

CONFORMING AND CONSEQUENTIAL AMENDMENTS TO INTERNATIONAL STANDARDS ON AUDITING (NEW ZEALAND) AND OTHER PRONOUNCEMENTS ARISING FROM ISA (NZ) 315 (REVISED 2019)¹

This Standard was issued on 23 April 2020 by the New Zealand Auditing and Assurance Standards Board of the External Reporting Board pursuant to section 12(b) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 21 May 2020.

An auditor that is required to apply this Standard is required to apply it for audits of financial statements for periods beginning on or after 15 December 2021. However, early adoption is permitted.

In finalising this Standard, the New Zealand Auditing and Assurance Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Standard has been issued to reflect conforming amendments necessary as a result of the approval of ISA (NZ) 315 (Revised 2019).

¹ ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

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Note: The footnote numbers and some paragraphs numbers within these amendments do not align with the actual footnote and paragraph numbers of the standards that will be amended, and reference should be made to those compiled standards.

A: INTRODUCTION

This Standard outlines conforming and consequential amendments to the International Standards on Auditing (New Zealand) and other pronouncements as a result of the revisions to International Standard on Auditing (New Zealand) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*.

These conforming amendments affect the following International Standards on Auditing (New Zealand) and other pronouncements and are arranged in the following manner:

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B: CONFORMING AND CONSEQUENTIAL AMENDMENTS TO INTERNATIONAL STANDARDS ON AUDITING (NEW ZEALAND) AND OTHER PRONOUNCEMENTS ARISING FROM ISA (NZ) 315 (REVISED 2019)²

Amendments to extant International Standards on Auditing (New Zealand) and other pronouncements as shown. New text is underlined and deleted text is struck through.
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Note: The footnote numbers and some paragraphs numbers within these amendments do not align with the actual footnote and paragraph numbers of the standards that will be amended, and reference should be made to those compiled standards.

ISA (NZ) 200, Overall objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)

Scope of this ISA (NZ)

...

An Audit of Financial Statements

...

7. The ISAs (NZ) contain objectives, requirements and application and other explanatory material that are designed to support the auditor in obtaining reasonable assurance. The ISAs (NZ) require that the auditor exercise professional judgement and maintain professional scepticism 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

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² ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

Definitions

13. For purposes of the ISAs (NZ), 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.

...

Application and Other Explanatory Material

Definitions

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

...

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

A2a. For the purposes of the ISAs (NZ), a risk of material misstatement exists when there is a reasonable possibility of:

- (a) A misstatement occurring (i.e., its likelihood); and
- (b) Being material if it were to occur (i.e., its magnitude).

...

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

Sufficiency and Appropriateness of Audit Evidence

NZA30.1 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 audit³) 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

³ ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph 169

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, the refusal of those charged with governance 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.

...

Risks of Material Misstatement

...

A40. Inherent risk is influenced by inherent risk factors, higher for some assertions and related classes of transactions, account balances, and disclosures than for others. Depending on the degree to which the inherent risk factors affect the susceptibility to misstatement of an assertion, 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 characterised 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 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 (NZ) 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.⁴

⁴ ISA (NZ) 330, *The Auditor's Responses to Assessed Risks*, paragraphs 7–17

A42.⁵ 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. The ISAs (NZ) ~~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 (NZ) 540~~315~~ (Revised 2019)⁶ requires a ~~separate assessment of inherent risk to be assessed separately from and~~ control risk 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 (NZ) 330.⁷ ~~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.~~

A43. ISA (NZ) 315 (Revised 2019) establishes requirements and provides guidance on identifying and assessing the risks of material misstatement at the financial statement and assertion levels.

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.⁸

...

Timeliness of Financial Reporting and the Balance between Benefit and Cost

...

A52. In light of the approaches described in paragraph A51, the ISAs (NZ) 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;⁹ 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.¹⁰

Other Matters that Affect the Inherent Limitations of an Audit

...

⁵ Note that paragraph A42 of ISA (NZ) 200 is marked to the updated paragraph presented separately as a conforming amendment relating to ISA (NZ) 540 (Revised) and its conforming amendments.

⁶ ISA (NZ) 540~~315~~ (Revised 2019), ~~*Auditing Accounting Estimates and Disclosures*, paragraph 15~~*Identifying and Assessing the Risks of Material Misstatement*

⁷ ISA (NZ) 330, paragraph 7(b)

⁸ ISA (NZ) 330, paragraph 6

⁹ ISA (NZ) 315 (Revised 2019), paragraphs 175–224~~0~~

¹⁰ ISA (NZ) 330; ISA (NZ) 500; ISA (NZ) 520, *Analytical Procedures*; ISA (NZ) 530, *Audit Sampling*

Conduct of an Audit in Accordance with ISAs (NZ)

...

Contents of the ISAs (NZ) (Ref: Para. 19)

...

A61. Where necessary, the application and other explanatory material provides further explanation of the requirements of an ISA (NZ) 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 (NZ) such as ISA (NZ) 315 (Revised 2019), why a procedure is required.
- Include examples of procedures that may be appropriate in the circumstances. In some ISAs (NZ), such as ISA (NZ) 315 (Revised 2019), 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 (NZ). The application and other explanatory material may also provide background information on matters addressed in an ISA (NZ).

Considerations Specific to Smaller Entities Scalability Considerations

A65a. Scalability considerations have been included in some ISAs (NZ) (e.g., ISA (NZ) 315 (Revised 2019)), illustrating the application of the requirements to all entities regardless of whether their nature and circumstances are less complex or more complex. Less complex entities are entities for which the characteristics in paragraph A66 may apply.

NZ A65b. The “considerations specific to smaller entities” included in some the ISAs (NZ) have been developed primarily with entities that are not FMC reporting entities considered to have a higher level of public accountability in mind. Some of the considerations, however, may be helpful in audits of smaller FMC reporting entities considered to have a higher level of public accountability.

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*]

Considerations Specific to Automated Tools and Techniques

A67a. The considerations specific to “automated tools and techniques” included in some ISAs (NZ) (for example, ISA (NZ) 315 (Revised 2019)) 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 (NZ) (Ref: Para. 21)

...

A71. In using the objectives, the auditor is required to have regard to the interrelationships among the ISAs (NZ). This is because, as indicated in paragraph A55, the ISAs (NZ) deal in some cases with general responsibilities and in others with the application of those responsibilities to specific topics. For example, this ISA (NZ) requires the auditor to adopt an attitude of professional scepticism; this is necessary in all aspects of planning and performing an audit but is not repeated as a requirement of each ISA (NZ). At a more detailed level, ISA (NZ) 315 (Revised 2019) and ISA (NZ) 330 contain, among other things, objectives and requirements that deal with the auditor’s responsibilities to identify and assess the risks of material misstatement and to design and perform further audit procedures to respond to those assessed risks, respectively; these objectives and requirements apply throughout the audit. An ISA (NZ) dealing with specific aspects of the audit (for example, ISA (NZ) 540 (Revised)) may expand on how the objectives and requirements of such ISAs (NZ) as ISA (NZ) 315 (Revised 2019) and ISA (NZ) 330 are to be applied in relation to the subject of the ISA (NZ) but does not repeat them. Thus, in achieving the objective stated in ISA (NZ) 540 (Revised), the auditor has regard to the objectives and requirements of other relevant ISAs (NZ).

...

ISA (NZ) 210, *Agreeing the Terms of Audit Engagements*

Application and Other Explanatory Material

...

Preconditions for an Audit

...

Agreement of the Responsibilities of Management

...

Internal Control

...

A16. Management maintains such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity’s financial reporting objectives due to the inherent limitations of internal control.¹¹

...

A18. It is for management to determine what internal control is necessary to enable the preparation of the financial statements. The term “internal control” encompasses a wide range of activities within components of the system of internal control that may be described as the control environment; the entity’s risk assessment process; the entity’s process to monitor the system of internal control, the information system, ~~including the related business processes relevant to financial reporting~~, and communication; and control activities; ~~and monitoring of controls~~. This division, however, does not necessarily reflect how a particular entity may design, implement and maintain its internal control, or how it may classify any particular component.¹² An entity’s internal control (in particular, its accounting books and records, or accounting systems) will reflect the needs of management, the complexity of the business, the nature of the risks to which the entity is subject, and relevant laws or regulation.

...

ISA (NZ) 230, *Audit Documentation*

Application and Other Explanatory Material

...

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

...

Form, Content and Extent of Audit Documentation (Ref: Para. 8)

NZA7.1 Audit documentation provides evidence that the audit complies with the ISAs (NZ). However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgement made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:

- ...
- In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
 - For example, there may be no single way in which the auditor’s professional scepticism is documented. But the audit documentation may nevertheless

¹¹ ISA (NZ) 315 (Revised 2019), “Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment~~,” paragraph A46 ~~Appendix 3 paragraph 22~~.

¹² ISA (NZ) 315 (Revised 2019), ~~paragraph A9159~~ and Appendix 34

provide evidence of the auditor’s exercise of professional scepticism in accordance with the ISAs (NZ). For example, in relation to accounting estimates, when the audit evidence obtained includes evidence that both corroborates and contradicts management’s assertions, documenting how the auditor evaluated that evidence, including the professional judgements made in forming a conclusion as to the sufficiency and appropriateness of the audit evidence obtained.

