agenda Item Objectives

For the Board to provide feedback on a proposed approach to perform a second follow up review of the New Zealand experience in adopting the revised auditor reporting requirements.

Background

1. In November 2017, the XRB and the FMA issues a joint publication, "[Key audit matters](#) A stock take of the first year in New Zealand".
2. The FMA has approached the XRB to perform a joint follow up review of the New Zealand experience in implementing the new auditor reporting standards, and to publish a joint report.
3. The proposed outline and timeline suggested by the FMA is outlined in agenda item 10.2.

Related international focus

4. The IAASB has commenced discussion on its post implementation review of the auditor reporting requirements with a revised objective of:
 - a. determining whether the standards are being consistently understood and implemented in a manner that achieves the IAASB's intended purpose to enable the IAASB to determine what further actions are needed;
 - b. Identifying how practical challenges and concerns are being addressed;
 - c. Understanding the global demand for even more information in the auditor's report (e.g. outcome of audit procedures with respect to KAMs, additional communication about going concern, materiality and scope of the audit);
 - d. Understanding the global demand for widening the scope of requirements that are currently restricted to listed entities in the IAASB standards (e.g., KAMs, engagement partner name, etc).

The June IAASB agenda paper on the Auditor Reporting post implementation review can be found [here](#).

5. The IAASB is expected to conduct targeted information gathering activities in the first half of 2020. Any information we gather as part of the review could be passed on to the IAASB as part of its exercise to gather data. The information to be gathered is expected to target:
 - a. General matters:
 - i. KAMs
 - ii. Form and structure, including disclosing the engagement partner name
 - iii. Going concern
 - iv. Extending the revised reporting requirements to other IAASB standards
 - b. ISA 720 (Revised) dealing with Other Information

Matters to Consider

6. When preparing the first report, we conducted an online survey and held one on one interviews with targeted stakeholders which was used to develop the commentary in the report.
7. The Board is asked for feedback on:
 - a. The scope, timing and role of the XRB as outlined in the information sheet prepared by the FMA in agenda item 10.2.
 - b. The proposed questions to raise with each stakeholder group. Some possible questions are identified at agenda item 10.3.
 - c. Stakeholders to target and suggestions for how best to engage with this audience as outlined in agenda item 10.4.
 - d. Any other suggestions on what or where it would be useful to gather information.

Material Presented

Agenda item 10.1	Board Meeting Summary Paper
Agenda item 10.2	Information sheet on joint project
Agenda item 10.3	Possible questions to pose and target audience
Agenda item 10.4	Stakeholder engagement plan

Report on the Key audit matters

Project background

In 2017 the FMA and the External Reporting Board (XRB) issued a report on the introductions of Key Audit Matters (KAM). This report gave insight in the use of KAM for listed entities and also provide additional information about other information in audit reports and the level of qualified audit reports.

From 31 December 2018 KAM are required for all FMC reporting entities consider to have a higher public accountability. This has resulted that audit reports of all registered banks, finance companies and insurance companies but not limited will include KAM as well.

The joined report intends to provide an update of our initial report publish in November 2018 “Key audit matters- A stock take of the first year in New Zealand” but also providing an overview of the first year of implementation of the standard for additional entities for which the standard applies. We are intending the issue the report at the end of February 2020.

Intended scope for the report

- All NZX listed entities for the year-end 30 September 2018 until 30th of June 2019.
- All registered Banks and Insurance companies year-ends 31 December 2018 until 30th of September 2019.
- We will review a couple of industries that have entities with higher public accountability such as Kiwisaver; funds; forestry and Property schemes to understand if there is any theme coming from those reports (approx. 10 for each)
- In addition we will analyse the auditor report of 20 large FMC reporting entities with higher public accountability

Content of the report

The report will aim to contain the following information:

- Statement by CEO's of the XRB and FMA
- Information to support stakeholders to understand the audit opinion and the various components within the audit opinion. This content could be included later in the FMA website as an educational material. This section should provide an investor with the necessary knowledge to understand the report without the need to review our previous report.
- Reported Key Audit Matters for the various categories such as listed entities but specific information about industries such as banking and insurance.
- Provide additional information about the views of various stakeholders on the introduction of Key Audit Matters

Roles and responsibilities

In conjunction with the XRB the tasks and responsibilities are split as follows:

FMA:

- Gathering and analysing the data from the audit reports of entities listed in the above section
- Design and layout of the report
- manage the relationship with media about the report stakeholders

XRB:

- Engage with various stake holders
- Provide the draft content for the report
- Distribution of the report among key stakeholders of the XRB

Staff involvement

Staff	Organisation	Role
Sabina Buza	FMA (Auditor Oversight)	Project leader and coordinator
Jacco Moison	FMA (Manager Auditor Oversight)	Peer quality reviewer
Contracted University student	FMA	Gathering data
Amy Jones	FMA (Manager Publications)	Editing and preparing layout of report
Andrew Park	FMA (Manager External Comm)	Promoting the report to appropriate stakeholders
Misha Pieters	XRB (Senior Project Manager)	Gathering feedbacks from users and stakeholders.
Sylvia van Dyk	XRB (Director – Assurance Standards)	Peer quality reviewer

Budgeting

FMA will bear the internal cost of staff involvement; student cost for collecting the data and any other cost associated with promoting the report to intended users.

FMA does not intend to produce any printed copy of the report and if any of the party desire to do so, they will bear the cost associated with the printing

Timeline

FMA

Time	Objectives
September 2019	<ul style="list-style-type: none">FMA will provide a project summary and the excel spreadsheet template for the data gathering to XRB.Draft Layout of the report agreed with Communication team
Mid October 2019:	<ul style="list-style-type: none">XRB to provide feedback and suggestionsFMA to prepare a draft report layout
November 2019	<ul style="list-style-type: none">2 weeks start collecting the data2 weeks data quality checks and analysis
December 2019	<ul style="list-style-type: none">First draft of the data analysis and graphsFirst draft of the report to Communication team
January 2019	<ul style="list-style-type: none">Second draft of the report to Communication team

XRB

Time	Objectives
November 2019	<ul style="list-style-type: none">Conducting interviews with users and stakeholders
December 2019	<ul style="list-style-type: none">Provide the first draft of the summary of the discussions and findings to FMA

Agenda 10.3

Questions for follow up auditor reporting survey

First question to identify who you are and separate Listed entities from FMC HLP. All questions should allow for open comments.

Question	Investor ¹	Regulators ²	TCWG ³	Management	Practitioners
General					
Has the new structure of the auditor's report improved its communicative value? Not at all A little Is an improvement Is a significant improvement	x	x	x	x	x
How useful do you find the disclosure of the name of the engagement partner? Not at all A little Useful Very useful	x	x	x	x	x
How useful would you find disclosure of the number of years for which the audit firm has been engaged as auditor? Not at all A little Useful Very useful	x	x	x	x	x
How useful would you find additional information on the fees earned by the audit firm, in the auditor's report? Not at all A little Useful Very useful	x	x	x	x	x
Do you ever read the full description of the auditor's responsibilities by clicking the link to the XRB website included in the auditor's report? Yes No	x	x	x	x	
KAMs					
How has the reporting of KAMs impacted on the interaction between TCWG, management and the auditors? Not at all A little Insightful and Useful Very insightful and useful			x	x	x
How insightful and useful do you find the KAMs included in the audit report? Not at all A little Insightful and Useful Very insightful and useful	x	x	x	x	x
Has the communication of KAMs met your expectations? Below expectation Met expectation Exceeded expectation	x	x	x	x	x
Do you find the reporting of KAMs to be boilerplate? Yes very A little No, KAMs are generally differentiated No, not at all					
Has the communication of KAMs increased your confidence in the audit process?					

¹ NZCGF, Shareholders association, INFENZ

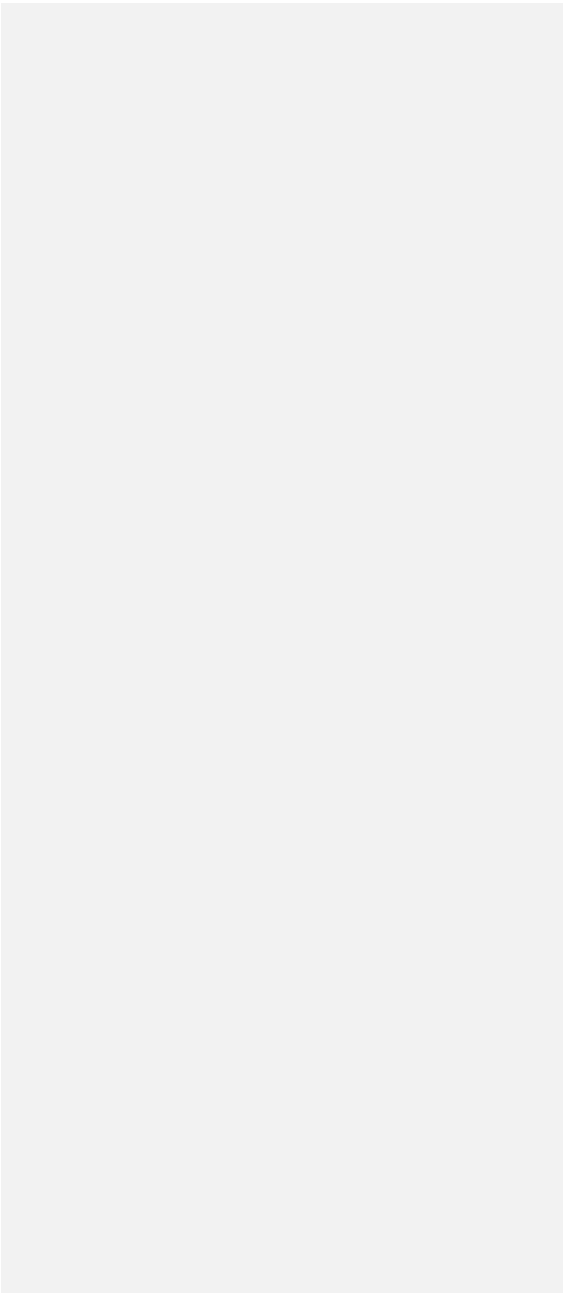
² Reserve Bank, FMA

³ IOD

Commented [MP1]: Three key areas tried to draw out and explore the need for more transparency in the report:
-Independence
-Going concern (following UK changes)
-Fraud

Question	Investor ¹	Regulators ²	TCWG ³	Management	Practitioners
Not at all A little Yes Significantly					
What additional information would you find useful? <ul style="list-style-type: none"> • Disclosure of outcomes of procedures • Scope of audit • Materiality • Other (please describe) (Open question) 	x	x	x	x	x
Please provide examples of auditor's reports you found especially useful and why you found them useful.	x	x	x	x	x
Where relevant, how useful is it to include a separate section related to a material uncertainty related to going concern? Not at all A little Insightful and Useful Very insightful and useful	x	x	x	x	x
How useful would you find a separate and clear, positive conclusion by the auditor on whether management's assessment on going concern is appropriate, and to set out the work they have done in this respect? Not at all A little Insightful and Useful Very insightful and useful	x	x	x	x	x
How useful would you find a separate and clear description of the risks of material misstatement due to fraud identified by the auditor and the auditor's responses and findings?	x	x	x	x	x
What additional improvements to the auditor's report would you recommend?	x	x	x	x	x
What implementation challenges arose and how did you respond? (Open question)		x	x	x	x
Was all of the other information available/provided by the date of the auditor's report? None Partial All			x	x	x
How useful do you find the other information section of the auditor's report? Not at all A little Insightful and Useful Very insightful and useful	x	x	x	x	x
What implementation challenges arose in dealing with Other Information and how did you respond? (Open question)		x	x	x	x

ASK FMA to analyse the data in the OI section - Does the OI section describe the OI in detail (i.e. the components that make it up) or generally to the annual report?



