Australian Government

Auditing and Assurance Standards Board

AUASB Bulletin

Auditing Considerations in an Uncertain Economic Environment

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Matters covered in this Bulletin

To assist auditors in considering how to deal with the greater risks presented by an uncertain or difficult economic environment, this Bulletin discusses the following matters:

- Continuance of the client relationship;
- Communications with those having oversight responsibility for the financial reporting process;
- Communications with management and those charged with governance;
- Going concern considerations;
- Planning the overall audit strategy;
- Understanding the entity and its environment, and assessing and responding to the risks of material misstatement;
- Auditing fair value measurements and accounting estimates;
- Audit considerations for other selected financial reporting areas;
- Financial report disclosures and auditor's opinions;
- Audits of superannuation plans; and
- Documentation.

Introduction

This Bulletin has been prepared in an environment when the breadth and depth of uncertain economic conditions impact all entities to some degree. In many cases, nearly every aspect of the entity's financial report may be affected. This includes the financial report of entities whose audits have largely been problem—free in the past. Therefore, auditors may need to make significant changes to many aspects of their financial report audits to respond to the effects of uncertain economic conditions. Matters to consider range from overall decisions regarding client continuance, staffing and the extent of supervision, to detailed decisions on the nature, timing and extent of specific audit procedures appropriate in the circumstances.[1]

The degree to which the entity and its financial report will be affected by an uncertain or difficult economic environment will depend on various matters, such as the following:

- The nature of the entity, the industry in which it operates and the likely effects of a severe economic downturn on the demand for its products or services. For example, retail entities may suffer declines in sales because of significant cutbacks in consumer discretionary spending. Resource entities may suffer a decline in revenues because of a significant decline in commodity prices and/or reduced demand for raw materials.
- The entity's financing or credit arrangements, including its ability to continue to obtain financing from financial institutions and other creditors (including suppliers). For example, some entities that have traditionally been able to obtain financing at reasonable rates with little difficulty may find that they face a considerable tightening in the lending practices of many financial institutions, which themselves may be facing liquidity difficulties. Also, entities may no longer be able to meet the requirements of debt covenants agreed to when the economic outlook was more positive.
- The extent to which the entity has invested in financial instruments, the market for which may have been hit hard by a credit crisis or other aspects of an economic downturn. For example, the entity may have significant investments in asset—backed commercial papers or credit default swaps.

1 This AUASB Bulletin is adapted from *Auditing Considerations in the Current Economic Environment*, a Risk Alert issued, in January 2009, by the Canadian Institute of Chartered Accountants (CICA). Reproduced with permission from the CICA and amended as appropriate by the AUASB, for the Australian business and regulatory environment.

- The extent of the entity's use of accounting estimates, particularly fair value measurements.
- The extent of the entity's exposure to real estate properties that are likely to be impaired in value due to market uncertainties.
- The inability of key suppliers to provide goods or services to the entity and the inability of key customers to meet credit terms.

This Bulletin is relevant to the financial report audits of all entities. Where there is reference to "company", it is taken to include all applicable types of entities and it needs to be read and understood in the context of the type of entity being audited.

This Bulletin is not meant to be exhaustive, and auditors should always refer to the Australian Auditing Standards when conducting an audit. In respect of matters not covered by this Bulletin, it is expected that auditors will use professional judgement appropriate to the audit. In conducting an audit in accordance with Australian Auditing Standards, auditors are required to comply with *all* the Australian Auditing Standards that are relevant to the engagement.

Continuance of the client relationship

The auditor is required to perform procedures regarding the continuance of the client relationship.[2] Matters for the auditor to consider in deciding whether to continue a client relationship include the integrity of the principal owners, those charged with governance and key management.[3] Faced with major pressures created by financial difficulties, management (perhaps with the co—operation or direction of those charged with governance) may have made changes to business practices or internal controls that could indicate a lack of integrity. If such indications are found to have substance, this would lead the auditor to question whether it is appropriate to continue the engagement to audit that entity's financial report. In such circumstances, the auditor should also consider any legal or regulatory requirements for continuing or withdrawing from the client relationship.[4]

2 See Auditing Standard ASA 300 *Planning an Audit of a Financial Report*, paragraph 9 (requirement).

3 See Auditing Standard ASA 220 *Quality Control for Audits of Historical Financial Information*, paragraph 19 (explanatory guidance).

4 See Section 329 of the *Corporations Act 2001* and ASIC Regulatory Guide 26 *Resignation of Auditors* for more information.

Communications with those having oversight responsibility for the financial reporting process

In Australia, those charged with governance (i.e. the board of directors of a company or, in the case of other entities, an equivalent governance body) are responsible for the oversight function of the entity. They may voluntarily, or in compliance with ASX Listing Rules, establish an audit committee to assist them in fulfilling their responsibilities.[5] Audit committees play a critical role in oversight of the financial reporting process. This role is even more important in times of uncertainty or financial stress for entities — overseeing the establishment and maintenance of internal controls to provide reasonable assurance with regard to the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

In respect of the oversight provided by the audit committee in an uncertain or difficult economic environment, the auditor may consider whether the audit committee has been involved, together with those charged with governance, in key activities that include some or all of the following:

- Reconsidering the risks that the entity faces and ensuring that the audit committee has considered the impact of any new risks, alone and in combination with pre—existing risks, on its oversight responsibility for the financial reporting process, in advance of the year or half—year end.
- Reconfirming with management that reporting and internal control systems are in place and functioning effectively and that resources are in place to support difficult year—end judgements.
- If the entity has heightened liquidity risk, discussing with management whether there are material uncertainties that may indicate significant doubt about whether the entity is a going concern, examining the rigour with which management's assessment of the entity's ability to continue as a going concern has been made and the appropriateness of any related disclosures in the financial report.
- In volatile financial and non—financial markets, obtaining a better understanding of management's judgements with respect to illiquid asset values and requiring more detailed analysis and supporting information than in previous years.
- Obtaining assurance from management that significant accounting policies (e.g. fair value measurements) and reporting judgements are supported by a degree of rigour and analysis appropriate to the circumstances, as well as appropriate documentation.

In discussing with the audit committee matters that have a significant effect on the qualitative aspects of accounting policies used in the entity's financial reporting,[6] the auditor may consider whether the audit committee is informed about the process used by management in formulating particularly sensitive and/or significant accounting estimates and disclosures. The auditor would also discuss the adoption of new accounting pronouncements and the clarity and completeness of the related financial report disclosures. For example, in difficult or uncertain economic conditions, auditors will have an increased focus on the completeness of the material measurement uncertainties disclosed in the financial report and auditors may consider discussing such matters with the audit committee.