- Similarly, that the engagement partner has taken responsibility for the direction, supervision and performance of the audit in compliance with the ISAs (NZ) may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner’s timely involvement in aspects of the audit, such as participation in the team discussions required by ISA (NZ) 315 (Revised 2019).¹³

Documentation of Significant Matters and Related Significant Professional Judgements (Ref: Para. 8(c))

A8. Judging the significance of a matter requires an objective analysis of the facts and circumstances. Examples of significant matters include:

- Matters that give rise to significant risks (as defined in ISA (NZ) 315 (Revised 2019)¹⁴).

...

Identification of Specific Items or Matters Tested, and of the Preparer and Reviewer (Ref: Para. 9)

...

Considerations Specific to Smaller Entities (Ref. Para 8)

...

A17. When preparing audit documentation, the auditor of a smaller entity may also find it helpful and efficient to record various aspects of the audit together in a single document, with cross-references to supporting working papers as appropriate. Examples of matters that may be documented together in the audit of a smaller entity include the understanding of the entity and its environment, the applicable financial reporting framework, and the entity’s system of internal control, the overall audit strategy and audit plan, materiality determined in accordance with ISA (NZ) 320,¹⁵ assessed risks, significant matters noted during the audit, and conclusions reached.

...

¹³ ISA (NZ) 315 (Revised 2019), “*Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*,” paragraph 4017.

¹⁴ ISA (NZ) 315 (Revised 2019), paragraph 4(ⓔ)12(1).

¹⁵ ISA (NZ) 320, *Materiality in Planning and Performing an Audit*

Specific Audit Documentation Requirements and Guidance in Other ISAs (NZ)

This appendix identifies paragraphs in other ISAs (NZ) that contain specific documentation requirements. The list is not intended to be exhaustive. Furthermore, it is not a substitute for considering the requirements and related application and other explanatory material in ISAs (NZ).

- ...
- ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* – paragraph 32~~8~~

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

Introduction

Scope of this ISA (NZ)

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) deals with the auditor's responsibilities relating to fraud in an audit of financial statements. Specifically, it expands on how ISA (NZ) 315 (Revised 2019)¹⁶ and ISA (NZ) 330¹⁷ are to be applied in relation to risks of material misstatement due to fraud.

...

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.

...

¹⁶ ISA (NZ) 315 (Revised 2019), "Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment~~."

¹⁷ ISA (NZ) 330, "The Auditor's Responses to Assessed Risks."

Requirements

Professional Scepticism

13. In accordance with ISA (NZ) 200,¹⁸ the auditor shall maintain professional scepticism throughout the audit, recognising 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. A8–A9)

...

Discussion among the Engagement Team

16. ISA (NZ) 315 (Revised 2019) 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.¹⁹ 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. A11–A12)

Risk Assessment Procedures and Related Activities

17. 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 (NZ) 315 (Revised 2019),²⁰ the auditor shall perform the procedures in paragraphs ~~2318–4325~~ to obtain information for use in identifying the risks of material misstatement due to fraud.

...

Those Charged with Governance

21. Unless all of those charged with governance are involved in managing the entity,²¹ 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. A20–A22)

...

¹⁸ ISA (NZ) 200, paragraph 15

¹⁹ ISA (NZ) 315 (Revised 2019), paragraph 17–18.40

²⁰ ~~ISA (NZ) 315 (Revised), paragraphs 5–24~~

²¹ ISA (NZ) 260 (Revised), *Communication with Those Charged with Governance*, paragraph 13

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

26. In accordance with ISA (NZ) 315 (Revised 2019), 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.²²

...

28. 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, and evaluate their design and determine whether they have been implemented.²³ (Ref: Para. A32–A33)

...

Documentation

45. The auditor shall include the following in the audit documentation²⁴ ~~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 (NZ) 315 (Revised 2019)~~:²⁵

- (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) Identified controls in the control activities component that address assessed risks of material misstatement due to fraud.

...

Application and Other Explanatory Material

Characteristics of Fraud (Ref: Para. 3)

...

Professional Scepticism (Ref: Para. 13–15)

A8. Maintaining professional scepticism 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 relevant.~~ Due to the characteristics of fraud, the auditor's professional scepticism is particularly important when considering the risks of material misstatement due to fraud.

²² ISA (NZ) 315 (Revised 2019), paragraph 2825

²³ ISA (NZ) 315 (Revised 2019), paragraph 26(a)(i) and 26(d)

²⁴ ISA (NZ) 230, *Audit Documentation*, paragraphs 8–11, and paragraph A6

²⁵ ISA (NZ) 315 (Revised 2019), paragraph 3832

...

Risk Assessment Procedures and Related Activities

...

Enquiry of Internal Audit (Ref: Para. 20)

A19. ISA (NZ) 315 (Revised 2019) and ISA (NZ) 610 (Revised 2013) establish requirements and provide guidance relevant to audits of those entities that have an internal audit function.²⁶ In carrying out the requirements of those ISAs (NZ) 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. 21)

A20. 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 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.²⁷

A21. 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~~ 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. 24)

A23. 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

²⁶ ISA (NZ) 315 (Revised 2019), paragraphs 14(a) and ~~24(a)(ii)6 and 23~~, and ISA (NZ) 610 (Revised 2013), *Using the Work of Internal Auditors*

²⁷ ISA (NZ) 260 (Revised), paragraphs A1–A8, discuss with whom the auditor communicates when the entity's governance structure is not well defined.

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. 25)

...

A26. 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 rationalise 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 include intentional management bias, are, insofar as they affect inherent risk, inherent risk factors.²⁸ 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 rationalise fraudulent actions. Fraud rRisk factors reflective of an attitude that permits rationalisation 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.²⁹ 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. 27)

...

Identifying and Assessing the Risks of Material Misstatement Due to Fraud and Understanding the Entity's Related Controls (Ref: Para. 28)

A31. Management may make judgements on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.³⁰ 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

²⁸ ISA (NZ) 315 (Revised 2019), paragraph 12(f)

²⁹ ISA (NZ) 315 (Revised 2019), paragraph 21

³⁰ ISA (NZ) 315 (Revised 2019), paragraph A7548

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 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. 29)

...

Assignment and Supervision of Personnel (Ref: Para. 30(a))

...

Unpredictability in the Selection of Audit Procedures (Ref: Para. 30(c))

...

Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level (Ref: Para. 31)

...

Audit Procedures Responsive to Risks Related to Management Override of Controls

Journal Entries and Other Adjustments (Ref: Para. 33(a))

...

- A43. Further, the auditor's consideration of the risks of material misstatement associated with inappropriate override of controls over journal entries³¹ 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.

- A44. 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:

³¹ ISA (NZ) 315 (Revised 2019), paragraph 26(a)(ii)

- *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 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.*

...

Appendix 1

(Ref: Para. A26)

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/rationalisations. 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 relate to incentives or pressures, or opportunities, that arise from conditions that create susceptibility to misstatement before consideration of controls (i.e., the inherent risk). Such factors are inherent risk factors, insofar as they affect inherent risk, and may be due to management bias. Fraud risk factors related to opportunities may also arise from other identified inherent risk factors (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 rationalisations 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 organisational 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/Rationalisations

...

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/rationalisation. 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 reimbursements.
- 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 authorisation 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/Rationalisations

- 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.
- Behaviour indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- Changes in behaviour or lifestyle that may indicate assets have been misappropriated.
- Tolerance of petty theft.

Appendix 2

(Ref: Para. A41)

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. A50)

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.

...

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

Requirements

...

The Auditor's Consideration of Compliance with Laws and Regulations

13. As part of obtaining an understanding of the entity and its environment in accordance with ISA (NZ) 315 (Revised 2019),³² the auditor shall obtain a general understanding of:
 - (a) The legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates; and

³² ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph 44-19

(b) How the entity is complying with that framework. (Ref: Para. A11)

...

Application and Other Explanatory Material

...

Audit Procedures When Non-Compliance is Identified or Suspected

...

Evaluating the Implications of Identified or Suspected Non-Compliance (Ref: Para. 22)

A23. As required by paragraph 22, the auditor evaluates the implications of identified or suspected non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations. The implications of particular identified or suspected non-compliance will depend on the relationship of the perpetration and concealment, if any, of the act to specific controls activities and the level of management or individuals working for, or under the direction of, the entity involved, especially implications arising from the involvement of the highest authority within the entity. As noted in paragraph 9, the auditor's compliance with law, regulation or relevant ethical requirements may provide further information that is relevant to the auditor's responsibilities in accordance with paragraph 22.

...

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

Application and Other Explanatory Material

...

Those Charged with Governance (Ref: Para. 11)

...

A3. Such diversity means that it is not possible for this ISA (NZ) to specify for all audits the person(s) with whom the auditor is to communicate particular matters. Also, in some cases, the appropriate person(s) with whom to communicate may not be clearly identifiable from the applicable legal framework or other engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family-owned entities, some not-for-profit organisations, and some government entities. In such cases, the auditor may need to discuss and agree with the engaging party the relevant person(s) with whom to communicate. In deciding with whom to communicate, the auditor's understanding of an entity's governance structure and processes obtained in accordance with ISA (NZ) 315 (Revised 2019)³³ is relevant. The appropriate person(s) with whom to communicate may vary depending on the matter to be communicated.

³³ ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*.

...

Matters to Be Communicated

...

Planned Scope and Timing of the Audit (Ref: Para. 15)

...

A12. Communicating significant risks identified by the auditor helps those charged with governance understand those matters and why they were determined to be significant risks ~~require special audit consideration~~. The communication about significant risks may assist those charged with governance in fulfilling their responsibility to oversee the financial reporting process.