Follow up review of auditor reporting stakeholder engagement plan

Request XRB board members, XRAP and NZASB members to participate in online survey.

Users (investors)

	Contact	Approach
Shareholders association	Martin Watson/Mathew Underwood	Encourage participation in online survey
INFINZ	Jim McElwain	
Garth Ireland		
Andy Bowley		
David Wallace		
Blair Cooper		
Clyde D'Souza		

Regulators

Reserve Bank		Mini-roundtable discussion or Participate in online survey
CAANZ		
Auditor-General		
NZX		

Management

Richard Smyth		Encourage participation in online survey. Possible online "roundtable" to share views?
Stuart Tabuteau		
Richard Perry		
Peter Gudsell		
Julia Fink		
Fergus Welsh		
Francis Caetano		
Karl Hickey		

Those Charged with governance

Institute of Directors	Felicity Caird	Encourage participation in online survey Possible to attend events and use polling during presentation
NZCGF	Katie Beith	Encourage participation in online survey Possible to attend events and use polling during presentation
James Ogden		
Alan Isaac		
Jane Taylor		
Annabel Cotton		
Julia Hoare		
Carol Campbell		
Jacqueline Robertson Cheyne		

Practitioners

Practitioner contacts at all big and medium sized firms (cover all licensed auditors)		Hold online interactive webinars with polling and the option to provide additional feedback by comments or even unmute participants if they wish to make any comments. (This may be more efficient than one on one interviews with practitioners). Practitioner members on the board asked to encourage participation by partners at their firms.
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NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO. 11.1
Meeting date: 24 October 2019
Subject: Amendment to ISA (NZ) 560
Date: 7 October 2019
Prepared By: Sharon Walker

☒ **Action Required**

☐ **For Information Purposes Only**

Agenda Item Objectives

1. For the Board to consider the proposed amendments to ISA (NZ) 560 to address issues raised by the FMA about subsequent events impacting on the auditor's opinion.

Background

2. At its July 2019 meeting the Board considered a request by the FMA to review the existing requirement of our standards in relation to situations where, subsequent to issuing the audit opinion, the audit is found to have been either incorrect or the evidence no longer supports the opinion.
3. The Board agreed to:
 - Add a timeframe of 'within a reasonable period' to clarify when the auditor should discuss the matter with management, but to avoid the use of language such as 'immediately' or 'as soon as possible' which may have unintended consequences.
 - To add some more guidance about possible steps the auditor could take to prevent reliance on the auditor's report.
4. The Board did not consider it appropriate to include a requirement to for the auditor to report to the FMA as soon as possible if the audit firm becomes aware of issues with the current audit opinion. The standard already notes that the auditor's action depends on the auditor's legal rights and obligations. Including such a reporting requirement may have unintended consequences.
5. The compelling reason test template has been completed and is included at agenda item 9.2. We believe the compelling reason test has been met.

Recommendation

6. We recommend that the Board approve the draft ITC and exposure draft. Given the nature of the proposed changes we consider 30 days to be an appropriate comment period.¹

Material Presented

Agenda item 11.1	Board Meeting Summary Paper
Agenda item 11.2	Subsequent Events – compelling reason test
Agenda item 11.3	Draft ITC and exposure draft – subsequent events

¹ Explanatory Guide Au2, *Overview of the Auditing and Assurance Standard Setting Process*, paragraph 32, indicates shorter comment periods are used only for urgent or minor matters and will never be less than 30 days.

Proposed Modification to the International Standard on Auditing 560	
Proposed modification Amendment to ISA (NZ) 560, <i>Subsequent Events</i>, <ul style="list-style-type: none"> Paragraph 14 is amended and replaced with NZ14.1 to clarify the timing of the communication with management and those charged with governance Paragraph NZ A20.1 is added to provide guidance of actions the auditor may consider appropriate to seek to take to prevent reliance on the auditor's report. 	
Rationale for the proposed modification	
The international standard is not consistent with NZ regulatory arrangements.	n/a
OR	
The international standard does not reflect, or is not consistent with, principles and practices that are considered appropriate in NZ	Concerns have been raised by the regulator about the timeliness of communications to inform users of the financial statements that they can no longer rely on the audit opinion and the practical difficulties auditors face about how to inform users. The proposed modification seeks to clarify the timing of the communication and provide guidance as to actions the auditor may take to seek to prevent reliance on the auditor's report.
A. Consideration of Compelling reason criteria where the international standard is not consistent with New Zealand regulatory requirements.	
<u>Compelling reason criteria as per agreed Principles of Convergence</u>	<u>Consideration whether the proposed modification meets the criteria</u>
The standard can be modified so as to result in a standard the application of which results in effective and efficient compliance with the legal framework in NZ.	n/a
The modification does not result in a standard that conflicts with, or results in lesser requirements than the international standard.	n/a
B. Consideration of Compelling reason criteria where the international standard does not reflect principles and practices that are considered appropriate in New Zealand.	
<u>Compelling reason criteria as per agreed Principles of Convergence</u>	<u>Consideration whether the proposed modification meets the criteria</u>

1. The application of the proposed modification will result in compliance with principles and practices considered appropriate by the NZAuASB	The proposed modification is consistent with the extant requirement and provides guidance on how to comply with the requirement.
2. The proposed modification results in a standard that is clear and promotes consistent application by all practitioners. <i>(For example, excluding options not relevant in NZ and Australia)</i>	The proposed modification provides clear guidance to the NZ auditor by clarifying possible actions the auditor could take to seek to prevent reliance on the auditor's report, thereby promoting consistent application.
3. The proposed modification will promote significant improvement in audit quality in New Zealand <i>(With improvement in audit quality being linked to one or more of the Applicable elements in the IAASB's Framework for Audit Quality)</i>	The proposed modification provides clear guidance to the NZ auditor by clarifying the timing of communications and possible actions the practitioner could take to seek to prevent reliance on the auditor's report, thereby promoting audit quality.
4. The relative benefits of modification outweigh the cost (with cost being compliance cost and the cost of differing from the international standard, and benefit relating to audit quality).	Cost implications are expected to be minimal as the proposed amendment is a clarification of the extant requirement.
5. The proposed modification does not conflict with or result in lesser requirements than the international standard.	The proposed modification clarifies the timing of the communication required by the international standard and provides guidance on the actions the auditor may take to seek to prevent reliance on the auditor's report. The proposals do not conflict with or result in lesser requirements than the international standard.
6. The proposed modification overall does not result in the standard being overly complex and confusing.	The proposed modification clarifies the timing of the communication required by the international standard and provides guidance on the actions the auditor may take to seek to prevent reliance on the auditor's report. We believe the proposals clarify the intent of the standard.
7. The proposed modification does not inadvertently change the meaning of the ISA wording by placing more onerous requirements on a practitioner in NZ than necessary to meet the intent of the ISA.	The proposed modification clarifies the timing of the communication required by the international standard and provides guidance on the actions the auditor may take to seek to prevent reliance on the auditor's report. We do not believe the modification inadvertently changes the meaning of the ISA or places more onerous requirements on the NZ auditor. Rather, it is a clarification of the extant requirements.
Conclusion	Compelling reason test met.



NZ AUDITING
AND ASSURANCE
STANDARDS BOARD

EXPOSURE DRAFT

**AMENDMENTS: ISA (NZ) 560 SUBSEQUENT
EVENTS**

ED NZAuASB 2019-3

Invitation to Comment

November 2019

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Information for Respondents

Invitation to Comment

The New Zealand Auditing and Assurance Standards Board (NZAuASB)¹ is seeking comments on the specific matters raised in this Invitation to Comment. We will consider all comments before finalising *Amendments: ISA (NZ) 560 Subsequent Events*.

If you want to comment, please supplement your opinions with detailed comments, whether supportive or critical of the proposals, as both supportive and critical comments are essential to a balanced view.

Comments are most useful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for an alternative. Feel free to provide comments only for those questions or issues that are relevant to you.

Comments should be submitted electronically using our 'Open for comment' page at

[\[insert link\]](#)

The closing date for submissions is [\[date\]](#)

Publication of Submissions, the Official Information Act and the Privacy Act

We intend publishing all submissions on the XRB website (xrb.govt.nz), unless the submission may be defamatory. If you have any objection to publication of your submission, we will not publish it on the internet. However, it will remain subject to the Official Information Act 1982 and may, therefore, be released in part or full. The Privacy Act 1993 also applies.

If you have an objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission be withheld, and the grounds under the Official Information Act 1982 for doing so (e.g. that it would be likely to unfairly prejudice the commercial position of the person providing the information).

¹ The NZAuASB is a sub-Board of the External Reporting Board and is responsible for setting auditing and assurance standards.

List of Abbreviations

The following abbreviations are used in this Invitation to Comment.

ED	Exposure Draft
ISAs (NZ)	International Standards on Auditing (New Zealand)
ITC	Invitation to comment
NZAuASB	New Zealand Auditing and Assurance Standards Board
XRB	External Reporting Board

Summary of Questions for Respondents

1. Do you agree with the proposed amendment to ISA (NZ) 560, *Subsequent Events*, to clarify the responsibility of the auditor when facts become known to the auditor after the financial statements (and related auditor's report) have been issued?
2. Do you have any other comments on ED NZAuASB 2019-3 *Amendments: ISA (NZ) 560 Subsequent Events* (please be specific)?
3. Do you agree with the proposed effective date? If not, please explain why not.

1. Introduction

1.1 Purpose of this Invitation to Comment

1. The purpose of this Invitation to Comment is to seek feedback on the proposed amendment to ISA (NZ) 560, *Subsequent Events*.