Communications with management and those charged with governance

Regular communication with management and those charged with governance is an essential aspect of an audit engagement. This becomes even more important in times of economic uncertainty in order to resolve on a timely basis any issues that may impact on the entity's ability to continue as a going concern. Auditors should be cognisant of the increased need to communicate in a timely manner with management and those charged with governance (including company directors and audit committees) about matters such as:

- When the auditor becomes aware of a material weakness in the design or implementation of internal controls which may give rise to a possible material misstatement in the financial report.[7]
- When the auditor obtains an understanding of the entity and its environment, including internal controls, and the auditor makes enquiries of management regarding:

5 See Auditing Standard ASA 260 *Communications of Audit Matters with Those Charged with Governance,* paragraph 10 (explanatory guidance).

6 See Auditing Standard ASA 260, paragraphs 15-16 (requirement and explanatory guidance).

7 See Auditing Standard ASA 315 *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*, paragraph 141 (requirement) and paragraph 142 (explanatory guidance).

- Management's assessment of the risk that the financial report may be materially misstated due to fraud;
- Management's process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or account balances, classes of transactions or disclosures for which a risk of fraud is likely to exist;
- Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.[8]

- When the auditor obtains an understanding of the nature of assumptions used in fair value measurements which are significant to the financial report (e.g. valuation of financial instruments), the degree of subjectivity involved in the development of those assumptions, and the materiality of the items being measured at fair value relative to the financial report as a whole.[9]
- When the auditor evaluates accounting estimates that are material to the entity's financial report, and considers whether those charged with governance have been appropriately informed about the processes used by management and other responsible personnel (e.g. third party experts) in developing and quantifying sensitive or difficult accounting estimates.[10]
- When auditors perform their assessment of the going concern assumptions and related disclosures prepared by those charged with governance.

Going concern considerations

The going concern assumption is a fundamental principle in the preparation of a financial report. Under the going concern assumption, the entity ordinarily is viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations. Accordingly, unless the going concern assumption is inappropriate in the circumstances of the entity, assets and liabilities are recorded on the basis that the entity will be able to realise its assets, discharge its liabilities, and obtain refinancing (if necessary) in the normal course of business.

The assessment of the entity's ability to continue as a going concern is the responsibility of the entity's management. In making its assessment, when management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, management is required to disclose those uncertainties in the financial report.[11] Also, in assessing whether the going concern assumption is appropriate, management is required by Australian Accounting Standards to take into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period.[12] In periods of economic uncertainty, it becomes even more critical that this assessment be documented and supported by appropriate evidence.

The auditor's responsibilities in respect of the assessment of going concern are as follows:

- The auditor needs to consider the appropriateness of management's use of the going concern assumption in the preparation of the financial report;
- The auditor needs to consider whether there are material uncertainties about the entity's ability to continue as a going concern that should be disclosed in the financial report;
- The auditor needs to consider the appropriateness of management's use of the going concern assumption even if the financial reporting framework used in the preparation of the financial report does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern;[13] and
- The auditor needs to consider the relevant period in evaluating management's assessment of the entity's ability to continue as a going concern. The relevant period is the period of approximately twelve months from the date of the current audit report to the expected audit report date for the next reporting period (i.e. next annual reporting

8 See Auditing Standard ASA 240 *The Auditor's Responsibility to Consider Fraud in an Audit of a Financial Report*, paragraph 17 (explanatory guidance).
9 See Auditing Standard ASA 545 *Auditing Fair Value Measurements and Disclosures*, paragraph 74 (explanatory guidance).
10 See Auditing Standard ASA 540 *Audit of Accounting Estimates*, paragraphs 15 and 25 (explanatory guidance).
11 See AASB 101 *Presentation of Financial Statements*, paragraph 25.
12 See AASB 101, paragraph 26.
13 See Compiled Auditing Standard ASA 570, *Going Concern,* paragraph 14 (requirement and explanatory guidance).

period for an annual financial report, or the corresponding reporting period in the following year for an interim financial report).[14] The auditor is required to ask management to extend its own assessment period to correspond to the auditor's relevant period, if management's assessment period is shorter than the auditor's relevant period.[15]

In an uncertain or difficult economic environment, the reduced availability of credit, and illiquidity in short-term funding, may create conditions that indicate a potential problem or jeopardise the continuance of the entity as a going concern. Issues surrounding liquidity and credit risk may create new uncertainties, or may exacerbate those already existing. Ordinarily, the management of the entity with a history of profitable operations and ready access to financial resources may make its going concern assessment without a detailed analysis.[16] However, economic uncertainties are likely to make this approach no longer appropriate for many entities. Previous assumptions relating to profitability may no longer suitably support management's assessment of the going concern status of the entity. Many entities with a long-standing history of profits and availability of capital may find it difficult to obtain or renew financing. Consequently, entities that have not previously found the need to prepare a detailed analysis in support of the going concern assumption may need to give the matter further consideration. Auditors may benefit from early discussions with management regarding the nature of the assessment that the auditor would expect management to prepare to demonstrate management's compliance with the Australian Accounting Standard requirements.[17]

The auditor needs to be alert throughout the audit process for any audit evidence of events or conditions and related business risks that may cast significant doubt on the entity's ability to continue as a going concern.[18] When such events or conditions have been identified, the auditor is required to gather sufficient appropriate audit evidence to confirm or dispel whether or not a material uncertainty exists by performing audit procedures considered necessary, including considering the effect of any plans of management and other mitigating factors.[19] The process of considering events or conditions continues as the audit progresses. When the auditor believes such events or conditions may significantly impact on the entity's ability to continue as a going concern, ordinarily the auditor enquires of management of its plans, considers any additional facts or information and obtains sufficient appropriate audit evidence to support the feasibility of management's plans.[20]

Conditions that the auditor may identify that may impact the entity's ability to continue as a going concern include:

- Changes in credit terms, for example, increase in spreads, shortened repayment periods, increase in loan security requirements;
- Withdrawal of credit from entities that previously had easy access to credit whenever necessary;
- Whether valuation, trading issues or a slowdown in business activities have led to or are projected to lead to breaches in lending covenants;
- Whether on—demand clauses in term loans or covenants affect the classification of such liabilities on the entity's balance sheet and whether the lenders may in fact invoke such clauses;
- Whether it is reasonable to assume that lenders will roll over existing credit facilities on similar terms, if at all;
- The likely unwillingness of lenders to commit to renewal of credit facilities (for example, to issue letters confirming that these facilities will be continued in the absence of unforeseen circumstances);
- Whether guarantees (for example, from those charged with governance or other group entities) will continue to be available and/or are of significant value;
- Trading difficulties of major customers or suppliers;
- Deteriorating market conditions;
- Effect of significant accounting estimates and fair value measurements on overall profitability and net asset position;
- Impact of changes in estimates and/or write downs on compliance with debt covenants; and
- Entity's exposure to procyclical movements in the economic environment.