A13. Matters communicated may include: ...

- How the auditor plans to address the significant risks of material misstatement, whether due to fraud or error.
- How the auditor plans to address areas of higher assessed risks of material misstatement.
- The auditor's approach to the entity's system of internal control, ~~relevant to the audit~~.
- The application of the concept of materiality in the context of an audit.

...

The Communication Process

...

Adequacy of the Communication Process (Ref: Para. 22)

...

A52. As noted in paragraph 4, effective two-way communication assists both the auditor and those charged with governance. Further, ISA (NZ) 315 (Revised 2019) identifies participation by those charged with governance, including their interaction with internal audit, if any, and external auditors, as an element of the entity's control environment.³⁴ Inadequate two-way communication may indicate an unsatisfactory control environment and influence the auditor's assessment of the risks of material misstatements. There is also a risk that the auditor may not have obtained sufficient appropriate audit evidence to form an opinion on the financial statements.

Appendix 2 (Ref: Para. 16(a), A19–A20)

Qualitative Aspects of Accounting Practices

³⁴ ISA (NZ) 315 (Revised 2019), ~~paragraph A77~~ Appendix 3.

The communication required by paragraph 16(a), and discussed in paragraphs A19–A20, may include such matters as:

...

Accounting Estimates

For items for which estimates are significant, issues discussed in ISA (NZ) 540, including, for example:

How management identifies those transactions, events ~~and~~ or conditions that may give rise to the need for accounting estimates to be recognised or disclosed in the financial statements.

...

ISA (NZ) 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance*

Introduction

Scope of this ISA (NZ)

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) deals with the auditor's responsibility to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements. This ISA (NZ) does not impose additional responsibilities on the auditor regarding obtaining an understanding of the entity's system of internal control and designing and performing tests of controls over and above the requirements of ISA (NZ) 315 (Revised 2019)³⁵ and ISA (NZ) 330. ISA (NZ) 260 (Revised) establishes further requirements and provides guidance regarding the auditor's responsibility to communicate with those charged with governance in relation to the audit.
2. The auditor is required to obtain an understanding of the entity's system of internal control relevant to the audit when identifying and assessing the risks of material misstatement.³⁶ In making those risk assessments, the auditor considers the entity's system of internal control in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The auditor may identify control deficiencies in internal control not only during this risk assessment process but also at any other stage of the audit. This ISA (NZ) specifies which identified deficiencies the auditor is required to communicate to those charged with governance and management.

...

Application and Other Explanatory Material

Determination of Whether Deficiencies in Internal Control Have Been Identified (Ref: Para 7)

³⁵ ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*, paragraphs 4-12 and 4221

³⁶ See ISA (NZ) 315 (Revised 2019), paragraph 4221. Appendix 5 Paragraphs A60–A65 provide guidance on controls relevant to the audit.

...

Considerations Specific to Smaller Entities

- A3. While the concepts underlying controls in the control activities component in smaller entities are likely to be similar to those in larger entities, the formality with which they operate will vary. Further, smaller entities may find that certain types of controls activities are not necessary because of controls applied by management. For example, management's sole authority for granting credit to customers and approving significant purchases can provide effective control over important account balances and transactions, lessening or removing the need for more detailed controls activities.

...

Significant Deficiencies in Internal Control (Ref: Para. 6(b), 8)

- A8. Controls may be designed to operate individually or in combination to effectively prevent, or detect and correct, misstatements.³⁷ For example, controls over accounts receivable may consist of both automated and manual controls designed to operate together to prevent, or detect and correct, misstatements in the account balance. A deficiency in internal control on its own may not be sufficiently important to constitute a significant deficiency. However, a combination of deficiencies affecting the same account balance or disclosure, ~~relevant~~ assertion, or component of the entity's system of internal control may increase the risks of misstatement to such an extent as to give rise to a significant deficiency.

ISA (NZ) 300, *Planning an Audit of Financial Statements*

Requirements

...

9. The auditor shall develop an audit plan that shall include a description of:
- (a) The nature, timing and extent of planned risk assessment procedures, as determined under ISA (NZ) 315 (Revised 2019).³⁸
 - (b) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under ISA (NZ) 330.³⁹
 - (c) Other planned audit procedures that are required to be carried out so that the engagement complies with ISAs (NZ). (Ref: Para. A12-A14)

Application and Other Explanatory Material

...

Involvement of Key Engagement Team Members (Ref: Para. 5)

³⁷ ISA (NZ) 315 (Revised 2019), paragraph ~~A66~~A175.

³⁸ ISA (NZ) 315 (Revised 2019), "Identifying and Assessing the Risks of Material Misstatements ~~through Understanding the Entity and Its Environment.~~"

³⁹ ISA (NZ) 330, "The Auditor's Responses to Assessed Risks."

A4. The involvement of the engagement partner and other key members of the engagement team in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process⁴⁰.

...

Documentation (Ref: Para. 12)

...

Considerations Specific to Smaller Entities

A21. As discussed in paragraph A11, a suitable, brief memorandum may serve as the documented strategy for the audit of a smaller entity. For the audit plan, standard audit programs or checklists (see paragraph A17) drawn up on the assumption of few ~~relevant~~ controls⁴¹ activities, as is likely to be the case in a smaller entity, may be used provided that they are tailored to the circumstances of the engagement, including the auditor's risk assessments.

...

ISA (NZ) 320, *Materiality in Planning and Performing an Audit*

Introduction

Materiality in the Context of an Audit

...

6. In planning the audit, the auditor makes judgements about misstatements that will be considered material. These judgements provide a basis for: (a) Determining the nature, timing and extent of risk assessment procedures; (b) Identifying and assessing the risks of material misstatement; and (c) Determining the nature, timing and extent of further audit procedures. The materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in the aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality. It is not practicable to design audit procedures to detect all misstatements that could be material solely because of their nature. However, consideration of the nature of potential misstatements in disclosures is relevant to the design of audit procedures to address risks of material misstatement⁴².

...

⁴⁰ ISA (NZ) 315 (Revised 2019), paragraph 170 establishes requirements and provides guidance on the engagement team's discussion of the susceptibility of the entity's financial statements to material misstatements ~~of the financial statements~~. ISA (NZ) 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," paragraph 15 provides guidance on the emphasis given during this discussion to the susceptibility of the entity's financial statements to material misstatement due to fraud.

⁴¹ ISA (NZ) 315 (Revised 2019), paragraph 26(a)

⁴² ISA (NZ) 315 (Revised 2019), Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and its Environment~~, paragraphs A134—A135 A191-A192.

Application and Other Explanatory Material

...

Materiality in the Context of an Audit

A2. Identifying and assessing the risks of material misstatement⁴³ involves the use of professional judgement to identify those classes of transactions, account balances and disclosures, including qualitative disclosures, the misstatement of which could be material (i.e., in general, misstatements are considered to be material if they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements as a whole).

....

ISA (NZ) 330, *The Auditor's Responses to Assessed Risks*

Introduction

Scope of this ISA (NZ)

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) 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 (NZ) 315 (Revised 2019)⁴⁴ in an audit of financial statements.

...

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

⁴³ ISA (NZ) 315 (Revised 2019), paragraph 25 ~~28~~, requires the auditor to identify and assess the risk of material misstatement at the financial statement and assertion level.

⁴⁴ ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

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)

...

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 enquiry 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, dDetermine 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)

...

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 enquiry 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~~ 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.

...

Evaluating the Sufficiency and Appropriateness of Audit Evidence

...

27. If the auditor has not obtained sufficient appropriate audit evidence ~~as to~~ 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.

...

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:

- Emphasising to the engagement team the need to maintain professional scepticism.
- 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 (NZ) 300, or planned audit procedures, and may include changes to:
- The auditor's determination of performance materiality in accordance with ISA (NZ) 320.
- The auditor's plans to tests 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.
- ~~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.~~

...

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 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 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. ~~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.

The auditor need not design and perform further audit procedures where the assessment of the risk of material misstatement is below the acceptably low level. 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 class of transactions, account balance, and disclosure.

...

- 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~~.

...

Responding to the Assessed Risks at the Assertion Level (Ref: Para. 7(a))

Nature

- A9. ISA (NZ) 315 (Revised 2019) 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 misstatement taking into account how, and the degree to which the inherent risk factors affect the susceptibility to misstatement of relevant assertions.⁴⁵ 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 to test the operating effectiveness of controls, and the auditor intends to base the substantive

⁴⁵ ISA (NZ) 315 (Revised 2019), paragraphs 31 and 34

procedures on that low assessment, then the auditor performs tests of those controls, as required by paragraph 8(a). 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.

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.

...

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 plans to test those controls. If substantially different controls were used at different times during the period under audit, each is considered 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.⁴⁶ 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.

...

Nature and Extent of Tests of Controls

Other audit procedures in combination with enquiry (Ref: Para. 10(a))

...

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 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 enquiry in combination with other audit procedures such as observation or the use of CAATs.

⁴⁶ ISA (NZ) 315 (Revised 2019), paragraph 3330

Extent of tests of controls

...

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 authorised 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 unauthorised access has not occurred during the period.~~

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 risk(s) arising from the use of IT that were identified in accordance with ISA (NZ) 315 (Revised 2019)⁴⁷ to provide the basis for the design of the auditor's additional procedures to address the assessed risk of material misstatement. Such procedures may address determining whether:

The related risk(s) arising from IT has occurred. For example, if users have unauthorised 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 risk(s) arising from the use of IT. If so, the auditor may identify such controls (if not already 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

⁴⁷ ISA (NZ) 315 (Revised 2019), paragraph 26(c)(i)

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 identified in accordance with ISA (NZ) 315 (Revised 2019) 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 authorised 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.