1.2 Reasons for Issuing this Exposure Draft

2. Concerns have been raised with the XRB about how to ensure that investors and other stakeholders are informed in a timely manner that they cannot rely on the audit opinion, when a fact becomes known to the auditor after the financial statements have been issued that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report. This is important for all stakeholders in the financial reporting chain. It is in the public interest for the market and investors or other stakeholders to be informed in a timely manner that they can no longer rely on the audit opinion.
3. ISA (NZ) 560 deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements. Paragraphs 14-17 of ISA (NZ) 560, and related application material, deal with circumstances when a fact becomes known to the auditor after the financial statements have been issued that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report.
4. There are practical difficulties that auditors face about how to inform users of the financial statements that they cannot rely on the auditor opinion attached to the financial statements. Accordingly, the NZAuASB proposes to amend ISA (NZ) 560 to add guidance about possible steps the auditor could take to prevent reliance on the auditor's report.

1.3 Timeline and Next Steps

5. Submissions on ED 2019-3 are due by **date**. Information on how to make submissions is provided on page 4 of this Invitation to Comment.
6. The NZAuASB will consider the submissions received immediately after the consultation period ends. Subject to the content of that feedback, the NZAuASB expects to issue the *Standard Amendment: ISA (NZ) 560 Subsequent Events* in early 2020.
7. The effective date for the final conforming amendments is a matter for the NZAuASB to determine. However, it is anticipated that, given the limited nature of the proposed amendments, the amendments can go into effect almost immediately.

2. Overview of Exposure Draft *Amendment: ISA (NZ) 560 Subsequent Events*

2.1 Matters Addressed in this Exposure Draft

8. The exposure draft proposes amendments to ISA (NZ) 560 to clarify the timing of and possible actions the auditor may take when facts become known to the auditor after the financial statements have been issued that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report.
9. There are practical difficulties that auditors face about how to inform users of the financial statements that they cannot rely on the auditor opinion attached to the financial statements. Accordingly, the NZAuASB proposes to amend ISA (NZ) 560 to add guidance about possible steps the auditor could take to prevent reliance on the auditor's report.

Questions for Respondents

- | |
|---|
| <ol style="list-style-type: none">1. Do you agree with the proposed amendment to ISA (NZ) 560, <i>Subsequent Events</i>, to clarify the responsibility of the auditor when facts become known to the auditor after the financial statements (and related auditor's report) have been issued?2. Do you have any other comments on ED NZAuASB 2019-3 <i>Amendments: ISA (NZ) 560 Subsequent Events</i> (please be specific)? |
|---|

2.3 Effective Date

10. The NZAuASB does not consider that a lengthy transition period is required given the extent of the change is limited in nature.

Questions for Respondents

- | |
|--|
| <ol style="list-style-type: none">3. Do you agree that a lengthy transition period is not required given the limited nature of the proposed changes? If not, please explain why not. |
|--|

EXPOSURE DRAFT NZAuASB 2019-3
Amendment: ISA (NZ) 560 Subsequent Events

CONTENTS

A: INTRODUCTION

B: PROPOSED AMENDMENTS TO ISA (NZ) 560

C: EFFECTIVE DATE

A: INTRODUCTION

This document sets out proposed amendments to ISA (NZ) 560, *Subsequent Events*.

Amended paragraphs are shown with new text underlined and deleted text struck through.

The footnote numbers within these amendments do not align with the ISAs (NZ) and reference should be made to those ISAs (NZ).

DRAFT

B: Proposed Amendments to International Standard on Auditing (New Zealand) 560

To clarify when the auditor should discuss the matter with management and, where appropriate, those charged with governance, paragraph 14 is amended and replaced with paragraph NZ 14.1. Paragraph NZ A20.1 is added to provide guidance of actions the auditor may consider appropriate to take to seek to prevent reliance on the auditor's report.

Requirements

...

Facts Which Become Known to the Auditor after the Financial Statements Have Been Issued

14. *Amended by the NZAuASB*

NZ 14.1 After the financial statements have been issued, the auditor has no obligation to perform any audit procedures regarding such financial statements. However, if, after the financial statements have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall: **(Ref: Para. A18)**

- (a) Discuss the matter with management and, where appropriate, those charged with governance within a reasonable period of time;
 - (a) Determine whether the financial statements need amendment; and, if so,
 - (b) Enquire how management intends to address the matter in the financial statements.
15. If management amends the financial statements, the auditor shall: **(Ref: Para. A19)**
- (a) Carry out the audit procedures necessary in the circumstances on the amendment.
 - (b) Review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation.
 - (c) Unless the circumstances in paragraph 12 apply:
 - (i) Extend the audit procedures referred to in paragraphs 6 and 7 to the date of the new auditor's report and date the new auditor's report no earlier than the date of approval of the amended financial statements; and
 - (ii) Provide a new auditor's report on the amended financial statements.
 - (d) When the circumstances in paragraph 12 apply, amend the auditor's report or provide a new auditor's report as required by paragraph 12.
16. The auditor shall include in the new or amended auditor's report an Emphasis of Matter paragraph or Other Matter(s) paragraph referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report provided by the auditor.

17. If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and does not amend the financial statements in circumstances where the auditor believes they need to be amended, the auditor shall notify management and, unless all of those charged with governance are involved in managing the entity², those charged with governance that the auditor will seek to prevent future reliance on the auditor's report. If, despite such notification, management or those charged with governance do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report. (Ref: Para. A20-NZ A20.1)

Application and Other Explanatory Material

...

Facts Which Become Known to the Auditor after the Financial Statements Have Been Issued

Implications of Other Information Received after the Financial Statements Have Been Issued (Ref: Para. 14)

- A18. The auditor's obligations regarding other information received after the date of the auditor's report are addressed in ISA (NZ) 720 (Revised). While the auditor has no obligation to perform any audit procedures regarding the financial statements after the financial statements have been issued, ISA (NZ) 720 (Revised) contains requirements and guidance with respect to other information obtained after the date of the auditor's report.

No Amendment of Financial Statements by Management (Ref: Para. 15)

Considerations Specific to Public Sector Entities

- A19. In some jurisdictions, entities in the public sector may be prohibited from issuing amended financial statements by law or regulation. In such circumstances, the appropriate course of action for the auditor may be to report to the appropriate statutory body.³

Auditor Action to Seek to Prevent Reliance on Auditor's Report (Ref: Para. 17)

- A20. Where the auditor believes that management, or those charged with governance, have failed to take the necessary steps to prevent reliance on the auditor's report on financial statements previously issued by the entity despite the auditor's prior notification that the auditor will take action to seek to prevent such reliance, the auditor's course of action depends upon the auditor's legal rights and obligations. Consequently, the auditor may consider it appropriate to seek legal advice.

NZ A20.1 Unless legal advice obtained recommends a different course of action, possible actions the auditor may consider include:

- (a) Notifying management and those charged with governance that the auditor's report must no longer be associated with the financial statements;
- (b) Notifying the regulatory agencies having jurisdiction over the entity that the auditor's report should no longer be relied upon, and requesting the regulatory agency to take

² ISA 260, "Communication with Those Charged with Governance," paragraph 13.

³ This is unlikely to be the case in New Zealand.

- whatever steps it may deem appropriate to provide appropriate disclosure.
- (c) If practicable, notifying each person known to the auditor to be relying on the financial statements that the auditor's report should no longer be relied upon.

D. Effective Date

The effective date for the final amendments is a matter for the NZAuASB to determine. However, it is anticipated that, given the limited nature of the amendments proposed, the amendments can go into effect almost immediately.

DRAFT



NZ AUDITING
AND ASSURANCE
STANDARDS BOARD

DATE: 11 October 2019

TO: Members of the New Zealand Auditing and Assurance Standards Board

FROM: Peyman Momenan

SUBJECT: International Update

Introduction

1. This Update summarises the significant news of the IAASB, other national auditing standards-setting bodies and professional organisations for the Board's information, for September and first quarter of October 2019.

International Federation of Accountants (IFAC)

1. A global alliance of accounting organisations has found that firms that offer both audit and non-audit services are best positioned to deliver robust and reliable assurance.

The report published today by Chartered Accountants Australia and New Zealand (CA ANZ), the Association of Chartered Certified Accountants (ACCA) and the International Federation of Accountants (IFAC) provides compelling evidence that “the presence of multidisciplinary firms in a large and evolving corporate reporting system fills a valuable market need” and simultaneously commends how the rules that have evolved over the past two decades “mitigate risks associated with audit firms providing non-audit services to some audit clients.”

The report, [*Audit Quality in a Multidisciplinary Firm*](#), draws its findings from leading academic literature, views of policy experts, and an in-depth study of how regulators worldwide manage risk. It is meant to contribute constructively to the international debate on the multidisciplinary firm business model and auditors providing non-audit services.

The report notes that high quality audits require “a diverse skill base” and that “the multidisciplinary model is one of the best mechanisms to develop the skills, expertise and consistency needed for quality audits.”

The narrower issue of providing non-audit services to audit clients is more nuanced. The report notes, “There continues to be concern that independence is compromised in doing so, in spite of strict rules that prohibit or restrict firms from providing such services to audit clients. “Services that are permitted quite often are complementary to the audit, and threats to independence can be effectively mitigated. However, demonstrating to the public that perceived conflicts of interest are being appropriately managed is challenging.”

The report continues: “As this issue continues to be considered, it is important to remember that evidence cited in this paper calls into question the need for sweeping regulatory changes that could

have unintended consequences on audit quality” and notes that “the vast majority of non-audit fees actually come from clients for whom firms do not provide audit services.”

International Auditing and Assurance Standards Board (IAASB)

1. The IAASB Ongoing projects (refer to appendix 1)

International Ethics Standards Board for Accountants (IESBA)

1. There have been no significant developments related to audit and assurance to report in the period.

Accountancy Europe (AE) (former FEE)

1. Key audit matters (KAMs) are the most significant risks in the audit of financial statements. They have the biggest impact on overall strategy and the allocation of resources in an audit. KAMs are communicated by the auditor in their report. Reporting on KAMs opens the way for more transparent and meaningful audits, this benefits users and stakeholders, at large.

For the second year in a row, Accountancy Europe has performed a [survey on the auditor's reporting of KAMs in the European banking sector](#). The survey aims to examine the additional value that KAMs reporting has for the auditor's report and to see if there are any emerging trends or significant changes from the previous year.

Our survey provides insights and conclusions on the auditor's reporting of KAMs for more than 60 European banks, which own the vast majority of the assets in the European banking sector. This year, we focus on the number and types of KAMs that are being reported. Even though it is still early days of reporting on KAMs, the key risks in the banking sector seem to be relatively consistent across Europe.