The above factors, and others, are likely to affect the nature and extent of audit evidence available (for

14 See Compiled Auditing Standard ASA 570, paragraph 7 (explanatory guidance).
15 See Compiled Auditing Standard ASA 570, paragraph 23 (requirement).
16 See Compiled Auditing Standard ASA 570, paragraph 11 (explanatory guidance).
17 See AASB 101, paragraphs 25-26.
18 See Compiled Auditing Standard ASA 570, paragraph 17 (requirement).
19 See Compiled Auditing Standard ASA 570, paragraph 31 (requirement).
20 See Compiled Auditing Standard ASA 570, paragraph 32 (explanatory guidance).

example, it may not be possible to obtain confirmation of the existence of or likely extension of facilities from banks and third parties). Also, the professional judgement required in assessing the effect of one or more factors on the risk of material misstatement of the financial report may be more difficult to make than in years when difficult economic conditions did not exist (for example, the ability to assess the possible effect of contractual provisions that were expected to come into effect only in exceptional circumstances).

In assessing to what extent identified conditions could affect the entity's ability to realise the carrying value of assets and continue as a going concern, the auditor may consider and discuss with management the process it followed to make its going concern assessment, the assumptions on which the assessment is based and management's plans for future actions. In evaluating management's assessment, the auditor also ordinarily considers whether the assessment has taken into account all relevant information of which the auditor is aware as a result of audit procedures performed.[21] For example, analysis of cash flows may be a significant factor in management's assessment. In evaluating management's assessment, the auditor should also consider the entity's processes for developing forecasts and budgets which are an important component of the going concern assessment. Assumptions used in preparing budgets and forecasts that have been applied in prior years (when the pervading economic conditions may have been more positive) may no longer be relevant and may need to be adjusted to reflect the pressures of an uncertain or difficult economic environment.

Management's going concern assessment reflected in the financial report may be effectively confirmed by those charged with governance via the Directors' Declaration, a requirement for all entities which prepare a financial report in accordance with the *Corporations Act 2001*. The Declaration is a confirmation from the directors that there are reasonable grounds to believe that the entity will be able to pay its debts as and when they fall due.[22]

Planning the overall audit strategy

The auditor is required to establish an overall strategy for the financial report audit.[23] Subject to updating and amendment as more information becomes available throughout the audit, the overall audit strategy sets out:

- Types and allocation of resources to be used for specific audit areas;
- Timing of audit procedures; and
- Materiality.

Types and allocation of resources

In an uncertain or difficult economic environment, an engagement partner is likely to encounter many circumstances when there will be a need to assign more experienced staff to an audit than were needed when economic conditions were more favourable. A greater amount of partner involvement in the engagement is also likely to be required.

In addition, some audit staff may not have had significant experience in auditing in a difficult economic environment with significantly greater uncertainties and complexities associated with it. Accordingly, appropriate coaching and training may be needed in advance of the audit to make staff aware of how their approach to the audit should change from prior years (when the economic conditions were more favourable). Further, the engagement partner should continue to emphasise an attitude of professional scepticism by the engagement team in the performance of the audit and encourage regular communications within the audit team. In an environment of economic uncertainty, these matters are likely to be more important than ever to the performance of an efficient and effective audit.

In planning the audit, the auditor will consider the nature, timing and extent of the use of experts to assist with aspects of the audit work, taking into account how the difficult economic environment has affected their assessment of the risk of material misstatement in the entity's financial report. For example, the auditor may consider it appropriate to use experts as part of the engagement team with respect to matters such as the following:

- Fair value measurements;
- Asset impairment calculations;
- Future tax asset write-downs;
- Legal issues concerning agreements, statutes and regulations;
- Superannuation fund measurements and disclosures;
- Fraud risk factors and audit implications; or

21 See Compiled Auditing Standard ASA 570, paragraph 25 (explanatory guidance).

22 As required by Section 295 (4)(c) of the *Corporations Act 2001*. See also ASIC's Regulatory Guide 22 *Directors' Statement as to Solvency*.

23 See Auditing Standard ASA 300 *Planning an Audit of a Financial Report*, paragraph 12 (requirement).

- Matters affecting the entity's ability to continue as a going concern.

Consideration of the advice of experts will be particularly important also in an uncertain economic environment. Engagement partners may want to stress to their engagement teams that consultation amongst team members and with other professionals (or subject matter experts) within or outside of the firm should be undertaken on any potentially difficult or contentious matters. Also, engagement quality control reviews (EQCRs) will become even more important for many engagements. An EQCR should include an objective evaluation of the significant judgements made by the engagement team and the conclusions reached in formulating the auditor's report.[24] In a difficult economic environment, the auditor may need to consider whether the criteria it has used when determining if the audit should be subject to an EQCR should be revised. Policies with respect to the nature, timing and extent of EQCRs may also need to be amended. For example, it may be appropriate to place increased emphasis on having the person performing the EQCR involved in the audit at an earlier stage and to be consulted more often than normal on significant matters as they arise during the engagement.

Timing of audit procedures

Higher assessed risks of material misstatement may cause the auditor to not only expand the extent of procedures applied, but also perform substantive procedures closer to, or at the period end,[25] (particularly in critical audit areas) given the uncertainties that are likely to underlie the financial report of many entities.

Materiality

When planning the audit, the auditor needs to consider what would make the financial report materially misstated.[26] In uncertain or difficult economic environments, there may be circumstances that affect the auditor's determination of materiality such as the following:

- Net income of the entity may be nominal during a period of economic difficulties, or be widely different from previous periods when the economy was stable;
- Misstatements that may exist in balances representing opening equity may contribute to a material misstatement during a financial period of economic uncertainty;
- Expectations of users of the financial report, including what they would consider to be material misstatements, may differ significantly from prior periods of economic stability or growth; or
- The auditor's own assessment of the risks that may lead to material misstatements in the financial report.