~~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 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))

...

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.

...

Evaluating the Operating Effectiveness of Controls (Ref: Para.16–17)

...

Substantive Procedures (Ref: Para. 6, 18)

A42. Paragraph 18 requires the auditor to design and perform substantive procedures for each material-class of transactions, account balance, and disclosure, ~~irrespective of the assessed risks of material misstatement.~~ 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 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 material in accordance with ISA (NZ) 315 (Revised 2019).⁴⁸

This requirement reflects the facts that: (a) the auditor's assessment of risk is judgemental 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 misstatement were to occur, there is a

⁴⁸ ISA (NZ) 315 (Revised 2019), paragraph 36

reasonable possibility of the misstatement being material, may assist in identifying the appropriate nature, timing and extent of the procedures to be performed.

Nature and Extent of Substantive Procedures

...

- 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 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~~ that the auditor 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.

Substantive Procedures Responsive to Significant Risks (Ref: Para. 21)

...

Using audit evidence obtained during an interim period (Ref: Para. 22)

...

- 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 analysing 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.

...

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 judgement 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 unrecognised 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 (NZ) 315 (Revised 2019) contains further guidance on revising the auditor's risk assessment.⁴⁹

...

A62. The auditor's judgement as to what constitutes sufficient appropriate audit evidence is influenced by such factors as the following:

- 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.

⁴⁹ ISA (NZ) 315 (Revised 2019), paragraph 533

- 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 judgement, 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.

...

ISA (NZ) 402, *Audit Considerations Relating to an Entity Using a Service Organisation*

Introduction

Scope of this ISA (NZ)

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) deals with the user auditor’s responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more service organisations. Specifically, it expands on how the user auditor applies ISA (NZ) 315 (Revised 2019)⁵⁰ and ISA (NZ) 330 in obtaining an understanding of the user entity, including the entity’s system of internal control relevant to the preparation of the financial statements ~~relevant to the audit~~, sufficient to identify and assess the risks of material misstatement and in designing and performing further audit procedures responsive to those risks.

...

3. Services provided by a service organisation are relevant to the audit of a user entity’s financial statements when those services, and the controls over them, are part of the user entity’s information system ~~including related business processes, relevant to financial reporting the preparation of the financial statements. Although in~~ Most controls at the service organisation are likely to relate to financial reporting be part of the user entity’s information system relevant to the preparation of the financial statements, there may be other or related controls that may also be relevant to the audit, such as controls over the safeguarding of assets. A service organisation’s services are part of a user entity’s information system; including related business processes, relevant to financial reporting if these services affect any of the following:

- (a) How information relating to significant classes of transactions, account balances and disclosures flows through the user entity’s information system, whether manually or

⁵⁰ ISA (NZ) 315 (Revised 2019), “Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment.~~”

using IT, and whether obtained from within or outside the general ledger and subsidiary ledgers. The classes of transactions in the user entity's operations that are significant to the user entity's financial statements; This includes when the service organisation's services affect how:

- (i) ~~(b) The procedures, within both information technology (IT) and manual systems, by which the user entity's transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements; Transactions of the user entity are initiated, and how information about them is recorded, processed, corrected as necessary, and incorporated in the general ledger and reported in the financial statements; and~~
- (ii) Information about events or conditions, other than transactions, is captured, processed and disclosed by the user entity in the financial statements.
- (b) ~~(e) The related accounting records, either in electronic or manual form, supporting information and specific accounts in the user entity's financial statements and other supporting records relating to the flows of information in paragraph 3(a) that are used to initiate, record, process and report the user entity's transactions; this includes the correction of incorrect information and how information is transferred to the general ledger;~~
- (d) ~~How the user entity's information system captures events and conditions, other than transactions, that are significant to the financial statements;~~
- (ce) The financial reporting process used to prepare the user entity's financial statements from the records described in paragraph 3(b), including as it relates to disclosures and to accounting estimates relating to significant classes of transactions, account balances and disclosures accounting estimates and disclosures; and
- (d) The entity's IT environment relevant to (a) to (c) above.
- (f) ~~Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.~~

...

Objectives

- 7. The objectives of the user auditor, when the user entity uses the services of a service organisation, are:
 - (a) To obtain an understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's system of internal control relevant to the audit, sufficient to provide an appropriate basis for the identification and assessment of identify and assess the risks of material misstatement; and
 - (b) To design and perform audit procedures responsive to those risks.

...

Requirements

Obtaining an Understanding of the Services Provided by a Service Organisation, Including Internal Control

9. When obtaining an understanding of the user entity in accordance with ISA (NZ) 315 (Revised 2019),⁵¹ the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including: (Ref: Para. A1-A2)
- (a) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity's internal control; (Ref: Para. A3-A5)
 - (b) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation; (Ref: Para. A6)
 - (c) The degree of interaction between the activities of the service organisation and those of the user entity; and (Ref: Para. A7)
 - (d) The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organisation. (Ref: Para. A8-A11)
10. When obtaining an understanding of the entity's system of internal control relevant to the audit in accordance with ISA (NZ) 315 (Revised 2019),⁵² the user auditor shall identify controls in the control activities component⁵³ ~~evaluate the design and implementation of relevant controls~~ at the user entity, from those that relate to the services provided by the service organisation, including those that are applied to the transactions processed by the service organisation, and evaluate their design and determine whether they have been implemented.⁵⁴ (Ref: Para. A12-A14)
11. The user auditor shall determine whether a sufficient understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's system of internal control relevant to the audit has been obtained to provide an appropriate basis for the identification and assessment of the risks of material misstatement.
12. If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor shall obtain that understanding from one or more of the following procedures:
- ...
- (c) Visiting the service organisation and performing procedures that will provide the necessary information about the relevant controls at the service organisation; or
 - (d) Using another auditor to perform procedures that will provide the necessary information about ~~the relevant~~ controls at the service organisation. (Ref: Para. A15-A20)

⁵¹ ISA (NZ) 315 (Revised 2019), paragraph 44.19.

⁵² ~~ISA (NZ) 315 (Revised), paragraph 12~~

⁵³ ISA (NZ) 315 (Revised 2019), paragraphs 26(a)

⁵⁴ ISA (NZ) 315 (Revised 2019), paragraph 26(d)

Using a Type 1 or Type 2 Report to Support the User Auditor's Understanding of the Service Organisation

...

14. If the user auditor plans to use a type 1 or type 2 report as audit evidence to support the user auditor's understanding about the design and implementation of controls at the service organisation, the user auditor shall:

...

- (b) Evaluate the sufficiency and appropriateness of the evidence provided by the report for the understanding of the user entity's internal controls at the service organisation relevant to the audit; and

...

Application and Other Explanatory Material

Obtaining an Understanding of the Services Provided by a Service Organisation, Including Internal Control

...

Understanding the Controls Relating to Services Provided by the Service Organisation (Ref: Para. 10)

...

- A14. As noted in ISA (NZ) 315 (Revised 2019),⁵⁵ in respect of some risks, the user auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions and account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. Such automated processing characteristics may be particularly present when the user entity uses service organisations. In such cases, the user entity's controls over such risks are relevant to the audit and the user auditor is required to obtain an understanding of, and to evaluate, such controls in accordance with paragraphs 9 and 10 of this ISA (NZ).

Further Procedures When a Sufficient Understanding Cannot Be Obtained from the User Entity (Ref: Para. 12)

...

- A19. Another auditor may be used to perform procedures that will provide the necessary information about the relevant controls at the service organisation related to services provided to the user entity. If a type 1 or type 2 report has been issued, the user auditor may use the service auditor to perform these procedures as the service auditor has an existing relationship with the service organisation. The user auditor using the work of another auditor may find the guidance in ISA (NZ) 600 useful as it relates to understanding another auditor (including that auditor's independence and professional competence), involvement in the

⁵⁵ ISA (NZ) 315 (Revised 2019), paragraph 30 26(a)(iii).

work of another auditor in planning the nature, timing and extent of such work, and in evaluating the sufficiency and appropriateness of the audit evidence obtained.

...

Using a Type 1 or Type 2 Report to Support the User Auditor's Understanding of the Service Organisation (Ref: Para. 13–14)

...

A22. A type 1 or type 2 report, along with information about the user entity, may assist the user auditor in obtaining an understanding of:

- (a) The aspects of controls at the service organisation that may affect the processing of the user entity's transactions, including the use of subservice organisations;
- (b) The flow of significant transactions through the service organisation to determine the points in the transaction flow where material misstatements in the user entity's financial statements could occur;
- (c) The control objectives at the service organisation that are relevant to the user entity's financial statement assertions; and
- (d) Whether controls at the service organisation are suitably designed and implemented to prevent, or detect and correct processing errors that could result in material misstatements in the user entity's financial statements.

A type 1 or type 2 report may assist the user auditor in obtaining a sufficient understanding to identify and assess the risks of material misstatement. A type 1 report, however, does not provide any evidence of the operating effectiveness of the ~~relevant~~ controls.

Responding to the Assessed Risks of Material Misstatement

...

Test of Controls

A29. The user auditor is required by ISA (NZ) 330 to design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of ~~relevant~~ controls in certain circumstances. In the context of a service organisation, this requirement applies when:

...