Public Interest Oversight Board of IFAC (PIOB)

1. There have been no significant developments related to audit and assurance to report in the period.

International Integrated Reporting Council (IIRC)

1. There have been no significant developments related to audit and assurance to report in the period.

Global Reporting Initiative (GRI)

1. The Corporate Reporting Dialogue (CRD) – an initiative bringing together the major standard setters and framework providers globally – [released a report today](#) showing high levels of alignment between the frameworks on the basis of the Task Force on Climate-related Financial Disclosures (TCFD) recommendations.

As part of the Dialogue's Better Alignment Project, CDP, the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB) collaborated intensively to assess alignment on the TCFD's disclosure principles, recommended disclosures and illustrative example metrics. .

International Forum of Independent Audit Regulators (IFIAR)

1. IFIAR has published [its comment letter](#) on the IAASB's project exploring the possible options to address the challenges in applying the ISAs in audits of less complex entities.

International Organization of Supreme Audit Institutions (INTOSAI)

1. There have been no significant developments related to audit and assurance to report in the period.

International Organization of Securities Commissions (IOSCO)

1. There have been no significant developments related to audit and assurance to report in the period.

Australia

The Australian Auditing and Assurance Standards Board (AUASB)

1. The AUASB meeting welcomed the Chair of the Financial Reporting Council, Bill Edge, for a discussion on the AUASB's planned submission to the Parliamentary Inquiry into the Regulation of Auditing in Australia. The AUASB confirmed its support for all activities that promote continuous improvement in audit quality, transparency and profession conduct across the auditing profession, and is looking forward to making a valuable contribution to this inquiry.
2. The AUASB were informed about, and discussed, the key matters on the IAASB's September 2019 Agenda, being:
 - ISA 315 Identifying and Assessing the Risks of Material Misstatement which is being presented at the IAASB September 2019 meeting for approval as a standard. The AUASB generally considered that the significant matters raised in its submission to the IAASB on ED 315 had been substantially addressed, however provided feedback on draft ISA 315 to Roger Simnett to consider in his capacity as an IAASB member. The key areas of feedback from the AUASB will also be provided directly to the IAASB's ISA 315 Task Force prior to the IAASB September 2019 meeting.
 - An update on ISA 600 Group Audits, particularly in the areas of special considerations in a group audit; access; materiality; and stand back requirements. The AUASB supported the direction that the ISA 600 Task Force was taking and supported the need for additional guidance on component materiality.
 - The feedback received from respondents to the IAASB ED on ISQM 1 Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements; and updated the AUASB as to the Task Force's proposed way forward and revised timelines. The AUASB Audit Technical Group noted that the feedback received by the IAASB from respondents was largely aligned with the AUASB submission on ED-ISQM 1, with the main areas of concern focusing around scalability and prescriptiveness. The AUASB noted that the IAASB ISQM 1 Task Force was considering a new standard (potentially to be known as 'ISQM 3') to apply specifically to related services engagements, that way aiding in the scalability aspects of ISQM 1. The AUASB did not support this suggestion as the AUASB considers that ISQM 1 should be scalable enough to cover related services engagements.

The other topics discussed by the AUASB as part of its review of September 2019 IAASB Papers were ISQM 2, ISA 220, Extended External Reporting and the IAASB Strategy.

3. The AUASB and the NZAuASB are working together to update ASRE 2410 Review of a Financial Report Performed by the Auditor of the Entity to align the format and content of the auditor's review report, with the enhanced annual auditor's report, as relevant to a limited assurance engagement. The AUASB and the NZAuASB have alternate views on how to describe, in the auditor's review report, the auditor's responsibility relating to going concern. The AUASB considered the alternate descriptions as well as feedback received from stakeholders on this matter. The AUASB's view is consistent with feedback from its stakeholders, that the NZAuASB's description was not consistent with the existing requirements in ASRE 2410. The AUASB will now wait for the NZAuASB to receive feedback from their stakeholders and reconsider this matter. The AUASB discussed the importance of the AUASB and the NZAuASB continuing to work together to arrive at a mutually acceptable position on this issue.

4. The AUASB was presented with a Project Plan outlining three publications covering assurance basics, guidance for prescribers of assurance and other assurance. The AUASB were supportive of the publications and provided feedback on the content of each publication as well as the proposed timeframe for completion.
5. The AUASB discussed and approved the submission to the IAASB's Discussion Paper on Audits of Less Complex Entities. The AUASB was pleased with the level of engagement on the topic through the AUASB's survey.
6. The AUASB reviewed and provided feedback on the Guidance Statement Revision Discussion Paper developed by the AUASB Technical Group. This Discussion Paper is designed to capture stakeholders' views identifying whether relevant legislation / regulation or relevant standards had changed and therefore which GSs required update or withdrawal. The Discussion Paper and a related survey will be made available in October 2019.
7. The AUASB considered and discussed the progress of the GS 005 Using the Work of a Management's Expert project. The AUASB provided input into the way forward to progress the finalisation of GS 005 which the Audit Technical Group aims to bring to the December 2019 AUASB meeting for approval to issue.

United Kingdom

FRC

1. New research supports the Financial Reporting Council (FRC) taking firmer action to hold companies to account. Participants in a series of 'citizens' juries' believed the FRC should have more "power" and "teeth" to hold companies to account, but any increase in regulation should not stifle companies' ability to operate and flourish.

[The independent research](#), conducted on behalf of the FRC by BritainThinks, involved in-depth research with members of the public across the country.

2. The Financial Reporting Council (FRC) has issued a [revised going concern standard](#) in response to recent Enforcement cases and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after.

The revised standard (ISA UK 570 Going Concern) follows concerns about the quality and rigour of audit and increases the work auditors are required to do when assessing whether an entity is a going concern. It means UK auditors will follow significantly stronger requirements than those required by current international standards.

The FRC hopes that UK experience will lead to further strengthening of requirements at the international level.

The revised standard requires:

- greater work on the part of the auditor to more robustly challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence, evaluate the risk of management bias, and make greater use of the viability statement;
 - improved transparency with a new reporting requirement for the auditor of public interest entities, listed and large private companies to provide a clear, positive conclusion on whether management's assessment is appropriate, and to set out the work they have done in this respect; and
 - a stand back requirement to consider all of the evidence obtained, whether corroborative or contradictory, when the auditor draws their conclusions on going concern.
3. Transparency reporting by accountancy firms performing audits is currently ineffective with a lack of awareness amongst investors and Audit Committee Chairs that the reports even exist and many being used as a marketing exercise, according to a review from the Financial Reporting Council (FRC).

While mandatory Transparency Reports broadly contain the required information, for those aware of the reports, there is a view they are too long and overly positive to be useful. The FRC is concerned that many firms treat the reports wrongly as a marketing tool which damages their perception among stakeholders and limits their usefulness.

Other findings of the review include:

- 84% of Audit Committee Chairs were not even aware of Transparency Reports
- 15% of reports were not found on firms' websites
- five of the 33 firms reviewed did not prepare a report at all.

The FRC is calling on firms to reduce the length of their Transparency Reports and explain within them the challenges they are facing in seeking to deliver consistently high-quality audits, along with their assessment of how successful they are being at meeting those challenges.

Sitting alongside the reports on audit quality that the FRC publishes, Transparency Reports by the firms should provide stakeholders with important information about each firm's quality processes and initiatives to improve audit quality.

Institute of Chartered Accountants in England and Wales

1. The BEIS consultation on the Competition and Market Authority's (CMA's) proposals for audit market reform in the FTSE350 has recently closed.

Not surprisingly most of the few responses made public mirror the original submissions to the CMA's own consultation on its provisional proposals earlier this year. Those seeking to resist real reform are faced with a challenge: the CMA has already considered their arguments ahead of its Final Report and, after a very thorough analysis, rejected them with only modest changes made. As evidenced by its rejection of the merger of two major supermarket groups, it is clear that the CMA is well able to withstand the heat of debate and form its views independently, without fear or favour.

In both its Update and Final Papers the CMA supported joint audit, with the later paper including some helpful modifications which address practical implementation issues. Joint audit lies at the heart of the CMA's cohesive package of reforms for the FTSE350 audit market. It is the one proposal that would allow challenger firms to build up a significant market share, thereby providing the justification for making the substantial investment necessary over a number of years, whilst also creating a vibrant new market capable of adapting to meet the changing needs of stakeholders and serving the public interest. For decades we have lived with an audit market resistant to change and with no new entrants to any meaningful extent.

(continue the article [here](#))

The Charity Commission

1. There have been no significant developments related to audit and assurance to report in the period.

Association of Chartered Certified Accountants (ACCA)

1. In response to the Department for Business, Energy and Industrial Skills' initial consultation on recommendations by the Competition and Markets Authority, Maggie McGhee, ACCA's executive director – governance, said:
'In assessing the remedies proposed by the Competition and Markets Authority (CMA), ACCA reiterates our long-held belief that any proposals must focus primarily on increasing audit quality. It is fundamental to investor and public confidence and the longevity of audit reform.
'ACCA is not supportive of the joint audit proposal in the CMA's interim study, and our position remains unchanged. The final proposal which requires FTSE 350 companies, with limited exceptions, to be jointly audited by at least two audit firms, with at least one being a non-Big Four firm, does not address the concerns that we raised in our initial response. 'There is an insufficient evidence base to demonstrate that the proposal will not be detrimental to audit quality - the evidence from academic research is mixed at best.

'ACCA recommends using the joint audit proposal for a five-year review of progress to trial, rather than mandate, recommendations in order to give an informed and balanced understanding of their viability.

'Our proposed interventions include a two-year "cooling-off" period following the end of an audit relationship during which the former audit firm is prohibited from selling services to the entity and considering a prohibition on management from firing their auditors during their terms of service.

'Ministers, including BEIS' new secretary of state Andrea Leadsom, should consider carefully the evidence base available in support of each suggestion, the related cost/benefit analysis, and the practicalities of implementation.

United States of America

Public Company Accounting Oversight Board (PCAOB)

1. There have been no significant developments related to audit and assurance to report in the period.

American Institute of Certified Public Accountants (AICPA)

2. The [American Institute of CPAs](#) (AICPA) has issued non-authoritative guidance in the form of a Practice Aid, [Allowance For Credit Losses – Audit Considerations](#), to assist auditors when communicating with management and audit committees on Financial Accounting Standards Board (FASB) (ASU) No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Statements*.

"This Practice Aid is intended to provide auditors with information that may help them improve the effectiveness and efficiency of their audits and practices," said Jason T. Brodmerkel, CPA, AICPA Senior Technical Manager, Accounting Standards and AICPA Depository Institutions Expert Panel. "It is based on existing professional literature, the experience of members of the AICPA Depository Institutions Expert Panel, the AICPA Insurance Expert Panel, and information from AICPA member firms."