The auditor's materiality measurement involves both quantitative and qualitative considerations, with the overall assessment based on their professional judgement. It is generally recognised that income from continuing operations (i.e. after-tax income before discontinued operations) is, in most circumstances, the quantitative measure of greatest significance to the users of financial reports particularly for entities whose debt or equity securities are traded publicly. When the entity's net income is nominal or fluctuates widely from year to year due to a variety of factors, other quantitative measures of materiality may be more appropriate, such as income from continuing operations adjusted for unusual or non-recurring revenue or expense items.

In changed circumstances, such as a substantial reduction in the entity's business activity or net income, which suggest the use of a significantly lower materiality level than that used in the previous audit, the auditor needs to pay particular attention to the level of misstatement that may exist in balances representing opening equity. These will have been audited to the previous (higher) materiality level and this may contribute to the risk of material misstatement during a period of difficult economic conditions. Also, in evaluating the effect of misstatements, qualitative considerations may result in misstatements of relatively small amounts having a material effect on the financial report. Some qualitative factors the auditor may consider relevant to determining materiality (in an uncertain or difficult economic environment) include:

- The potential effect of a material misstatement on trends, especially trends in profitability;
- A misstatement that changes a loss into income or vice versa;
- The potential effect of the misstatement on the entity's compliance with debt covenants,

24 See Auditing Standard ASA 220 *Quality Control for Audits of Historical Information*, paragraph 42 (requirement).
25 See Auditing Standard ASA 330 *The Auditor's Procedures in Response to Assessed Risks*, paragraph 22 (explanatory guidance).
26 See Auditing Standard ASA 320 *Materiality and Audit Adjustments*, paragraph 10 (explanatory guidance).

other contractual agreements, and regulatory provisions;

- The existence of statutory reporting requirements that affect materiality thresholds;
- A misstatement that has the effect of increasing management's compensation;
- The significance of the misstatement or disclosures relative to performance measures such as earnings per share or net income relative to expectations;
- The motivation of management with respect to the misstatement such as managing earnings or smoothing earnings trends, indications of possible management bias, or an unwillingness to address weaknesses in financial reporting; and
- Weaknesses in the entity's system of internal control.

Understanding the entity and its environment, and assessing and responding to the risks of material misstatement

Difficult or uncertain economic conditions will likely have a significant effect on the risks of material misstatement of the entity's financial report. The nature and extent of the effect will depend on matters such as industry conditions, the competitive environment, supplier and customer relationships, and the regulatory environment. Uncertain or difficult economic conditions may make the entity's financial report more susceptible to material misstatement because:

- Operations of the entity are exposed to volatile markets (for example, exposure to volatility in stock markets, commodity prices or exchange rates);
- There are going concern and liquidity issues including the loss of significant customers;
- There are constraints on the availability of capital and credit;
- Accounting measurements involve complex processes (e.g. financial instruments);
- Events or transactions involve significant measurement uncertainty, including accounting estimates (e.g. fair value measurements);
- Assets have declined significantly in value (e.g. real estate properties);
- There have been significant disposals of assets or restructurings that impact operations;
- There have been significant changes to the internal control environment (for example, if the entity's control consciousness becomes lax because management is distracted by other operating issues); or
- There have been changes to management's risk assessment processes, control and monitoring activities (for example, in cases when, as a result of significant staff reductions, activities are no longer being performed, being performed less frequently, or being performed by less experienced staff).

An important overall consideration in an uncertain or difficult economic environment is the increased risk of material misstatement resulting from management bias. With or without fraudulent intent, there may be a natural temptation for management to bias judgements underlying estimates and disclosures towards the most favourable end of what may be a wide spectrum of possible decisions. On the other hand, management may bias judgements towards the least favourable end of the spectrum, taking the opportunity of the economic uncertainty to overestimate, for example, the write-down of assets.

Risk assessment procedures

Outlined below are examples of how auditors may need to reassess the nature, extent and timing of risk assessment procedures in an uncertain economic environment:

- Auditors may consider making enquiries of the entity's valuation experts that the entity may have used or review reports by analysts, lenders or rating agencies to obtain information about the entity.
- Auditors often perform analytical procedures to obtain an understanding of the entity and its environment. In a difficult or uncertain economic environment, it may be harder to develop meaningful relationships among various types of information. Usually, meaningful relationships are those that are relevant to the entity's business and are expected to continue. However, this may not be the case in a difficult or uncertain economic environment. Auditors may need to reconsider analytical procedures performed in previous periods when there was economic stability or growth, in assessing whether there are

meaningful relationships among various types of information that will enable the auditor to form expectations for comparison with recorded amounts. Results of analytical procedures may need to be interpreted more carefully. Further, the auditor may conclude that analytical procedures will not be effective in identifying risks of material misstatement and may need to be supplemented, or replaced by, other more effective risk assessment procedures.

- The relevance of information the auditor used in prior periods, when there were favourable economic conditions, about the entity's organisational structure, business and internal controls may have to be reassessed.
- Identifying the susceptibility of the entity's financial report to material misstatements may be difficult, due to the complex interplay of different direct and indirect economic factors that may have a sudden significant impact on the entity. The discussion among the audit team regarding the susceptibility of the entity's financial report to material misstatements[27] may need to be more extensive than in previous years, during times of economic growth. The discussion enables the team members to exchange information about the business risks to which the entity is exposed and about how and where the financial report might be susceptible to material misstatement.

Internal control considerations

Given the possible changes to the internal control environment, specific control activities and risk assessment processes as a result of a difficult or uncertain economic environment, the auditor's assessment of the effectiveness of relevant internal controls that are designed to prevent, or detect and correct material misstatements may also change. Auditors may need to pay particular attention to the adequacy of the entity's existing internal controls for determining significant estimates and assumptions, as these areas require management to exercise a substantial amount of judgement.

Assessing the risks of material misstatement

Due to economic uncertainties, there may be more significant risks that require special audit consideration. An example would be judgements that management must make in developing accounting estimates (including fair values) and disclosing material uncertainties in the financial report.