A30. If a type 2 report is not available, a user auditor may contact the service organisation, through the user entity, to request that a service auditor be engaged to provide a type 2 report that includes tests of the operating effectiveness of the ~~relevant~~ controls or the user auditor may use another auditor to perform procedures at the service organisation that test the operating effectiveness of those controls. A user auditor may also visit the service organisation and perform tests of ~~relevant~~ controls if the service organisation agrees to it. The user auditor's risk assessments are based on the combined evidence provided by the work of another auditor and the user auditor's own procedures.

Using a Type 2 Report as Audit Evidence that Controls at the Service Organisation Are Operating Effectively

...

A33. It may also be necessary for the user auditor to obtain additional evidence about significant changes to the ~~relevant~~ controls at the service organisation outside of the period covered by the type 2 report or determine additional audit procedures to be performed. Relevant factors in determining what additional audit evidence to obtain about controls at the service organisation that were operating outside of the period covered by the service auditor's report may include:

...

- The effectiveness of the control environment and the user entity's process to monitor the system of internal control ~~monitoring of controls at the user entity~~.

A34. Additional audit evidence may be obtained, for example, by extending tests of controls over the remaining period or testing the user entity's process to monitor the system of internal control ~~monitoring of controls~~.

...

A39. The user auditor is required to communicate in writing significant deficiencies identified during the audit to both management and those charged with governance on a timely basis.¹¹ The user auditor is also required to communicate to management at an appropriate level of responsibility on a timely basis other deficiencies in internal control identified during the audit that, in the user auditor's professional judgement,¹² are of sufficient importance to merit management's attention. Matters that the user auditor may identify during the audit and may communicate to management and those charged with governance of the user entity include:

- Any controls within the entity's process to monitor the system of internal control ~~monitoring of controls~~ that could be implemented by the user entity, including those identified as a result of obtaining a type 1 or type 2 report;

...

ISA (NZ) 500, *Audit Evidence*

Introduction

Scope of this ISA (NZ)

...

2. This ISA (NZ) is applicable to all the audit evidence obtained during the course of the audit. Other ISAs (NZ) deal with specific aspects of the audit (for example, ISA (NZ) 315 (Revised 2019)⁵⁶), the audit evidence to be obtained in relation to a particular topic (for example, ISA

⁵⁶ ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement* ~~through Understanding the Entity and Its Environment~~

(NZ) 570⁵⁷), specific procedures to obtain audit evidence (for example, ISA (NZ) 520⁵⁸), and the evaluation of whether sufficient appropriate audit evidence has been obtained (ISA (NZ) 200⁵⁹ and ISA (NZ) 330⁶⁰).

...

Application and Other Explanatory Material

Sufficient Appropriate Audit Evidence (Ref: Para. 6)

A5. 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 evaluated whether such information remains relevant and reliable as audit evidence for the current audit⁶¹~~determined whether changes have occurred since the previous audit that may affect its relevance to the current audit~~) 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 using the work of a management’s expert. 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.

...

Audit Procedures for Obtaining Audit Evidence

...

A14. As required by, and explained further in, ISA (NZ) 315 (Revised 2019) and ISA (NZ) 330, audit evidence to draw reasonable conclusions on which to base the auditor’s opinion is obtained by performing:

- (a) Risk assessment procedures; and
- (b) Further audit procedures, which comprise:
 - (i) Tests of controls, when required by the ISAs (NZ) or when the auditor has chosen to do so; and
 - (ii) Substantive procedures, including tests of details and substantive analytical procedures.

⁵⁷ ISA (NZ) 570 (Revised), *Going Concern*

⁵⁸ ISA (NZ) 520, *Analytical Procedures*

⁵⁹ ISA (NZ) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)*

⁶⁰ ISA (NZ) 330, *The Auditor’s Responses to Assessed Risks*

⁶¹ ISA (NZ) 315 (Revised 2019), paragraph 9 16

Observation

A21. Observation consists of looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of controls ~~activities~~. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed. See ISA (NZ) 501 for further guidance on observation of the counting of inventory.

...

A42. The nature and extent of the auditor's consideration takes into account the assessed risks of material misstatement at the assertion level to which the use of the external information is relevant, the degree to which the use of that information is relevant to the reasons for the assessed risks of material misstatement and the possibility that the information from the external information source may not be reliable (for example, whether it is from a credible source). Based on the auditor's consideration of the matters described in paragraph A39, the auditor may determine that further understanding of the entity and its environment, including its internal control, is needed, in accordance with ISA (NZ) 315 (Revised 2019), or that further audit procedures, in accordance with ISA (NZ) 330²⁰, and ISA (NZ) 540 (Revised)²¹ when applicable, are appropriate in the circumstances, to respond to the assessed risks of material misstatement related to the use of information from an external information source.

...

ISA (NZ) 501, *Audit Evidence—Special Considerations for Selected Items*

...

Application and Other Explanatory Material

Inventory

Attendance at Physical Inventory Counting (Ref: Para. 4(a))

...

Evaluate Management's Instructions and Procedures (Ref: Para. 4(a)(i))

A4. Matters relevant in evaluating management's instructions and procedures for recording and controlling the physical inventory counting include whether they address, for example:

- The application of appropriate controls ~~activities~~, for example, collection of used physical inventory count records, accounting for unused physical inventory count records, and count and re-count procedures.

...

ISA (NZ) 505, *Audit Evidence—External Confirmations*

....

Application and Other Explanatory Material

...

Management’s Refusal to Allow the Auditor to Send a Confirmation Request

...

Implications for the Assessment of Risks of Material Misstatement (Ref: Para. 8(b))

A9. The auditor may conclude from the evaluation in paragraph 8(b) that it would be appropriate to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures in accordance with ISA (NZ) 315 (Revised 2019).⁶² For example, if management’s request to not confirm is unreasonable, this may indicate a fraud risk factor that requires evaluation in accordance with ISA (NZ) 240.

...

Results of the External Confirmation Procedures

...

Unreliable Responses (Ref: Para. 11)

A17. When the auditor concludes that a response is unreliable, the auditor may need to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures accordingly, in accordance with ISA (NZ) 315 (Revised 2019).⁶³ For example, an unreliable response may indicate a fraud risk factor that requires evaluation in accordance with ISA (NZ) 240.

...

Non-Responses (Ref: Para. 12)

...

A19. The nature and extent of alternative audit procedures are affected by the account and assertion in question. A non-response to a confirmation request may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures, in accordance with ISA (NZ) 315 (Revised 2019).⁶⁴ For example, fewer responses to

⁶² ISA (NZ) 315 (Revised 2019), “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment,” paragraph 34-37.

⁶³ ISA (NZ) 315 (Revised 2019), paragraph 34-37.

⁶⁴ ISA (NZ) 315 (Revised 2019), paragraph 34-37.

confirmation requests than anticipated, or a greater number of responses than anticipated, may indicate a previously unidentified fraud risk factor that requires evaluation in accordance with ISA (NZ) 240.

...

ISA (NZ) 520, *Analytical Procedure*

Introduction

Scope of this ISA (NZ)

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) deals with the auditor's use of analytical procedures as substantive procedures ("substantive analytical procedures"). It also deals with the auditor's responsibility to perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements. ISA (NZ) 315 (Revised 2019)⁶⁵ deals with the use of analytical procedures as risk assessment procedures. ISA (NZ) 330 includes requirements and guidance regarding the nature, timing and extent of audit procedures in response to assessed risks; these audit procedures may include substantive analytical procedures.

...

Application and Other Explanatory Material

...

Analytical Procedures that Assist When Forming an Overall Conclusion (Ref: Para. 6)

...

- A18. The results of such analytical procedures may identify a previously unrecognised risk of material misstatement. In such circumstances, ISA (NZ) 315 (Revised 2019) requires the auditor to revise the auditor's assessment of the risks of material misstatement and modify the further planned audit procedures accordingly.⁶⁶

...

ISA (NZ) 530, *Audit Documentation*

Application and Other Explanatory Material

...

Sample Design, Size, and Selection of Items for Testing

⁶⁵ ISA (NZ) 315 (Revised 2019), "Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and its Environment,~~" paragraph 146(b).

⁶⁶ ISA (NZ) 315 (Revised 2019), paragraph 3437.

Sample Design (Ref: Para. 6)

...

A7. In considering the characteristics of a population, for tests of controls, the auditor makes an assessment of the expected rate of deviation based on the auditor's understanding of the ~~relevant~~ controls or on the examination of a small number of items from the population. This assessment is made in order to design an audit sample and to determine sample size....

...

Appendix 2 (Ref: Para. A11)

Example of Factors Influencing Sample Size for Test of Controls

The following are factors that the auditor may consider when determining the sample size for tests of controls. These factors, which need to be considered together, assume the auditor does not modify the nature or timing of tests of controls or otherwise modify the approach to substantive procedures in response to assessed risks.

Factor 1 An increase in the extent to which the auditor's risk assessment takes into account ~~relevant~~ plans to test the operating effectiveness of controls.

...

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

Scope of this ISA (NZ)

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) 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 (NZ) 315 (Revised 2019),⁶⁷ ISA (NZ) 330,⁶⁸ ISA (NZ) 450,⁶⁹ ISA (NZ) 500⁷⁰ and other relevant ISAs (NZ) 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

...