Center for Audit Quality (CAQ) - (affiliated with AICPA)

1. Some important themes are emerging in auditors' reporting of critical audit matters, which are the key component of the biggest change to public company auditor reporting in 70 years. Goodwill and intangible assets, revenue, and income taxes were the most frequent topical areas reported identified in a summary of 52 audit reports of large accelerated filers analysed by Deloitte. Meanwhile, a sample of public company auditors' reports reviewed for the JofA showed that in reporting on critical audit matters, practitioners are providing detailed discussion of the audit procedures they performed and including cross-references to the related notes in the financial statements that are related to the critical audit matters. Critical audit matters provide auditors with an unprecedented opportunity to communicate in auditor's reports, and the first reports filed under the new PCAOB rules show that practitioners are providing a thorough and thoughtful approach to that communication.

The requirement to report on critical audit matters arose from the new auditor reporting standard adopted in June 2017. The standard requires additional disclosures about critical audit matters identified during the audit. This new standard, Auditing Standard 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion, requires the communication of critical audit matters in a separate section of the auditor's report. The report must include identification of the critical audit matters, why the auditor considered them "critical," the related accounts and financial statement disclosures, and how the matters were addressed during the audit. This reporting does not change the auditor's opinion, but it provides additional insights into the audit issues.

2. The percentage of US retail investors expressing confidence that public company auditors are effective in their investor protection roles has climbed to 83%, according to the 2019 [Main Street Investor Survey](#). The annual Center for Audit Quality (CAQ) poll captures the views of US retail investors with at least \$10,000 invested in the capital markets through retirement plans or direct holdings.

"Healthy investor confidence is critical at all levels, from the biggest asset managers to people saving in their 401(k)," said CAQ Executive Director Julie Bell Lindsay. "Our survey shows that retail investors in the US have healthy and consistent levels of confidence in both our capital markets system and in the public company auditing profession."

Fielded by Morning Consult from August 19 to August 22, 2019, the survey's key findings include the following:

- 74% of US investors express confidence in US capital markets, unchanged from 2018 levels.
- 76% of US investors have confidence in US companies that are publicly traded, down two points from 2018.
- 78% of US investors express confidence in audited financial statements, up three points from 2018.
- 47% of US investors have confidence in capital markets outside the US, down significantly from a level of 56% in 2018.

Other news from US:

1. A Non-GAAP financials can be described as the "numbers management talks about once the auditor leaves the room." Often described as "adjusted," "core," or "cash" earnings, these figures purport to give investors a cleaner view of a company's true operations before the subtraction of a whole host of pesky expenses required by generally accepted accounting principles (GAAP). Non-GAAP financials are not audited and are most often disclosed through earnings press releases and investor presentations, rather than in the company's annual report filed with the Securities and Exchange Commission.

Once upon a time, non-GAAP financials were used to isolate the impact of significant one-time events like a major restructuring or sizable acquisition. In recent years, they have become increasingly prevalent and prominent, used by both the shiniest new-economy IPO companies and the old-economy stalwarts.

An in-depth study by [Audit Analytics](#) revealed that 97% of companies in the S&P 500 used non-GAAP financials in 2017, up from 59% in 1996, while the average number of different non-GAAP metrics used per filing rose from 2.35 to 7.45 over two decades. That has led to a growing divergence between the earnings calculated according to accepted accounting principles and the "earnings" touted in press releases and analyst research reports.

(read the rest of the article [here](#))

2. The number of companies across the world who issue some form of sustainability report continues to increase. However, even as organizations place more emphasis on improving reporting quality related to the environmental and social impact of their business activities, little is known about whether assurance for these reports improves the quality, and whether accounting firm assurers improve that quality to a greater extent than nonaccounting firm assurers. "With investor attention on such information higher than ever, corporate sustainability reporting is ripe for the next phase of its evolution," said a 2018 report posted on the Harvard Law School Forum on Corporate Governance and Financial Regulation. [This article](#) provides a summary of insights on these issues based on an academic study we recently published in the *Journal of Accounting and Public Policy* ("Corporate Social Responsibility Assurance and Reporting Quality: Evidence From Restatements").

Canada

Canadian Auditing and Assurance Standards Board (AASB)

1. The AASB unanimously approved amendments to CAS 700, Forming an Opinion and Reporting on Financial Statements. CAS 700 will require auditors to communicate key audit matters in the auditor's report for audits of complete sets of general purpose financial statements of other listed entities for periods ending on or after December 15, 2022. This excludes listed entities required to comply with National Instrument 81-106, Investment Fund Continuous Disclosure.

The AASB concluded that the revisions to the standard are significantly different from the proposals issued in the Exposure Draft, "Communicating Key Audit Matters in the Auditor's Report." The Board decided not to re-expose the changes as they were based on the feedback received on the Exposure Draft.

Once the Auditing and Assurance Standards Oversight Council confirms that the AASB followed due process with proper regard for the public interest, the amendments will be included in the December 2019 Handbook update.

2. The AASB discussed the status of matters that caused the deferral of paragraph 46 of CAS 700. This paragraph relates to disclosure of the engagement partner name in certain audit reports. The Board concluded that deferring paragraph 46 served its purpose and the issues that led to the deferral have been resolved. Paragraph C5B will be removed from the CPA Canada Handbook – Assurance in December 2020.
3. The AASB discussed its draft response to the International Auditing and Assurance Standards Board's (IAASB) Discussion Paper, "Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs."
The Chair and Director will review the final letter prior to submission.
The AASB decided to form an Advisory Group to support staff and the Board on the Audits of Less Complex Entities project. The Advisory Group will help identify key issues related to audits of less complex entities in the Canadian environment and provide input to the AASB on proposals developed by the IAASB as this project evolves.
4. The AASB discussed its approach to responding to the IAASB's Exposure Draft on non-authoritative guidance related to Emerging External Reporting, expected to be issued in January 2020.
The AASB decided to form an Advisory Group to support staff and the Board in reviewing and responding to materials issued by the IAASB. The Advisory Group will help identify key issues related to the evolution of audit in response to environmental changes in Canada.

CPA Canada

1. There have been no significant developments related to audit and assurance to report in the period.

Project	Overview of the project and its current status
<p>Quality Control</p> <p>Has update for the period</p>	<p>Objective of the Project: Initial activities in scoping the project will focus on whether there is a need to revisit specific aspects of the quality control standards to enhance clarity and consistency of their application. This may include restructuring ISQC 1, additional requirements or guidance within the standard or additional guidance in support of the standard. Specific aspects within ISQC 1 and ISA 220 being explored include, governance, engagement partner responsibilities, engagement quality control reviews, monitoring, remediation, alternative audit delivery models and specific issues pertaining to small- and medium-sized practices</p> <p>Background and current status: The proposed changes to QC were included in the IAASB Audit Quality ITC. The ITC response period is closed now. From May to September 2016, the various Working Groups analysed the comment letters to the Overview and detailed ITC, reviewed feedback from outreach activities, and developed project proposals for quality control that were presented at the September 2016 IAASB meeting.</p> <p>The IAASB considered the Quality Control Other Working Group's (QCOWG) proposals in respect of:</p> <ul style="list-style-type: none"> • Setting the objective of an engagement quality control (EQC) Revising the definition of an EQC review; • Determining the scope of the engagements subject to an EQC review; and • The execution of an EQC review. <p>At its March 2017 meeting, the IAASB discussed matters to do with the eligibility of the engagement quality control reviewer.</p> <p>QC-Firm Level</p> <p>In June 2017 the Board discussed the Quality Control Task Force's (QCTF) recommendations on the possible revisions to ISQC 1, a result of incorporating a quality management approach (QMA) into ISQC 1, that included a discussion of a working draft of ISQC 1 (Revised) and how the proposals are expected to change firm behaviors. The Board was supportive of the overall direction proposed by the QCTF and emphasized the importance of outreach with a variety of stakeholders to seek input on the practicality of the proposals. The Board also encouraged the QCTF to develop guidance and examples to accompany the revised standard in order to explain the implementation and application of the standard.</p> <p>In its September 2017, the Board discussed the Quality Control Task Force's (QCTF) recommendations on the possible revisions to ISQC1 in relation to documentation of the system of quality management. The Board was supportive of the QCTF's proposals and suggested various refinements. Some of the key proposals were as follow:</p> <ul style="list-style-type: none"> • the proposal to retain the requirement for an EQC review for all audits of financial statements of listed entities, i.e., not only for general purpose financial statements

- the proposals in relation to other engagements for which the firm determines that an EQC review is required (see here for details)
- the objective of ISQC 2, including whether it is appropriate to locate the responsibilities of the EQC reviewer in ISQC 2, instead of ISA 220
- the IAASB supports the proposal to remove the reference to “team” from the definition of an EQC reviewer, and instead explain the use of a team in the application material supporting the appointment of the EQC reviewer
- the proposed requirements and application material in relation to the eligibility of the EQC reviewer.

The Board also discussed the QCTF's recommendations in relation to EQC reviews that would be incorporated in ISQC 1 and the proposed new standard, ISQC2. The Board confirmed that the purpose of the EQC review is to evaluate the significant judgments made by the engagement team. In addition to various recommendations to further enhance and clarify the various requirements and application material, the Board encouraged the QCTF to improve the robustness of the requirement relating to the scope of the engagements subject to EQC review.

In December 2017, the Board discussed a first read of the proposed exposure draft of ISQC 1 (Revised) 5 and was broadly supportive of the direction of the standard. The Board focused on the scalability of the standard, clarifying the interrelationship of the components, and the appropriate placement of the governance and leadership component. As well as requesting the Task Force to clarify the meaning of deficiencies and major deficiencies, the Board asked that a framework be developed for assessing deficiencies in the system of quality management and requested clarification of how such deficiencies may impact the achievement of the overall objective of the standard. The Board also asked the Task Force to reconsider the threshold for the identification of quality risks and encouraged the Task Force to explore the development of appropriate guidance to accompany the proposed exposure draft that addresses the application of the standard to a spectrum of firms.

The Board discussed the exposure draft (ED) of proposed ISQC 1 (Revised)1 and was supportive of the direction that the Quality Control Task Force was taking the standard, noting the improvement in the readability and understandability overall. The Board encouraged the Quality Control Task Force to consider whether there are further opportunities to address scalability, including further refinement and simplification of the standard, where possible. The Board also discussed changing the title of the standard

In finalizing the ED in December 2018, the Board discussed the definition of deficiencies and bringing more emphasis to positive findings from the firm's monitoring activities and how they may be used in the system of quality management. The Board also discussed the requirement for the firm to establish additional quality objectives beyond those required by the standard and further clarifying the identification and assessment of quality risks. In addition, the Board suggested further simplification of the requirement addressing communication with external parties, although in general agreed to retain an explicit reference to transparency reports in the requirement. The Board also discussed network requirements or network services, and

adjusted the requirement to clearly reflect the expectations of the firm regarding the effect of network requirements or network services on the firm's system of quality management.