The nature of the risks arising from a weak control environment is such that they are not likely to be confined to specific individual risks of material misstatement, in particular to classes of transactions, account balances or disclosures. Such weaknesses may require an overall response from the auditor.[28]

Responding to assessed risks

Because a difficult or uncertain economic environment may increase inherent and control risks, the auditor may need to modify the planned further audit procedures from those performed in the past. For example, the auditor may need to:

- Look for opportunities to perform more effective substantive procedures that provide more persuasive audit evidence such as external confirmations;
- Change the timing of substantive procedures towards the period end date; and
- Change the extent of tests of controls and substantive procedures to reflect the changing control environment and higher risk of material misstatement.

Fraud considerations

An uncertain or difficult economic environment may trigger certain risk factors that affect the risk of material misstatement in the financial report due to fraud. The following are examples of such factors:

- Financial stability or profitability is threatened by economic, industry or entity operating conditions such as (or as indicated by):
  - A high degree of competition or market saturation, accompanied by declining margins;
  - High vulnerability to rapid changes such as changes in technology, product obsolescence or interest rates;
  - Significant declines in customer demand and increasing business failures in either the industry or the overall economy;
  - Operating losses that make the threat of bankruptcy, liquidation or hostile takeover imminent;
  - Recurring negative cash flows from operations or an inability

27 See Auditing Standard ASA 315 *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, paragraph 20 (requirement).
28 See Auditing Standard ASA 315, paragraph 121 (explanatory guidance).

to generate cash flows from operations while reporting earnings and earnings growth; and

  — New accounting, statutory or regulatory requirements.

- Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:
  - — Need to obtain additional debt or equity financing to stay competitive (including financing of major research and development or capital expenditures);
  - — Marginal ability to meet exchange listing requirements or debt repayment, or other debt covenant requirements; and
  - — Perceived or real adverse effects of reporting poor financial results on significant pending transactions such as business combinations or contract awards.
- Reduced staff resources in critical risk management areas (e.g. internal audit, compliance functions) or reduced management emphasis on risk management practices, leading to:
  - — A weakening of the internal control environment;
  - — Increased opportunities to commit fraud; or
  - — Increased risk of material misstatement.

These factors may present opportunities for manipulation of input and assumptions used in models to calculate fair value measurements and other accounting estimates including items, such as asset impairments, inventory write-downs, future tax asset write-downs and superannuation benefit obligations.

Management override of controls

Often fraudulent financial reporting involves management override of internal controls that otherwise may appear to be operating effectively.[29] This may include inappropriately adjusting assumptions and changing judgements used to estimate account balances (for example, using assumptions for fair value accounting estimates that are inconsistent with observable marketplace assumptions). In illiquid markets, the increased use of models and lack of market comparisons may present opportunities for manipulation or override of amounts calculated by brokers or experts.

Responding to fraud risks

Responses to such fraud risks include the following:

- Emphasising to the engagement team the importance of maintaining an attitude of professional scepticism throughout the audit, recognising the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience with the entity regarding the honesty and integrity of management and those charged with governance.[30]
- Focusing the discussion among the engagement team members more extensively on the susceptibility of the entity's financial report to material misstatement due to fraud.[31]
- Evaluating whether the design of the entity's anti-fraud programs and internal controls are adequate to address the assessed increase in fraud risks, determining whether they have been implemented, and determining if they are working as designed.[32]
- Incorporating an element of unpredictability in the selection of the nature, extent and timing of audit procedures, including the use of valuation experts.[33]
- Obtaining an understanding of the business rationale for significant transactions that are outside the normal course of business.[34]

Auditing fair value measurements and accounting estimates

In a difficult or uncertain economic environment, a primary area for increased risk of material misstatement relates to fair value measurements and accounting estimates, particularly those involving management judgement. In Australia, fair value measurements are determined in accordance with Australian Accounting Standards. Examples include fair value measurements of certain financial assets and impairment calculations for assets such as financial instruments, accounts and loans receivable, goodwill and other intangible assets (not subject to amortisation), inventory holdings subject to valuation, (e.g. mining industry), property and infrastructure assets. The major focus of the auditor's procedures to respond to the increased risk of material misstatement associated with these calculations will be on

29 See Auditing Standard ASA 240 *The Auditor's Responsibility to Consider Fraud in an Audit of a Financial Report*, paragraph 12 (explanatory guidance).
30 See Auditing Standard ASA 240, paragraph 27 (requirement).
31 See Auditing Standard ASA 240, paragraph 30 (requirement).
32 See Auditing Standard ASA 240, paragraph 61 (requirement).
33 See Auditing Standard ASA 240, paragraph 70 (requirement).
34 See Auditing Standard ASA 240, paragraph 80 (requirement).

evaluating the assumptions and data used by management in the fair value measurements or other accounting estimates, including of impairment, within the context of the auditor's own understanding of the entity and its industry.

When evaluating the assumptions and data used by management in the fair value measurements and other accounting estimates, auditors may find the following helpful:

(a) Under Auditing Standard ASA 545 *Auditing Fair Value Measurements and Disclosures* the auditor needs to:

- Pay particular attention to the significant assumptions underlying a valuation method and evaluate whether such assumptions are reasonable. Assumptions need to be relevant, reliable, neutral, understandable and complete to provide a reasonable basis for the fair value measurements and disclosures in the financial report.[35]

- Perform audit procedures dealing with management's assumptions in the context of the audit of the entity's financial report. The objective of those audit procedures is not intended to obtain sufficient appropriate audit evidence to provide an opinion on the assumptions themselves. Rather, the auditor performs audit procedures to consider whether the assumptions provide a reasonable basis in measuring fair values in the context of an audit of the financial report taken as a whole.[36]

- Identify those assumptions that appear to be significant to the fair value measurement that require management to exercise judgement. The auditor needs to focus attention on significant assumptions, which may include matters that materially affect the fair value measurement, such as:
  - Susceptibility to incorrect application or bias; or
  - Sensitivity to variation or uncertainty in amount or nature. For example, assumptions about short-term interest rates may be less susceptible to significant variation compared to assumptions about long-term interest rates.[37]

- Evaluate whether the data on which the fair value measurements are based are accurate, complete and relevant; and whether the fair value measurements have been determined properly using such data and management's assumptions. The auditor's procedures also may include, for example, verifying the source of the data, consulting a subject matter expert, mathematical recalculation and reviewing of information for internal consistency, including whether such information is consistent with management's intent to carry out specific courses of action.[38]