⁶⁷ ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

⁶⁸ ISA (NZ) 330, *The Auditor's Responses to Assessed Risks*

⁶⁹ ISA (NZ) 450, *Evaluation of Misstatements Identified during the Audit*

⁷⁰ ISA (NZ) 500, *Audit Evidence*

Key Concepts of This ISA (NZ)

4. ~~This ISA (NZ) 315 (Revised 2019)~~ requires a separate assessment of inherent risk for identified risks of material misstatement at the assertion level.⁷¹ ~~purposes of assessing the risks of material misstatement at the assertion level for accounting estimates.~~ In the context of ISA (NZ) 540 (Revised), and ~~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 (NZ) 200,⁷² 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 (NZ)~~ as the spectrum of inherent risk. (Ref: Para. A8–A9, A65–A66, Appendix 1)

5. This ISA (NZ) refers to relevant requirements in ISA (NZ) 315 (Revised 2019) and ISA (NZ) 330, and provides related guidance, to emphasise 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 (NZ) 315 (Revised 2019), 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 (NZ) 315 (Revised 2019)~~ 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 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.⁷³ (Ref: Para. A10)

7. This ISA (NZ) emphasises 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 scepticism 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

⁷¹ ISA (NZ) 315 (Revised 2019), paragraph 31

⁷² ISA (NZ) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)*, paragraph A40

⁷³ ISA (NZ) 530, *Audit Sampling*, Appendix 3

professional scepticism 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)

...

Objective

...

Definitions

...

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 (NZ) 315 (Revised 2019),⁷⁴ 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 audit evidence that provides 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 ~~or~~ conditions that may give rise to the need for, or changes in, accounting estimates to be recognised 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)

Obtaining an Understanding of tThe 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).

⁷⁴ ISA (NZ) 315 (Revised 2019), paragraphs 3, 5–6, 9, 11–12, 15–17, and 20–21/19–27

- (f) How management identifies the need for, and applies, specialised 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 component⁷⁵ ~~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.

...

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

⁷⁵ ISA (NZ) 315 (Revised 2019), paragraphs 26(a)(i)–(iv)

risk and control risk at the assertion level, as required by ISA (NZ) 315 (Revised 2019),⁷⁶ 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 judgement, a significant risk.⁷⁷ 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,⁷⁸ and evaluate whether such controls have been designed effectively, and determine whether they have been implemented.⁷⁹ (Ref: Para. A80)

...

19. As required by ISA (NZ) 330,⁸⁰ 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.

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.⁸¹ (Ref: Para. A85–A89)

...

Application and Other Explanatory Material

Nature of Accounting Estimates (Ref: Para. 2)

⁷⁶ ISA (NZ) 315 (Revised 2019), paragraph ~~25 and 26~~31 and 34

⁷⁷ ISA (NZ) 315 (Revised 2019), paragraph ~~32~~27

⁷⁸ ISA (NZ) 315 (Revised 2019), paragraph ~~26(a)(i)~~29

⁷⁹ ISA (NZ) 315 (Revised 2019), paragraph 26(a)

⁸⁰ ISA (NZ) 330, paragraph 8

⁸¹ ISA (NZ) 330, paragraph 9

Examples of Accounting Estimates

...

Key Concepts of This ISA (NZ)

Inherent Risk Factors (Ref: Para. 4)

- A8. ~~Inherent risk factors are characteristics of conditions and events or 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.~~⁸² 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 that the auditor may consider in identifying and~~ When assessing the risks of material misstatement at the assertion level⁸³, 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 (NZ) 315 (Revised 2019), (other than estimation uncertainty, complexity, and subjectivity), affect susceptibility to misstatement of assertions to misstatement about the accounting estimate. Such additional inherent risk factors 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 is~~ In assessing control risk at the assertion level in accordance with ISA (NZ) 315 (Revised 2019), 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, 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 the plan to test them.~~

Professional Scepticism (Ref: Para. 8)

....

⁸² ISA (NZ) 315 (Revised 2019), paragraph 12(f)

⁸³ ISA (NZ) 315 (Revised 2019), paragraph 31

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 ~~1911–2724~~ of ISA (NZ) 315 (Revised 2019) 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 (NZ) relate more specifically to accounting estimates and build on the broader requirements in ISA (NZ) 315 (Revised 2019).

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 judgements, 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 identified controls in that process are designed effectively and when determining whether the control has been implemented).

...

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.⁸⁴

...

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 (NZ) 315 (Revised 2019),⁸⁵ 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 behaviour; ~~and~~
- The ~~strengths in 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.

...

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 25(a)18(a) and (d) of ISA (NZ) 315 (Revised 2019). 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.

⁸⁴ ISA (NZ) 260 (Revised), paragraph 16(a)

⁸⁵ ISA (NZ) 315 (Revised 2019), paragraph 21(a)14

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 (NZ) 315 (Revised 2019) deals with circumstances where the auditor identifies risks of material misstatement that management failed to identify, including ~~determining whether there is a significant deficiency in internal control with regard to considering the implications for the auditor's evaluation of~~ the entity's risk assessment process.⁸⁶

...

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. When complexity in relation to models is present, controls over data integrity are also more likely to be identified controls in accordance with ISA (NZ) 315 (Revised 2019)~~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:
 - o The model's theoretical soundness;
 - o The model's mathematical integrity; and
 - o 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;
- 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.

⁸⁶ ISA (NZ) 315 (Revised 2019), paragraph 22(b)~~43~~

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 judgement 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 activities~~ in relation to all ~~the elements~~ aspects of paragraph 13(h)(ii); ~~depending on the complexity 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 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 unauthorised 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 (NZ) 315 (Revised 2019).⁸⁷

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;

⁸⁷ ISA (NZ) 315 (Revised 2019), Appendix 3 paragraph A77

- 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)

...

A60. A difference between the outcome of an accounting estimate and the amount recognised 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 finalised, or that could reasonably be expected to have been obtained and taken into account in the context of the applicable financial reporting framework.⁸⁸ 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.

Specialised 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 recognised in the financial statements, but also those that are included in the notes to the financial statements.

A65. Paragraph A42 of ISA (NZ) 200 states that the ISAs (NZ) ~~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 (NZ) 315 (Revised 2019) requires a separate assessment of inherent risk and control risk to provide a basis for designing and performing further audit procedures to respond to the risks of material misstatement at the assertion level,⁸⁹ including significant risks, at the assertion level for accounting estimates in accordance with ISA (NZ) 330.⁹⁰~~

A66. In identifying the risks of material misstatement and in assessing inherent risk ~~for accounting estimates in accordance with ISA (NZ) 315 (Revised 2019),⁹¹ 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 that affect susceptibility to misstatement of assertions, and how they do~~

⁸⁸ ISA (NZ) 560, Subsequent Events, paragraph 14

⁸⁹ ISA (NZ) 315 (Revised 2019), paragraphs 31 and 34

⁹⁰ ISA (NZ) 330, paragraph 7(b)

⁹¹ ISA (NZ) 315 (Revised 2019), paragraph 31(a)

~~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 misstatement (i.e., ~~W~~where inherent risk is assessed on the spectrum of inherent risk); and
- Determining ~~T~~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.

...

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.

...

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,⁹² regardless of how the inherent risk factors affect susceptibility of assertions to misstatement relating to 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.

...

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.

⁹² ISA (NZ) 315 (Revised 2019), paragraph 37~~34~~

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.

...

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 judgement 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.

...

Responses to the Assessed Risks of Material Misstatement

...

Testing How Management Made the Accounting Estimate (Ref. Para. 22)

...

Significant Assumptions (Ref: Para. 24)

...

A104. Through the knowledge obtained in performing the audit, the auditor may become aware of or may have obtained an understanding of assumptions used in other areas of the entity's business. Such matters may include, for example, business prospects, assumptions in strategy documents and future cash flows. Also, if the engagement partner has performed other engagements for the entity, ISA (NZ) 315 (Revised 2019)⁹³ requires the engagement partner to consider whether information obtained from those other engagements is relevant to identifying risks of material misstatement. This information may also be useful to consider in addressing whether significant assumptions are consistent with each other and with those used in other accounting estimates.

...

Overall Evaluation Based on Audit Procedures Performed (Ref: Para. 33)

A137. 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.⁹⁴ In relation to accounting estimates, information may come to the auditor's attention through performing procedures to obtain audit evidence that differs significantly from the information on which the risk assessment was based. For example, the auditor may have identified that the only reason for an assessed risk of material misstatement is the subjectivity

⁹³ ISA (NZ) 315 (Revised 2019), paragraph 8.16

⁹⁴ ISA (NZ) 330, paragraph A60

involved in making the accounting estimate. However, while performing procedures to respond to the assessed risks of material misstatement, the auditor may discover that the accounting estimate is more complex than originally contemplated, which may call into question the assessment of the risk of material misstatement (for example, the inherent risk may need to be re-assessed on the higher end of the spectrum of inherent risk due to the effect of complexity) and therefore the auditor may need to perform additional further audit procedures to obtain sufficient appropriate audit evidence.⁹⁵

...

Documentation (Ref: Para. 39)

A149. ISA (NZ) 315 (Revised 2019)⁹⁶ and ISA (NZ) 330 provide requirements and guidance on documenting the auditor's understanding of the entity, risk assessments and responses to assessed risks. This guidance is based on the requirements and guidance in ISA (NZ) 230. In the context of auditing accounting estimates, the auditor is required to prepare audit documentation about key elements of the auditor's understanding of the entity and its environment related to accounting estimates. In addition, the auditor's judgements about the assessed risks of material misstatement related to accounting estimates, and the auditor's responses, may likely be further supported by documentation of communications with those charged with governance and management.