The Board supported the Quality Control Task Force's recommendations regarding matters to be addressed in the Explanatory Memorandum, including the proposed questions.

Update for the period

In September 2019, the Board discussed the comment letters received on certain areas of the Exposure Draft (ED) of ISQM 1 (ED-ISQM 1)³ relating to the quality management approach, implementation challenges, the components and structure of the standard and the firm's risk assessment process. The Board concurred that four significant themes had emerged from the comments: scalability; prescriptiveness; addressing firms who do not perform audit or assurance engagements; and challenges with implementation. The Board, in general, supported proposals to address the structure of the standard and clarify the nature of the components and how they interrelate. The Board also supported addressing the granularity of the quality objectives, introducing quality risk considerations, and refining the required responses. The Board agreed with the ISQM 1 Task Force's proposals to simplify the firm's risk assessment process, including addressing concerns about the threshold for the identification of quality risks. The Board did not support the proposal to develop a separate standard for quality management for related services engagements and encouraged exploration of other ways to address scalability concerns. The ISQM 1 Task Force will take these comments into account in preparing revised drafting and issues for discussion at the December 2019 IAASB meeting.

Quality Control – Engagement Level

In December 2017, The IAASB supported the direction of the proposed changes to ISA 220.4 In particular, the Board supported the proposed changes that emphasize that the engagement partner is responsible and accountable for audit quality. The Board encouraged the ISA 220 Task Force to consider, as it progresses revisions to ISA 220, how the proposed changes will strengthen the performance of quality audits.

The Board discussed a draft ED of proposed ISA 220 (Revised)² and was supportive of the proposed changes. The discussions focused on whether changes were needed to the objective of the standard and the wording of the requirement regarding the engagement partner being "sufficiently and appropriately involved." The Task Force plans on presenting the ED of proposed ISA 220 (Revised) for approval by the Board at the December 2018 meeting.

In December 2018 the Board supported the requirement for the firm to establish policies or procedures addressing limitations on the engagement partner moving into the role of engagement quality reviewer, including the reference to a cooling-off period in the application material. The Board agreed

	<p>that stakeholder views were needed relating to the objectivity of the engagement quality reviewer and a cooling-off period and supported the ISQM 2 Task Force's recommendation for including specific questions in the Explanatory Memorandum on this matter to be developed in coordination with the IESBA. The Board also clarified the requirement for notifications by the engagement quality reviewer to the engagement partner and, when applicable, individual(s) within the firm, as well as the documentation requirements.</p> <p>The Board discussed the requirements that address firm policies or procedures, the role of the engagement partner vis-à-vis other members of the engagement team and the difference between the usages of the phrases "the auditor shall determine" and "the auditor shall be satisfied." The board also discussed how best to clarify the requirement addressing communications from the firm about the firm's monitoring and remediation process.</p> <p>Update for the period</p> <p>The Board discussed the comment letters received to ED-ISA 2205 and the ISA 220 Task Force's proposals for addressing the key issues respondents raised. The Board supported the fundamental principle that the engagement partner has overall responsibility for managing and achieving quality and being sufficiently and appropriately involved in the engagement. The Board also supported clarifying the requirement addressing circumstances when the engagement partner assigns procedures or tasks to other engagement team members, the principles underpinning the proposed engagement team definition and proposals to address scalability of the requirements to audits of larger or more complex entities. The ISA 220 Task Force will take these comments into account in preparing revised drafting and issues for discussion at the December 2019 IAASB meeting.</p>
<p>Group Audits– ISA 600</p> <p>Has update for the period</p>	<p>Objective of the project: Determining the nature of the IAASB's response to issues that have been identified, relating to Group Audits, from the ISA Implementation Monitoring project and outreach activities, inspection reports from audit regulators, discussion with NSS and responses to the IAASB's Work Plan consultation (i.e., whether standard-setting activities are appropriate to address the issues, and if so, whether specific enhancements within ISA 600 or a more holistic approach to the standard would be more appropriate).</p> <p>Background and current status: The IAASB commenced work on one aspect of this project relating to the responsibilities of the engagement partner in circumstances where the engagement partner is not located where the majority of the audit work is performed in December 2014. A Staff Audit Practice Alert on this aspect was published in August 2015. Information gathering on the broader aspects of group audits commenced in March 2015.</p> <p>The issues identified and discussed at the IAASB meetings form part of a combined Invitation to Comment on Enhancing Audit Quality in the public interest which was issued in December 2015 and is open for comments till May 16, 2016. The ITC is now closed. From May to September 2016, the various Working Groups analysed the comment letters to the Overview and detailed</p>

	<p>ITC, reviewed feedback from outreach activities, presented the results to IAASB at the September 2016 IAASB meeting.</p> <p>In its June 2017 meeting, the IAASB received an update on the activities of the GATF. The IAASB supported the proposal of the GATF to engage more directly with the QCTF, ISA 220 TF and ISA 315 (Revised)³ TF, to help ensure that the requirements in those standards provide appropriate connection points between those projects and ISA 600.⁴ The IAASB also supported the proposal of the GATF to publish a short project update and asked the GATF to consider topics that are related to standards not under revision, for example, materiality and audit evidence.</p> <p>In December 2017, the Board received a presentation about the interconnections between ISA 600 and other ongoing projects, and how the Task Force is monitoring the activities of the other task forces, providing input and considering implications of changes in the other standards on ISA 600.</p> <p>In March 2019, the Board was updated on the work performed by the Group Audit Task Force since the start of the project to revise ISA 600¹ and was asked for its views on issues related to scoping a group audit, the definitions, and the linkages with other ISAs. The Board continued to support developing a risk-based approach for scoping a group audit and generally supported the Group Audit Task Force's approach on the definitions and the issues that were presented in relation to the responsibilities of the group engagement partner, acceptance and continuance, understanding the group and its components, understanding the component auditor, identifying and assessing the risks of material misstatement and responding to assessed risks, the consolidation process, communication between the group auditor and component auditors, and evaluating the audit evidence obtained. These and other issues need to be further developed in the context of the risk-based approach and changes made to other of the IAASB's International Standards. The Group Audit Task Force will continue to work on the issues related to scoping a group audit, the definitions and other issues identified in the Invitation to Comment, and will present it for further discussion at the June 2019 IAASB meeting.</p> <p>In June 2019, the Board was updated on the ISA 600³ Task Force's progress since the March 2019 meeting and discussed the public interest issues that the ISA 600 Task Force identified, the ISA 600 Task Force's proposals with respect to the risk-based approach to scoping a group audit, and the special considerations related to auditing a group. The Board also discussed indicative drafting related to the risk-based approach to scoping a group audit and the special considerations related to proposed ISA 220 (Revised).⁴ Generally, the Board was supportive of the approach taken but had suggestions on the way forward and the indicative drafting. The ISA 600 Task Force will take these comments into account and will present further drafting at the September 2019 meeting. The ISA 600 Task Force will also continue its outreach to key stakeholders and coordinate with IESBA and other IAASB Task Forces as needed.</p>
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¹ International Standard on Auditing (ISA) 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

	<p>Update for the period</p> <p>In September 2019, the Board was updated on the work of the ISA 600 Task Force since the June 2019 meeting, including the outreach performed and the feedback received from the IAASB's Consultative Advisory Group. The Board discussed, among other matters, the updated public interest issues, a draft of a significant part of the standard and the ISA 600 Task Force's proposals with respect to the scope and structure of the standard, materiality considerations in a group audit and a proposed stand-back requirement. The ISA 600 Task Force will take these comments into account in preparing revised drafting and issues for discussion at the December 2019 IAASB meeting</p>
<p>Professional Scepticism</p> <p>No Update for the period</p>	<p>Objective of the project: To make recommendations on how to more effectively respond to issues related to professional scepticism.</p> <p>Background and current status: The IAASB commenced its initial information gathering on the topic of professional scepticism in June 2015. The issues identified and discussed at the IAASB meetings are part of the Invitation to Comment on Enhancing Audit Quality in the Public Interest which was issued in December 2015 and is open for comments till May 16, 2016.</p> <p>The working group is comprised of representatives from the IAASB, the International Ethics Standards Board for Accountants (IESBA), and the International Accounting Education Standards Board (IAESB) to explore the topic of professional scepticism, enabling the three independent standard-setting Boards to consider what actions may be appropriate within their collective Standards and other potential outputs to enhance professional scepticism.</p> <p>Together with the Quality Control and ISA 600-Group Audits project, this project is part of the Audit Quality Enhancements Coordination Group (AQECG). The AQECG intends to coordinate the various inputs to the invitation to comment developed at the individual working group level, and take a holistic approach as to how the matters are presented in one invitation to comment. From May to September 2016, the various Working Groups analysed the comment letters to the Overview and detailed ITC, reviewed feedback from outreach activities, presented the results to IAASB at the September 2016 IAASB meeting.</p> <p>Subsequent to the December 2016 IAASB meeting, the joint PSWG held a teleconference to discuss matters related to potential changes to the concept/definition of professional scepticism in the ISAs. The March meeting papers are available here.</p> <p>In June 2017 meeting, the IAASB received an update on the activities of the Professional Skepticism Working Group (PSWG) and the Professional Skepticism IAASB Subgroup since the last Board meeting in March 2017. The Board supported the release of a communication to update stakeholders about the actions and current status of the PSWG's work. The Board also discussed the concept of "levels" of professional skepticism and supported the recommendations of the Professional Skepticism IAASB Subgroup not to introduce the concept into the ISAs.</p>