(b) Auditing Standard ASA 540 *Auditing Accounting Estimates* requires the auditor to perform audit procedures to obtain sufficient appropriate audit evidence as to whether the entity's accounting estimates are reasonable in the circumstances.[39] Further, the auditor needs to have an understanding of the procedures and methods, including relevant control activities used by management in developing the estimates, to be able to identify and assess risks of material misstatements.[40] In auditing an accounting estimate, the auditor should perform one, or a combination of, the following procedures:

- Review and test the process used by management to develop the estimate;
- Use an independent estimate for comparison with that prepared by management; or
- Review subsequent events which provide audit evidence of the reasonableness of the estimate made.[41]

The risk of misstatement of accounting estimates included in a financial report varies, with such factors as the complexity and subjectivity involved in preparing estimates, the availability and reliability of data, the nature and extent of assumptions required and the degree of uncertainty of future events. Because of the uncertainties inherent in accounting estimates, evaluating the difference between the auditor's estimates and management's estimates included in the financial report can be more difficult than in other areas of the audit. The auditor needs to

35 See Auditing Standard ASA 545, paragraph 48 (explanatory guidance).
36 See Auditing Standard ASA 545, paragraph 51 (requirement).
37 See Auditing Standard ASA 545, paragraph 52 (explanatory guidance).
38 See Auditing Standard ASA 545, paragraph 59 (explanatory guidance).
39 See Auditing Standard ASA 540, paragraph 11 (requirement).
40 See Auditing Standard ASA 540, paragraph 13 (explanatory guidance).
41 See Auditing Standard ASA 540, paragraph 14 (requirement).

determine whether such a difference is material and, as a consequence, requires adjustment. If the difference falls within the auditor's range of acceptable results, it may not require adjustment. However, if the auditor believes the difference is unreasonable, management would be requested to revise its estimate. If management refuses to revise its estimate, the difference would be considered a misstatement and would be considered with all other misstatements in assessing whether the effect on the financial report is material.[42]

Audit considerations for other selected financial reporting areas

The following selected financial reporting areas may be affected by difficult or uncertain economic conditions. This list is not intended to be exhaustive.

Subsequent Events

Financial conditions can change rapidly in difficult or uncertain economic environments. There is an increased likelihood that there may be events occurring after the reporting date that indicate a need for management to adjust items or make specific disclosures in the financial report.

Auditing Standard ASA 560 *Subsequent Events* provides examples of matters that may require adjustment to, or disclosure in, the financial report. Examples of matters about which the auditor would enquire of management that may be particularly relevant during times of economic uncertainty[43] include whether:

- There are any changes in commitments, borrowings or guarantees or other contingencies;
- Any events have occurred that indicate impairment of recorded asset values, e.g. goodwill, property and infrastructure assets;
- There has been any change or proposed change in the share capital or long-term debt arrangements;
- There have been any developments regarding key risk areas;
- Any unusual accounting adjustments have been made subsequent to the reporting date, or are contemplated;
- Any events have occurred that affect the assumptions used in valuations and accounting estimates; and
- Any events have occurred or are likely to occur that may bring into question the appropriateness of accounting policies used in the financial report, as would be the case, for example, if such events call into question the validity of the going concern assumption.

Impairment of Assets

Australian Accounting Standards require management to assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, management is required to estimate the recoverable amount of the asset.[44] Examples of indications that an asset may be impaired include:

- During the period under audit, there was a significant decrease in the market value of the asset, more than would be expected as a result of the passage of time or normal use;
- Significant changes which adversely affect the entity have taken place during the period under audit, or are expected to take place in the near future, with respect to how an asset is used or expected to be used;
- Significant changes which adversely affect the entity have taken place during the period under audit, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated;
- The carrying amount of the net assets of the entity is more than its market capitalisation;
- Cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, are significantly higher than those originally budgeted;
- Actual net cash flows or operating profit or loss flowing from the asset are significantly worse than those budgeted;
- There is a significant decline in budgeted net cash flows or operating profit, or a significant increase in budgeted loss, flowing from the asset; or
- Operating losses or net cash outflows for the asset, when current period amounts are aggregated with budgeted amounts for the future, are significant.[45]

Throughout the audit, the auditor should be alert for the existence of the above and/or other circumstances indicating that the carrying amount of assets may not be recoverable.

42 See Auditing Standard ASA 540, paragraph 30 (explanatory guidance).
43 See Auditing Standard ASA 540, paragraph 10 (explanatory guidance).
44 See AASB 136 *Impairment of Assets*, paragraph 9.
45 See AASB 136, paragraphs 12 and 14.

Goodwill and Intangibles

Management is required to test annually for impairment of:

- An intangible asset with an indefinite useful life, or an intangible asset not yet available for use; and
- Goodwill acquired in a business combination.[46]

An impairment test is required in between annual impairment tests whenever there are events or circumstances that indicate that the recoverable amount of a cash-generating unit with goodwill has declined below its carrying value.[47] When management performs the impairment tests, the auditor would be alert for circumstances when the estimated future cash flows used in determining recoverable amounts are substantially lower due to difficult economic circumstances than estimates used in prior periods, when there were favourable economic conditions. Auditors would also be alert for circumstances when the estimated future cash flows used in determining recoverable amounts are not substantially lower than estimates used in prior years, when there are indications that they should be. Management may find it particularly difficult to perform such calculations in an uncertain economic environment. It is important for auditors to be aware of, and consider the audit implications of, an inability by management to perform the appropriate calculations. Some other key management assumptions that may come under pressure in difficult economic environments are growth rates, discount rates, control premiums and earnings multiples.

The impairment test should consist of a comparison of the carrying amount of the intangible asset with its recoverable amount.[48] Considerations similar to those that apply to the audit of fair value measurements, as discussed above, apply to the audit of intangibles.

Receivables

Management needs to provide an allowance for doubtful accounts whenever there are specific accounts and notes receivables that are doubtful of collection. In a difficult economic environment, there is likely to be an increased risk of uncollectible receivables. In obtaining sufficient appropriate audit evidence regarding management's valuation of accounts receivable, the auditor would consider indicators of collection problems such as an increase in days' sales outstanding, the ageing of receivables, the amount of overdue receivables, and post reporting date cash receipts review.