...

ISA (NZ) 550, *Related Parties*

Introduction

Scope of this ISA (NZ)

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) deals with the auditor's responsibilities relating to related party relationships and transactions in an audit of financial statements. Specifically, it expands on how ISA (NZ) 315 (Revised 2019),⁹⁷ ISA (NZ) 330,⁹⁸ and ISA (NZ) 240⁹⁹ are to be applied in relation to risks of material misstatement associated with related party relationships and transactions.

...

11. As part of the risk assessment procedures and related activities that ISA (NZ) 315 (Revised 2019) and ISA (NZ) 240 require the auditor to perform during the audit,¹⁰⁰ the auditor shall perform the audit procedures and related activities set out in paragraphs 12-17 to obtain information relevant to identifying the risks of material misstatement associated with related party relationships and transactions. (Ref: Para. A8)

⁹⁵ See also ISA (NZ) 315 (Revised 2019), paragraph ~~31~~37

⁹⁶ ISA (NZ) 315 (Revised 2019), paragraphs ~~32~~38 and ~~A153-A156~~A237-A241

⁹⁷ ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

⁹⁸ ISA (NZ) 330, "The Auditor's Responses to Assessed Risks."

⁹⁹ ISA (NZ) 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements."

¹⁰⁰ ISA (NZ) 315 (Revised 2019), paragraph ~~5~~13; and ISA (NZ) 240, paragraph 16.

12. The engagement team discussion that ISA (NZ) 315 (Revised 2019) and ISA (NZ) 240 require¹⁰¹ shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions. (Ref: Para. A9-A10)

...

18. In meeting the ISA (NZ) 315 (Revised 2019) requirement to identify and assess the risks of material misstatement,¹⁰² the auditor shall identify and assess the risks of material misstatement associated with related party relationships and transactions and determine whether any of those risks are significant risks. In making this determination, the auditor shall treat identified significant related party transactions outside the entity's normal course of business as giving rise to significant risks.

...

Application and Other Explanatory Material

...

Risk Assessment Procedures and Related Activities

...

A7. In some circumstances, a special-purpose entity¹⁰³ may be a related party of the entity because the entity may in substance control it, even if the entity owns little or none of the special-purpose entity's equity.

...

Understanding the Entity's Related Party Relationships and Transactions

Discussion among the Engagement Team (Ref: Para. 12)

A9. Matters that may be addressed in the discussion among the engagement team include:

- ...
- The importance that management and those charged with governance attach to the identification, appropriate accounting for, and disclosure of related party relationships and transactions (if the applicable financial reporting framework establishes related party requirements), and the related risk of management override of ~~relevant~~ controls.

¹⁰¹ ISA (NZ) 315 (Revised 2019), paragraph ~~40~~17; and ISA (NZ) 240, paragraph 15.

¹⁰² ISA (NZ) 315 (Revised 2019), paragraph ~~25~~28.

¹⁰³ ISA (NZ) 315 (Revised 2019), paragraphs ~~A27-A28~~ A68-A70, provides guidance regarding the nature of a special-purpose entity.

...

The Identity of the Entity's Related Parties (Ref: Para. 13(a))

...

A12. However, where the framework does not establish related party requirements, the entity may not have such information systems in place. Under such circumstances, it is possible that management may not be aware of the existence of all related parties. Nevertheless, the requirement to make the inquiries specified by paragraph 13 still applies because management may be aware of parties that meet the related party definition set out in this ISA (NZ). In such a case, however, the auditor's inquiries regarding the identity of the entity's related parties are likely to form part of the auditor's risk assessment procedures and related activities performed in accordance with ISA (NZ) 315 (Revised 2019) to obtain information regarding the entity's organisational structure, ownership, governance and business model.¹⁰⁴

- ~~The entity's ownership and governance structures;~~
- ~~The types of investments that the entity is making and plans to make; and~~
- ~~The way the entity is structured and how it is financed.~~

In the particular case of common control relationships, as management is more likely to be aware of such relationships if they have economic significance to the entity, the auditor's inquiries are likely to be more effective if they are focused on whether parties with which the entity engages in significant transactions, or shares resources to a significant degree, are related parties.

...

The Entity's Controls over Related Party Relationships and Transactions (Ref: Para. 14)

...

A17. In meeting the ISA (NZ) 315 (Revised 2019) requirement to obtain an understanding of the control environment,¹⁰⁴ the auditor may consider features of the control environment relevant to mitigating the risks of material misstatement associated with related party relationships and transactions, such as:

...

Considerations specific to smaller entities

A20. Controls ~~activities~~ in smaller entities are likely to be less formal and smaller entities may have no documented processes for dealing with related party relationships and transactions. An owner-manager may mitigate some of the risks arising from related party transactions, or potentially increase those risks, through active involvement in all the main aspects of the transactions. For such entities, the auditor may obtain an understanding of the related party relationships and transactions, and any controls that may exist over these, through enquiry of management combined with other procedures, such as observation of management's oversight and review activities, and inspection of available relevant documentation.

¹⁰⁴ ISA (NZ) 315 (Revised 2019), paragraph 4421.

...

Sharing Related Party Information with the Engagement Team (Ref: Para. 17)

A28. Relevant related party information that may be shared among the engagement team members includes, for example:

- The identity of the entity's related parties.
- The nature of the related party relationships and transactions.
- Significant or complex related party relationships or transactions that may be determined to be significant risks ~~require special audit consideration~~, in particular transactions in which management or those charged with governance are financially involved.

...

Responses to the Risks of Material Misstatement Associated with Related Party Relationships and Transactions (Ref: Para. 20)

...

A34. Depending upon the results of the auditor's risk assessment procedures, the auditor may consider it appropriate to obtain audit evidence without testing the entity's controls over related party relationships and transactions. In some circumstances, however, it may not be possible to obtain sufficient appropriate audit evidence from substantive audit procedures alone in relation to the risks of material misstatement associated with related party relationships and transactions. For example, where intra-group transactions between the entity and its components are numerous and a significant amount of information regarding these transactions is initiated, recorded, processed or reported electronically in an integrated system, the auditor may determine that it is not possible to design effective substantive audit procedures that by themselves would reduce the risks of material misstatement associated with these transactions to an acceptably low level. In such a case, in meeting the ISA (NZ) 330 requirement to obtain sufficient appropriate audit evidence as to the operating effectiveness of ~~relevant~~ controls,¹⁰⁵ the auditor is required to test the entity's controls over the completeness and accuracy of the recording of the related party relationships and transactions.

...

ISA (NZ) 570 (Revised), *Going Concern*

...

Requirements

Risk Assessment Procedures and Related Activities

¹⁰⁵ ISA (NZ) 330, paragraph 8(b)

10. When performing risk assessment procedures as required by ISA (NZ) 315 (Revised 2019),¹⁰⁶ the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern. ...

...

Application and Other Explanatory Material

...

Remaining Alert throughout the Audit for Audit Evidence about Events or Conditions (Ref: Para. 11)

- A7. ISA (NZ) 315 (Revised 2019) requires the auditor to revise the auditor's risk assessment and modify the further planned audit procedures accordingly when additional audit evidence is obtained during the course of the audit that affects the auditor's assessment of risk.¹⁰⁷...

...

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

...

Requirements

Understanding the Group, Its Components and Their Environments

17. The auditor is required to identify and assess the risks of material misstatement through obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the system of internal control.¹⁰⁸ The group engagement team shall:
- (a) ...
18. The group engagement team shall obtain an understanding that is sufficient to:
- (a) Confirm or revise its initial identification of components that are likely to be significant; and
 - (b) Assess the risks of material misstatement of the group financial statements, whether due to fraud or error.¹⁰⁹ (Ref: Para. A30-A31)

...

Application and Other Explanatory Material

¹⁰⁶ ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

¹⁰⁷ ISA (NZ) 315 (Revised), paragraph ~~34~~37.

¹⁰⁸ ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

¹⁰⁹ ISA (NZ) 315 (Revised 2019).

...

Definitions

...

Significant Component (Ref: Para. 9(m))

...

A6. The group engagement team may also identify a component as likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances, ~~(that is, risks that require special audit consideration¹¹⁰)~~. For example, a component could be responsible for foreign exchange trading and thus expose the group to a significant risk of material misstatement, even though the component is not otherwise of individual financial significance to the group.

...

Understanding the Group, Its Components, and Their Environments

Matters about Which the Group Engagement Team Obtains an Understanding (Ref: Para. 17)

A23. ISA (NZ) 315 (Revised 2019) contains guidance on matters the auditor may consider when obtaining an understanding of the industry, regulatory, and other external factors that affect the entity, including the applicable financial reporting framework; the nature of the entity; objectives and strategies and related business risks; and measurement and review of the entity's financial performance.¹¹¹ Appendix 2 of this ISA (NZ) contains guidance on matters specific to a group including the consolidation process.