	<p>The IAASB discussed the Professional Skepticism Subgroup's analysis and related conclusions regarding different "mindset" concepts of professional skepticism and the use of the words in the ISAs in its December 2017. The Board supported the conclusions of the Subgroup, including that the current concept of the attitude of professional skepticism involving a "questioning mind" continues to be appropriate and should be retained within the ISAs. The IAASB Professional Skepticism Subgroup will liaise as needed with the Professional Skepticism Joint Working Group.</p> <p>In September 2018 meeting, The Board received an update on the activities of the IAASB's Professional Skepticism Subgroup (Subgroup) since March 2018. The Chair of the Subgroup also presented the Board with a draft publication that seeks to highlight the IAASB's efforts to appropriately reflect professional scepticism into the IAASB standards as well as other relevant news and information on professional skepticism, including collaboration with the International Ethics Standards Board for Accountants (IESBA) and International Accounting Education Standards Board (IAESB). The Board supported the issuance of the publication and future publications of this nature.</p>
<p>Accounting Estimates (ISA 540) and Special Audit Considerations Relevant to Financial Institutions (No Update for the period)</p>	<p>Objective of the project: The objective of the financial institutions project is to:</p> <ul style="list-style-type: none"> A. Clarify and enhance the relationship between the banking supervisors and the bank's external auditors; B. Consider and address issues of particular significance in audits of financial institutions; and C. Consider as to whether the issues relating to ISA 540 that have been highlighted as particularly relevant to audits of banks and other financial institutions are more broadly applicable to other entities <p>Background and current status: The ISA Implementation Monitoring project, specific requests from banking and insurance regulators and outreach activities by the ISA 540 Working Group, have identified issues with respect to auditing accounting estimates, in particular in relation to audits of financial institutions. Also, inspection finding reports from audit regulatory bodies highlighted consistent issues with respect to the audit of accounting estimates, including in relation to audits of financial institutions. There are areas where there have been calls for clear er or additional requirements or guidance to enable auditors to appropriately deal with increasingly complex accounting estimates and related disclosures, including obtaining sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements as a whole.</p> <p>A draft exposure draft of revised ISA 540 has been developed and is to be deliberated by IAASB with an approved ED expected to be issued for comment in December 2016. The board reviewed the draft in its June 2016 meeting.</p> <p>IAASB expects to complete its deliberation of responses to the exposure draft and resulting proposed changes to ISA 540 (Revised) in 2017 with the revised standard expected to be issued in last quarter of 2017.</p> <p>The IAASB has released the ED ISA 540 for comment in May 2017.</p> <p>The Board received an overview of the comment letters received on proposed ISA 540 (Revised) in its September 2017 meeting. The Board discussed</p>

	<p>respondents' concerns about the complexity of the proposed ISA and potential difficulties in understanding and applying it in practice, and asked the ISA 540 Task Force to look at ways to restructure the proposed ISA to improve its clarity and readability. The Board also discussed the scalability of the ISA, how risk factors could be taken into account, and how best to structure the response to the assessed risks of material misstatement. The Board highlighted the importance of achieving the right balance between issuing a high-quality standard and the public interest in finalizing the ISA in a timely fashion. The IAASB is holding an additional meeting in October to progress proposed ISA 540 (Revised).</p> <p>The IAASB discussed key issues raised by respondents in relation to the Exposure Draft of ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures', including the scalability of the ISA, the use of the term "reasonable," the exercise of professional skepticism and the Task Force's approach to the application material. The IAASB also discussed the Task Force's revisions to requirements and application material based on comments received on the Exposure Draft. The IAASB asked the Task Force to focus on redrafting the application material according to the planned approach with a view to conducting a first read of ISA 540 (Revised)¹ in March 2018, ahead of a targeted approval in June 2018.</p> <p>The ISA (540) was approved in IAASB's June 2018 meeting.</p>
<p>Data Analytics</p> <p>No Update for the period</p>	<p>Objective of the project: The objective of the Data Analytics Working Group (WG) is to:</p> <ul style="list-style-type: none"> A) Explore emerging developments in audit data analytics; and B) Explore how the IAASB most effectively can respond via International Standards or non-authoritative guidance (including Staff publications) and in what timeframe. <p>Background and current status: Information gathering on data analytics began in April 2015 and the Data Analytics Working Group will continue with its planned outreach activities in future. The DWAG published its first publication "The IAASB's Work to Explore the Growing Use of Technology in the Audit" in June 2016.</p> <p>At the March meeting, the IAASB received a video presentation of a panel discussion among members of the DAWG that was presented at the International Forum of Independent Audit Regulators Inspections Workshop.</p> <p>The Chair of the DAWG provides an update on the project in February 2017 on the IFAC website.</p> <p>In its June 2017 meeting, the IAASB received a presentation of high-level observations from respondents to the IAASB's Request for Input: Exploring the Growing Use of Technology in the Audit, with a Focus on Data Analytics. It was noted that respondents supported the IAASB in undertaking this work and encouraged continued active participation of the Data Analytics Working Group in other current standard-setting projects of the IAASB underway.</p>

<p>Emerging External Reporting has update for the period</p>	<p>Objective of the project: The objective of the Integrated Reporting Working Group (IRWG) is to:</p> <ul style="list-style-type: none"> A) Explore emerging developments in integrated reporting and other emerging developments in external reporting; B) Gather further information on the demand for assurance, the scope of the assurance engagement and the key assurance issues; and C) Explore how the IAASB most effectively can respond via International Standards or non-authoritative guidance (including Staff publications) and in what timeframe. <p>Background and current status: At its September 2014 meeting the Innovation WG proposed, and the IAASB agreed to establish a WG to specifically monitor the developing interest in integrated reporting and the demand for assurance on integrated reports. This includes initial thinking on the nature of such engagements, including the scope of the assurance engagement, the suitability of the criteria, and other matters related to assurance on integrated reports. The Board considered the draft working paper prepared by the IRWG <i>Supporting Credibility and Trust in Emerging Forms of External Reporting</i> in its June 2016.</p> <p>The Discussion Paper was issued in August 2016.</p> <p>In its June 2017 meeting, the IAASB received a presentation about the high-level observations from the comment letters received to the Discussion Paper, Supporting Credibility and Trust in Emerging Forms of External Reporting. It was noted that respondents generally supported the development of guidance on how to apply existing international assurance standards rather than developing new standards, and that the IAASB should continue to provide thought leadership on assurance issues and coordinate its work with other relevant organizations.</p> <p>The Board received an update on the project in December 2017. It was noted that the grant agreement with the World Business Council for Sustainable Development (WBCSD) was finalized for the funding of the project and that the Project Proposal and Feedback Statement has been finalized to be published on the IAASB's website. The board also received an update on the plan for developing the framework for the non-authoritative guidance for EER during the next year, including the required research to be gathered and the establishment of a Project Advisory Panel (PAP).</p> <p>In its September 2018 meeting, the EER Task Force presented the remaining Phase 1 'issues' that were not presented in June alongside a first draft of the Phase 1 guidance. The Board noted the need for the guidance to demonstrate its full alignment with the requirements of ISAE 3000 (Revised), 5 and for the EER Task Force to provide further explanations about any guidance that goes beyond the requirements and application material in ISAE 3000 (Revised). The EER Task Force expects to receive further input from stakeholders during its forthcoming series of discussion events and will present a revised draft of the guidance to the IAASB in December 2018.</p> <p>In December 2018 The EER Task Force presented an updated version of the Phase 1 draft guidance, which reflects changes to address feedback received from the IAASB at the September 2018 IAASB meeting, and from other</p>
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	<p>stakeholders, including in relation to a 'materiality process' and assertions as they relate to the characteristics of suitable criteria. The Board noted that the draft guidance had significantly improved since discussions at the September 2018 meeting, but that further work on the drafting is enquired. The Board will discuss a further version on a teleconference in January 2019 before the draft guidance is published for public comment.</p> <p>In March 2019, the Board approved for public comment Phase 1 of the draft guidance in January 2019. At its March 2019 meeting, the Board discussed several challenges related to Phase 2 of the guidance. The challenges include: determining the scope of an EER assurance engagement; communicating effectively in the assurance report; exercising professional skepticism and professional judgment; obtaining the competence necessary to perform the engagement; and obtaining evidence in respect of narrative and future-oriented information. The Board's deliberations of the challenges concerned were facilitated through breakout sessions, after which each breakout group reported back to the Board in a plenary session. The EER Task Force will consider the inputs that were received in progressing the development of Phase 2 of the guidance for further discussion at the June 2019 IAASB meeting.</p> <p>In June 2019, the Board was updated on the work of the EER Task Force on the challenges allocated to Phase 2 of the project. These challenges include: determining the scope of an EER assurance engagement; obtaining evidence in respect of narrative and future-oriented information; exercising professional skepticism and professional judgment; obtaining the competence necessary to perform the engagement; and communicating effectively in the assurance report. The Board discussed views on the EER Task Force's initial proposals to address each of these challenges in the Phase 2 guidance. The EER Task Force will consider the inputs received from the Board, together with responses to the Phase 1 EER Consultation Paper in so far as they impact the Phase 2 guidance, in developing the draft Phase 2 guidance, which will be presented for discussion at the September 2019 IAASB meeting.</p> <p>Update for the period</p> <p>In September 2019, the Board received an overview of the comment letters received on the EER Assurance Consultation Paper. The Board discussed respondents' comments on the Consultation Paper, that included the draft Phase 1 guidance, and the EER Task Force's proposals for addressing the comments. The Board also discussed the initial drafting of the Phase 2 guidance developed to date by the EER Task Force. A revised draft of the combined Phase 1 and Phase 2 guidance will be presented to the Board, for approval of an exposure draft at the December 2019 IAASB meeting.</p>
Agreed-Upon Procedures	<p>The objective of the project is to:</p> <p>A) Revise International Standard on Related Services (ISRS) 4400, Engagements to Perform Agreed-Upon Procedures Regarding Financial Information in the Clarity format; and</p>

No Update for the period

B) Consider whether standard-setting or other activities may be appropriate for engagements that use a combination of procedures derived from review, compilation and agreed-upon procedures engagements (also known as "hybrid engagements"), in light of the existing standards that may be applicable to these services in the IAASB's current suite of standards.

Background and current status: During consultations on the IAASB's 2015-2019 Strategy and the related 2015-2016 Work Plan, many stakeholders expressed the need to revise ISRS 4400 to meet the growing demand for agreed-upon procedure engagements. In response to the stakeholders' comments, the IAASB established a working group to explore issues involving agreed-upon procedure engagements. The issues identified and discussed at the IAASB meetings will be used to revise ISRS 4400 and possibly develop new standard(s) or guidance that would address engagements where there is a combination of agreed-upon procedures and assurance.

The Agreed-Upon Procedures (AUP) Working Group presented a first draft of its Discussion Paper, [*Exploring the Growing Demand for Agreed-Upon Procedures Engagements and Other Services and the Implications for the IAASB's Standards*](#), to the Board in June 2016. The IAASB provided the AUP Working Group with input to enhance the Discussion Paper and suggested that the paper pose a question to explore whether the IAASB should develop guidance on multi-scope engagements. The AUP Working Group will present a revised draft of the Discussion Paper at the September 2016 IAASB meeting.

In its September 2017 meeting, the Board discussed the feedback received on the Discussion Paper and **approved** a standard-setting project proposal to revise ISRS 4400, subject to clarifications around the use of judgment, independence, restriction of the report of factual findings and required documentation.

In its September 2018 meeting, The Board approved the ED of ISRS 4400 (Revised)³ for public exposure. In finalizing the ED, the Board agreed that independence is not required for an AUP engagement and that the AUP report would include statements addressing circumstances when the practitioner is (or is not) required to be independent, and whether the practitioner is (or is not) independent. The ED will be issued in early November with a 120 day comment period.