Loan Impairments

Management needs to assess whether there is any objective evidence that a loan is impaired.[48] If there is evidence that a loan has been impaired, then the entity is required to recognise a loss in the profit and loss account. The auditor evaluates management's conclusion about the impairment in terms of deterioration in the quality of the loan. Factors that may indicate such deterioration in an uncertain economic environment include:

- A financial report that portrays a decline in the financial position of the borrower or guarantor, particularly its liquidity, as evidenced by severe losses, a serious deficiency in working capital or cash flow, or an excess of liabilities over assets;
- Independent credit reports that indicate concerns about the entity's ability to meet its continuing obligations;
- A current default in making interest or principal payments when due on debt obligations;
- A failure to meet debt covenants on existing debt obligations;
- Downgrading of the credit status of the borrower or guarantor by a recognised credit rating agency; and
- A decline in the market value of a traded debt instrument issued by the borrower or guarantor that is unrelated to a change in market interest rates.

Inventories

Inventories should be measured at the lower of cost and net realisable value.[49] Management's estimates of net realisable value are based on the most reliable evidence available, at the time the estimates are made, of the amount the inventories are expected to realise.[50] The auditor would assess whether the assumptions that management reflects in these estimates appropriately incorporate the impact of an uncertain economic environment on the entity's business (e.g. compared to inventory turnovers).

Deferred Tax Assets

Management should review the carrying amount of any recorded deferred tax assets at the reporting date and reduce the assets' carrying

46 See AASB 136, paragraph 10.
47 See AASB 136, paragraphs 88 and 90. See AASB 3 *Business Combinations* for relevant accounting standards on goodwill recognition and measurement.
48 See AASB 139 *Financial Instruments: Recognition and Measurement*, paragraph 58.
49 See AASB 102 *Inventories*, paragraph 9.
50 See AASB 102, paragraph 30.

amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit in part, or all, of the deferred tax assets to be utilised.[51] Uncertainty in the economy could have an adverse effect on the entity's ability to generate income in the forthcoming periods. This could affect the likelihood that sufficient taxable income will be generated to utilise any deferred tax assets. Evaluating whether and when to write down a deferred tax asset requires significant judgement on the part of management. The auditor will need to obtain sufficient appropriate audit evidence about management's judgements in light of any difficult economic circumstances affecting the entity.

Superannuation Plan Obligations

The obligations of entities that contribute to a defined benefit or defined contribution superannuation plan on behalf of their employees are also affected by difficult economic conditions. In such times, many plans will report significant losses in their fair value, and rates of return, given their assets' exposure to share markets and other investments. Funding obligations are determined by the terms of the respective plan's trust deed, and the actual financial performance of the plan. Further, a contributing entity is required to make reporting disclosures in respect of its obligations. Such disclosures include:

- Amount recognised as an expense for defined contribution plans;[52]
- Information about contributions to defined contribution plans for key management personnel, as appropriate;[53]
- An analysis of the defined benefit obligation into amounts arising from plans that are wholly unfunded and amounts arising from plans that are wholly or partly funded;[54]
- Reconciliation of opening and closing balances of the present value of the defined benefit obligation;[54] and
- Total expense recognised in profit and loss for current service cost, interest cost, past service cost, actuarial gains and losses and expected return on plan assets.[54]

Refer to Accounting Standard AASB 119 *Employee Benefits* for a more detailed discussion of the required reporting disclosures for superannuation plans.

For defined benefit plans, the recorded value of employees' accrued benefits is determined from periodic actuarial valuations.[56] Each year, the entity's management is required to review matters such as changes to the plan, the actuarial assumptions, amount of benefit payments, changes to the nature of the underlying employee group and the rate of return on plan assets, to determine whether such matters may necessitate a new actuarial valuation or an adjustment of the valuation (via an extrapolation).

In periods of economic uncertainty, it is likely that in many cases new valuations will be necessary. Further, if management does not consult an actuary, it may find it difficult to make (and support) valuation judgements because of the increased level of measurement uncertainty. In these circumstances, auditors may need to consider engaging their own actuary as a subject matter expert to assist in auditing elements of the financial report affected by the entity's defined benefit plan.

Contingencies and Guarantees

In difficult or uncertain economic environments, there is likely to be an increased risk of unidentified or undisclosed contingencies related to, for example:

- Pending or threatened litigation;
- Guarantees of indebtedness of others (e.g. cross guarantees to related entities);
- Guarantees to repurchase receivables or property previously sold;
- Violations of laws or regulations;
- Guarantees of contractual performance of others; and
- Outstanding purchase commitments at prices in excess of market values.

Examples of audit procedures that may assist auditors in identifying contingencies and guarantees include:

- Reviewing minutes of meetings of shareholders, directors and appropriate committees;
- Reviewing contracts, loan agreements, leases and correspondence from regulators and other governmental agencies;
- Making enquiries of legal counsel, internal audit personnel and senior management;
- Obtaining information concerning guarantees from bank confirmations; and
- Inspecting other documents for possible guarantees by the client.

51 See AASB 112 *Income Taxes*, paragraph 56.
52 See AASB 119, paragraph 46.
53 See AASB 119, paragraph 47.
54 See AASB 119, paragraph 120A.

In a significant number of cases, difficult or uncertain economic environments may warrant a more detailed approach to performing these types of procedures and greater involvement of more experienced members of the audit engagement team.

Financial report disclosures and auditor's opinions

Australian Accounting Standards provide the framework for financial reporting presentations and establishing required disclosures in the financial report. Disclosures assist users of financial reports to better understand the entity's financial position, financial performance and cash flows,[55] as well as its exposure to particular risks and uncertainties.

Australian Accounting Standards also require a financial report to include disclosures that assist users to understand the effects of material transactions and events on the financial report and potentially, the entity's financial results. For example, the entity needs to disclose the nature and extent of risks arising from its exposure to financial instruments at the reporting date, and how those risks are managed.[56] These disclosures (which are both qualitative and quantitative in nature) provide users with a view of the entity's use of financial instruments and related risk exposures (which include liquidity, credit and market risks).[57] The auditor is required to evaluate these disclosures to ensure that they are in accordance with applicable Australian Accounting Standards.