Discussion among Group Engagement Team Members and Component Auditors Regarding the Risks of Material Misstatement of the Group Financial Statements, Including Risks of Fraud (Ref: Para. 17)

A28. The key members of the engagement team are required to discuss the susceptibility of an entity to material misstatement of the financial statements due to fraud or error, specifically emphasising the risks due to fraud. In a group audit, these discussions may also include the component auditors.¹¹²

Appendix 2

Examples of Matters about Which the Group Engagement Team Obtains an Understanding

¹¹⁰ ISA (NZ) 315 (Revised), paragraphs 27–29

¹¹¹ ISA (NZ) 315 (Revised 2019), paragraphs A6225–A6449 and Appendix 1

¹¹² ISA (NZ) 240, paragraph 15; ISA (NZ) 315 (Revised 2019), paragraph 4017.

...

Group-Wide Controls

1. Group-wide controls may include a combination of the following:

Regular meetings between group and component management to discuss business developments and to review performance.

...

Controls ~~activities~~ within an IT system that is common for all or some components.

Controls within the group's process to monitor ~~Monitoring the system of internal~~ controls, including activities of the internal audit function and self-assessment programs.

...

Appendix 5

Required and Additional Matters Included in the Group Engagement Team's Letter of Instruction

Matters that are relevant to the planning of the work of the component auditor:

...

...

Matters that are relevant to the conduct of the work of the component auditor:

The findings of the group engagement team's tests of controls ~~activities~~ of a processing system that is common for all or some components, and tests of controls to be performed by the component auditor.

...

ISA (NZ) 610 (Revised 2013), *Using the Work of Internal Auditors*

Introduction

...

Relationship between ISA (NZ) 315 (Revised 2019) and ISA (NZ) 610 (Revised 2013)

...

7. ISA (NZ) 315 (Revised 2019) addresses how the knowledge and experience of the internal audit function can inform the external auditor's understanding of the entity and its

environment, the applicable financial reporting framework and the entity's system of internal control, and identification and assessment of risks of material misstatement. ISA (NZ) 315 (Revised 2019)¹¹³ also explains how effective communication between the internal and external auditors also creates an environment in which the external auditor can be informed of significant matters that may affect the external auditor's work.

...

Application and Other Explanatory Material

Definition of Internal Audit Function (Ref: Para. 2, 14(a))

...

- A3. In addition, those in the entity with operational and managerial duties and responsibilities outside of the internal audit function would ordinarily face threats to their objectivity that would preclude them from being treated as part of an internal audit function for the purpose of this ISA (NZ), although they may perform controls ~~activities~~ that can be tested in accordance with ISA (NZ) 330. For this reason, monitoring controls performed by an owner-manager would not be considered equivalent to an internal audit function.
- A4. While the objectives of an entity's internal audit function and the external auditor differ, the function may perform audit procedures similar to those performed by the external auditor in an audit of financial statements. If so, the external auditor may make use of the function for purposes of the audit in one or more of the following ways:
- To obtain information that is relevant to the external auditor's assessments of the risks of material misstatements due to error or fraud. In this regard, ISA (NZ) 315 (Revised 2019)¹¹⁴ requires the external auditor to obtain an understanding of the nature of the internal audit function's responsibilities, its status within the organisation, and the activities performed, or to be performed, and make enquiries of appropriate individuals within the internal audit function (if the entity has such a function); ...

...

Evaluating the Internal Audit Function

...

Application of a Systematic and Disciplined Approach (Ref: Para. 15(c))

- A10. The application of a systematic and disciplined approach to planning, performing, supervising, reviewing and documenting its activities distinguishes the activities of the internal audit function from other monitoring controls ~~activities~~ that may be performed within the entity.

...

¹¹³ ISA (NZ) 315 (Revised 2019), paragraph ~~A14~~**A118**

¹¹⁴ ISA (NZ) 315 (Revised 2019), paragraph ~~614~~(a).

A21. As explained in ISA (NZ) 315 (Revised 2019),¹¹⁵ significant risks ~~require special audit consideration~~ are risks assessed close to the upper end of the spectrum of inherent risk and therefore the external auditor's ability to use the work of the internal audit function in relation to significant risks will be restricted to procedures that involve limited judgement. In addition, where the risks of material misstatement is other than low, the use of the work of the internal audit function alone is unlikely to reduce audit risk to an acceptably low level and eliminate the need for the external auditor to perform some tests directly.

...

A26. ISA (NZ) 200¹¹⁶ discusses the importance of the auditor planning and performing the audit with professional scepticism, including being alert to information that brings into question the reliability of documents and responses to enquiries to be used as audit evidence. Accordingly, communication with the internal audit function throughout the engagement may provide opportunities for internal auditors to bring matters that may affect the work of the external auditor to the external auditor's attention.¹¹⁷ The external auditor is then able to take such information into account in the external auditor's identification and assessment of risks of material misstatement. In addition, if such information may be indicative of a heightened risk of a material misstatement of the financial statements or may be regarding any actual, suspected or alleged fraud, the external auditor can take this into account in the external auditor's identification of risk of material misstatement due to fraud in accordance with ISA (NZ) 240.¹¹⁸

...

ISA (NZ) 620, *Using the Work of an Auditor's Expert*

...

Application and Other Explanatory Material

...

Determining the Need for an Auditor's Expert (Ref: Para. 7)

A4. An auditor's expert may be needed to assist the auditor in one or more of the following:

- Obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the, including its entity's system of internal control.

...

¹¹⁵ ISA (NZ) 315 (Revised 2019), paragraph 12(l)

¹¹⁶ ISA (NZ) 200, paragraphs 15 and A18.

¹¹⁷ ISA (NZ) 315 (Revised 2019), paragraph A116A118.

¹¹⁸ ISA (NZ) 315 (Revised 2019), paragraph A11 in relation to ISA (NZ) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.

ISA (NZ) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

...

Application and Other Explanatory Material

...

NZA47.1 Law or regulation prescribing the responsibilities of those charged with governance may specifically refer to a responsibility for the adequacy of accounting books and records, or accounting system. As books, records and systems are an integral part of internal control (as defined in ISA (NZ) 315 (Revised 2019)¹¹⁹, the descriptions in ISA (NZ) 210 and in paragraph 34 do not make specific reference to them.

...

ISA (NZ) 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

...

Determining Key Audit Matters (Ref: Para. 9–10)

Considerations in Determining Those Matters that Required Significant Auditor Attention (Ref: Para. 9)

9. The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following: (Ref: Para. A9–A18)
 - a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with ISA (NZ) 315 (Revised 2019).¹²⁰(Ref: Para. ~~A19–A22~~ A39–A43) ...

Application and Other Explanatory Material

...

Areas of Higher Assessed Risk of Material Misstatement, or Significant Risks Identified in Accordance with ISA (NZ) 315 (Revised 2019) (Ref: Para. 9(a))

...

A20. ISA (NZ) 315 (Revised 2019) defines a significant risk as an identified ~~and assessed~~ risk of material misstatement 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

¹¹⁹ ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* paragraph 4.12(c)

¹²⁰ ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur that, in the auditor's judgement, requires special audit consideration.¹²¹ Areas of significant management judgement and significant unusual transactions may often be identified as significant risks. Significant risks are therefore often areas that require significant auditor attention.

...

A22. ISA (NZ) 315 (Revised 2019) explains that the auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained.¹²²...

...

ISA (NZ) 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

...

Application and Other Explanatory Material

...

Reading and Considering the Other Information (Ref: Para. 14–15)

...

Considering Whether There Is a Material Inconsistency between the Other Information and the Auditor's Knowledge Obtained in the Audit (Ref: Para. 14(b))

...

A31. The auditor's knowledge obtained in the audit includes the auditor's understanding of the entity and its environment, the applicable financial reporting framework, and including the entity's system of internal control, obtained in accordance with ISA (NZ) 315 (Revised 2019).¹²³ ISA (NZ) 315 (Revised 2019) sets out the auditor's required understanding, which includes such matters as obtaining an understanding of:

- (a) The entity's organisational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT;
- (b) ~~The r~~Relevant industry, regulatory, and other external factors;
- (c) The relevant measures used, internally and externally, to assess measurement and review of the entity's financial performance; ~~and~~

¹²¹ ISA (NZ) 315 (Revised 2019), paragraph 12(l)

¹²² ISA (NZ) 315 (Revised 2019), paragraph 34-37.

¹²³ ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraphs 19-27-22

- (b) ~~The nature of the entity;~~
- (c) ~~The entity's selection and application of accounting policies;~~
- (d) ~~The entity's objectives and strategies;~~

...

Responding When a Material Misstatement in the Financial Statements Exists or the Auditor's Understanding of the Entity and Its Environment Needs to Be Updated (Ref: Para. 20)

A51. In reading the other information, the auditor may become aware of new information that has implications for:

- The auditor's understanding of the entity and its environment, the financial reporting framework and the entity's system of internal control and, accordingly, may indicate the need to revise the auditor's risk assessment.

...

ISA (NZ) 800 (Revised), *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*

...

Considerations When Planning and Performing the Audit

...

10. ISA (NZ) 315 (Revised 2019) requires the auditor to obtain an understanding of the entity's selection and application of accounting policies.¹²⁴ In the case of financial statements prepared in accordance with the provisions of a contract, the auditor shall obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements. An interpretation is significant when adoption of another reasonable interpretation would have produced a material difference in the information presented in the financial statements.

...

XRB Au1, *Application of Auditing and Assurance Standards*

In Appendix 2, ISA (NZ) 315 (revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, is amended to reflect the issue of ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*.

¹²⁴ ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraphs ~~14~~(e) 19(b)

EFFECTIVE DATE

An auditor that is required to apply the amendments in this Standard is required to apply it for audits of financial statements for periods beginning on or after 15 December 2021. However, early adoption is permitted.