In June 2019 the Board received an overview of the responses to proposed ISRS 4400 (Revised)² (ED-4400). The Board discussed, among other matters, respondents' comments on the application of professional judgment when performing procedures, the independence disclosure requirements, and the effective date.

The Board also acknowledged areas of broad support, including not including a precondition for the practitioner to be independent, using the term "findings" and requiring an explanation of this term in the engagement letter and the AUP report, not requiring or prohibiting a reference to the practitioner's expert in the AUP report, and not requiring a restriction on use or distribution of the AUP report. The AUP Task Force will deliberate the Board's input and will present the first read of the post-exposure ISRS 4400 (Revised) to the Board in the second half of 2019.

<p>ISA 315 (Revised) Has update for the period</p>	<p>The tentative objectives of the projects at this stage are:</p> <ul style="list-style-type: none"> A) to address the issues that have been identified by the ISA Implementation Monitoring project. B) Possible changes that may be necessary to ISA 315 (Revised) to enhance the requirements and guidance for evolving environmental influences (such as changing internal control frameworks and more advanced technology systems being utilized by both management and auditors). C) In its June 2016 meeting, the IAASB directed the ISA 315 (Revised) Working Group to present a project proposal for the IAASB's consideration at its September 2016 meeting to commence standard-setting activities. The project proposal was presented and approved in the IAASB's September 2016 meeting. <p>Since the December 2016 IAASB meeting, the task force has had one physical meeting and two teleconferences to develop the March meeting papers.</p> <p>In September 2017, the ISA 315 Task Force presented proposed changes to the requirements in ISA 315 (Revised) to address identified issues relating to understanding the entity and its environment, including the applicable financial reporting framework, and internal control, including obtaining an understanding of the five components of internal control. The Board broadly supported the proposals, but asked for consideration about some of the proposed changes to the definitions, as well as the perceived focus on controls in obtaining the necessary understanding of the components of internal control. With regard to proposed changes to the identification and assessment of inherent and control risk, the Board supported a separate assessment of inherent and control risk, but asked that the ISA 315 Task Force further consider how this works practically and highlighted that further clarification is needed relating to the assessment of control risk.</p> <p>In December 2017, the Board discussed a first read of proposed changes to the requirements and application material of ISA 315 (Revised)². The Board broadly supported the proposals, but asked for further consideration by the Task Force on various matters, including aspects of the definitions of 'controls' and 'relevant assertions,' and regarding the introduction of the term 'business model' and its interactions with current requirements of the standard. The Board also questioned the use of 'sufficient and appropriate' as it relates to potential confusion with "sufficient appropriate audit evidence" and whether a change may have unintended consequences if this concept were to be introduced as proposed. The Board encouraged further consideration about how fraud can be included as a qualitative inherent risk factor, taking into account how this would link to the fraud risk factors in ISA 240.3 The Board continued to be supportive of the introduction of "spectrum of risk" but thought the spectrum of risk could be better emphasized and explained earlier in the standard.</p> <p>The Board recognized the need for further consideration about scalability, but agreed that scalability should be presented through the requirements and application material in context of the auditor's consideration of risk thereby eliminating the need for "considerations for smaller entities."</p>
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	<p>The Task Force will continue to progress the proposed changes to the standard for a second read of an exposure draft in March 2018.</p> <p>The ED was issued in July 2018 for public consultation.</p> <p>In March 2019 The Board discussed the ISA 315 Task Force's initial proposals to address specific responses to the proposed ISA 315 (Revised)² (ED-315), in particular, the broad concerns in relation to the length and complexity of the standard. In doing so, the Board considered alternative approaches about how to present the requirements for the auditor's understanding of the entity's system of internal control.</p> <p>The Board agreed to move forward by presenting the requirements at a broader, higher level (i.e., in a more direct way in terms of focusing on the 'what' that is required from the auditor), while maintaining the robustness of the current standard. Accordingly, all of the requirements will be reconsidered, the criteria or matters that are definitional will be relocated to definitions, and the 'why' and 'how' will be further explicitly considered as to where it is appropriate to be moved to. The Board acknowledged that scalability was likely best addressed in the application material.</p> <p>The Board's discussions also focused on proposed changes to address specific issues within the section on understanding the entity's system of internal control, in particular, in relation to clarifications on controls relevant to the audit, the information system and control activities components, and the various evaluations required within this section of the standard.</p> <p>Aspects of ED-315 and related feedback that have not been addressed during this meeting will be presented at the June 2019 IAASB meeting. The ISA 315 Task Force will continue to progress the proposed changes to ED-315 with a targeted approval of the final standard at the September 2019 IAASB meeting.</p> <p>In June 2019, the Board discussed a full version of the standard reflecting the new drafting approach that was broadly supported with the Board at its March 2019 meeting. The Board broadly supported specific aspects of this approach, in particular the enhanced flow and understandability of the requirements, as well as the separate presentation or signposting of examples and scalability paragraphs in the application material.</p> <p>Notwithstanding broad support for the overall approach, concern was expressed about the change to move certain material (primarily criteria or terms previously included in requirements relating to the understanding of the system of internal control) to definitions. It was also highlighted that this could cause challenges in navigating the standard. The Board was presented with a revised approach to drafting the requirements for the understanding the system of internal control, which reconnected the definitions, and the Board broadly supported moving forward.</p> <p>Specific other areas discussed and agreed include revisions to the definitions of significant risk and the inherent risk factors, specifically in relation to how fraud is presented within the inherent risk factors. Conforming amendments</p>
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² Proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*

	<p>arising from the proposed changes to the standard will be discussed at an IAASB teleconference in August 2019 and a final draft of the proposed standard will be presented to the IAASB for approval at its September 2019 meeting.</p> <p>Update for the period</p> <p>In September 2019, the Board approved the revisions to ISA 315 (Revised),¹ as well as the related conforming amendments. The revised ISA will be effective for audits of financial statements for periods beginning on or after December 15, 2021. Once the Public Interest Oversight Board's (PIOB) confirmation that due process was followed is received, the Board will formally release the standard. In finalizing ISA 315 (Revised), the Board continued to focus on the understandability and complexity of the ISA, as well as the iterative nature of the standard. The Board continued to discuss the threshold for identifying risks of material misstatement and agreed the supporting guidance for this as a conforming amendment to ISA 200.2 The Board also recognized that support is critical when initially applying the changes to ISA 315 (Revised) and will further consider the most appropriate actions in providing this initial support. The Board also acknowledged the need to monitor implementation challenges as they arise.</p>
Less Complex Entities	<p>In March 2019 the Board discussed a proposed Discussion Paper (DP), <i>Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Implementing the ISAs</i>. The discussion highlighted the shift in focus on complexity of the entity rather than its size in driving the ongoing discussions and activities to address issues and challenges in audits of less complex entities (LCEs). The Board was supportive of the DP's overall direction, noting the importance of the project and the need for action by the IAASB and others.</p> <p>The Board liked the simple, clear way the DP had been presented and noted it was appropriate for its key target audience (i.e., auditors of LCEs). The Board made suggestions for improvements, particularly with respect to the issues and challenges, the possible actions presented within the DP and the questions to be posed to respondents in order to obtain relevant and useful feedback. Proposed changes to the DP will be presented in a Board call on April 10th, with the final DP targeted to be published for public consultation before the end of April 2019.</p>
Audit Evidence has Update for the period	<p>The Board discussed the analysis undertaken by the Audit Evidence Working Group of the issues across the ISAs related to audit evidence and the use of technology more broadly, and the possible actions to address the issues. The Board concurred that guidance should be developed on the effect of technology when applying certain aspects of the ISAs, and that this should be actioned expeditiously.</p> <p>The Board also indicated that more extensive information gathering and research need to be undertaken to understand the issues related to audit</p>

	<p>evidence, so that the Board is fully informed of the issues in determining the need for revisions to ISA 5005 and possibly other related standards.</p> <p>Update for the period</p> <p>In September 2019, the Board was provided with an overview of the development of the Audit Evidence Workstream Plan. The Audit Evidence Working Group will accordingly undertake further information gathering and research, and develop recommendations for possible further actions to be presented to the Board in the first half of 2020.</p>
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Agenda Item 12.2



NZ AUDITING
AND ASSURANCE
STANDARDS BOARD

DATE: 10 October 2019

TO: Members of the New Zealand Auditing and Assurance Standards Board

FROM: Peyman Momenan

SUBJECT: Domestic Update

Introduction

1. This Update summarises the significant news from Financial Market Authority, New Zealand Institute of Chartered Accountants and other organisations for the Board's information, for the period September and first quarter of October 2019.

Financial Markets Authority (FMA)

1. No update for the period.

The New Zealand Institute of Chartered Accountants

1. Intense debate about the 'expectation gap' in auditing is unfolding in the UK, set against a government review into the value and effectiveness of the audit process.

Audit professionals around the globe are watching. Sir Donald Brydon, the review's chair, has declared "change is in the air" when it comes to the purpose and scope of audit. He has called for views on control attestation, culture audits, non-financial assurance and even cybersecurity audits.

A UK Parliamentary Committee has noted: "If the performance of auditors against the current regime needs to improve, the audit product itself also needs to evolve in fundamental ways." The UK Competition and Markets Authority found "a strong case for reviewing the purpose and scope of audit to consider the issues holistically."

Could all this bring audit closer to meeting the demands of investors and the public?

(read the rest of the article [here](#))

2. The importance of independence is something I've been reflecting on this year. The highest quality audit work can be undermined by the slightest doubt about the independence and objectivity of that work. But both here and overseas, increasingly people are questioning the audit profession's independence from those they audit.

A May 2019 Financial Markets Authority report found investors hold concerns about auditors' independence. These concerns stem, in part, from New Zealand's small

market and the fact that audit companies offer other consultancy services to their audit clients.

In the UK, the Big Four accounting firms came under fire after the sudden collapse of construction firm Carillion in January 2018. KPMG had been Carillion's external auditor, Deloitte its internal auditor, EY had been engaged to turn the company around and PwC had been an adviser.

A scathing report by the House of Commons highlighted the practice by accountancy firms of using audit services as "loss leaders" to establish relationships that would "increase their chances of winning more lucrative non-audit consultancy work".

These comments should concern us all. Independence is an auditor's most critical asset; it's what underpins the value of audit. When our independence is questioned, even if we believe in substance it's not at risk, the value of an audit is undermined.

(read the rest of the article [here](#))

CPA Australia

1. The auditing profession is under pressure due to changing expectations, technological shifts and increasing competition; but could these pressures be the catalyst for audit's reinvention?

(read the rest of the article [here](#))

The Institute of Directors (IoD)

1. No update for the period.