Financial report disclosures are also required when a material uncertainty exists related to events or conditions that, alone or in aggregate, may cast significant doubt on the entity's ability to continue as a going concern. In assessing the adequacy of disclosures in the financial report, the auditor considers whether the information disclosed in the financial report explicitly draws the reader's attention to the possibility that the entity may be unable to continue as a going concern.[58]

When management adequately discloses material uncertainties in the financial report and the auditor believes the disclosures are adequate, the auditor's report should include an emphasis of matter paragraph.[59] An emphasis of matter paragraph regarding a going concern uncertainty should:

- State clearly that there is significant uncertainty as to whether the entity will continue as a going concern and, therefore, whether it will realise its assets and extinguish its liabilities in the normal course of business and at the amounts stated in the financial report; and
- Adequately describe, or refer to a note in the financial report that adequately describes:
  - The principal conditions that raise doubt about the entity's ability to continue as a going concern; and
  - The extent to which the financial report includes appropriate adjustments, if any, relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary if the entity does not continue as a going concern.[60]

Where the disclosures are assessed as inadequate by the auditor, and management refuses to make the appropriate disclosures, the auditor is required to issue a modified audit opinion.[61]

As in every audit, there are other circumstances that may arise that require the auditor to modify the opinion in the auditor's report (i.e. by issuing a qualified or adverse opinion, or a disclaimer of opinion).[62] These circumstances are:

- The auditor is unable to obtain sufficient appropriate audit evidence about whether the going concern assumption is appropriate;
- The auditor disagrees with the information included in the financial report in relation to going concern, because it is insufficient or incorrect;
- The auditor disagrees with the basis on which the financial report has been prepared – that is:
  - Management has used the going concern basis when the auditor considers that a liquidation basis is appropriate; or
  - The auditor considers a going concern basis to be appropriate but management has used a liquidation basis; or
- The auditor has identified multiple uncertainties, including going concern. Where there are multiple uncertainties that are significant to the financial report, the auditor may consider it appropriate to express a disclaimer of opinion instead of adding an emphasis of matter paragraph.[63]

55 The relevant financial report disclosure requirements are discussed in AASB 101 and AASB 7 *Financial Instruments: Disclosures*.

56 See AASB 7, paragraphs 31-32.

57 See AASB 7, paragraphs 33-42.

58 See Compiled Auditing Standard ASA 570, paragraph 40 (explanantory guidance).

59 See Compiled Auditing Standard ASA 570, paragraph 39 (requirement).

60 See Compiled Auditing Standard ASA 570, paragraph 39 (requirement).

The table below summarises the range of auditor opinions possible on a financial report:[64]

Management's Assessment	Financial Report Disclosures Made	Auditor's Opinion
Management concludes that the going concern basis is appropriate. No material uncertainties leading to a significant doubt about going concern have been identified.	Disclosure indicating that the entity's financial report is prepared on a going concern basis.	Disclosure in the financial report is assessed as adequate. *The auditor expresses an unqualified opinion.*
Management concludes that the going concern assumption is appropriate, but a material uncertainty exists.	Disclosures made explaining the specific nature of the material uncertainty and why the going concern basis has still been adopted.	Disclosures in the financial report assessed as adequate. *Unqualified opinion with an emphasis of matter paragraph is included to highlight the existence of a material uncertainty* - provided the auditor concurs with management's assessment and supporting disclosures.
Management concludes that the going concern assumption is appropriate, but a material uncertainty exists.	Disclosures made explaining the specific nature of the material uncertainty and why the going concern basis has still been adopted.	Disclosures assessed as inadequate. *A qualified or adverse opinion is expressed by the auditor, as appropriate.* The audit report should include specific reference to the fact that there is a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern.
Management concludes that the going concern basis is not appropriate, with the financial report prepared on an alternative authoritative basis.	Disclosures made of significant uncertainty and explanations of the basis of the conclusion and the accounting policies applied in drawing up the financial report on a non—going concern basis.	Disclosures assessed as adequate. *Unqualified opinion with an emphasis of matter paragraph* - provided the financial report contains adequate disclosures and the auditor considers the basis to be appropriate to the facts and circumstances.
Management concludes that the going concern assumption is appropriate.	Disclosure indicating that the entity's financial report is prepared on a going concern basis.	The auditor does not concur with management's assessment that the entity is a going concern and does not consider the disclosures adequate. *The auditor expresses an adverse opinion.*

Appendix I to this Bulletin illustrates the relationship of the auditor's going concern considerations with the different types of audit opinions.

61 See Compiled Auditing Standard ASA 570, paragraph 36 (requirement).

62 See Compiled Auditing Standard ASA 570, paragraphs 41-48 (requirements and explanatory guidance) and Compiled Auditing Standard ASA 701 *Modifications to the Auditor's Report* set out the form and content of modifications to the auditor's opinion, including a disclaimer of opinion.

63 See Compiled Auditing Standard ASA 701, paragraph 14 (explanatory guidance).

64 See Compiled Auditing Standard ASA 570 for a related discussion of the various circumstances affecting the auditor's opinion, paragraphs 35—45.

Audits of superannuation plans

Uncertain or difficult economic conditions can make auditing superannuation plans more challenging. For both defined contribution and defined benefit superannuation plans, key calculations are often complex, and require the services of an actuary. Key financial reporting areas that are affected by uncertain or difficult economic conditions include:

- Assets and liabilities measured at net market value;[65]
- Changes in assets' net market value during the year recorded in the profit and loss account as revenue;[66]
- Accrued benefits to members calculated using actuarial assumptions and valuations, at the present value of expected future payments arising from membership up to reporting date (where the present value is determined by discounting the gross benefit payments at the current, market-determined, risk-adjusted discount rate appropriate to the fund);[67] and
- Benefits accrued during the reporting period measured as the sum of the net change in the amount of accrued benefits between the beginning and end of the reporting period, adjusted for benefits paid during the period.[68]

Difficult economic conditions will therefore significantly affect the financial position and performance of superannuation plans given the requirement to value their assets and financial liabilities at net market value.

Documentation

In performing all audits, auditors are reminded that all significant aspects of the auditor's work will need to be documented in accordance with Auditing Standard ASA 230 *Audit Documentation*. This includes the auditor documenting:

- The nature, timing and extent of audit procedures performed;
- The audit evidence obtained;
- Results of audit procedures performed; and
- Significant matters identified during the audit and conclusions reached.

Audit documentation ensures that the auditor has a sufficient and appropriate record of the work performed, to support the conclusions reached and the auditor's report, and demonstrates that the audit was performed in accordance with Australian Auditing Standards and applicable legal and regulatory requirements.

65 See AAS 25 *Financial Reporting by Superannuation Plans*, paragraph 37.
66 See AAS 25, paragraph 44.
67 See AAS 25, paragraph 50.
68 See AAS 25, paragraph 55.

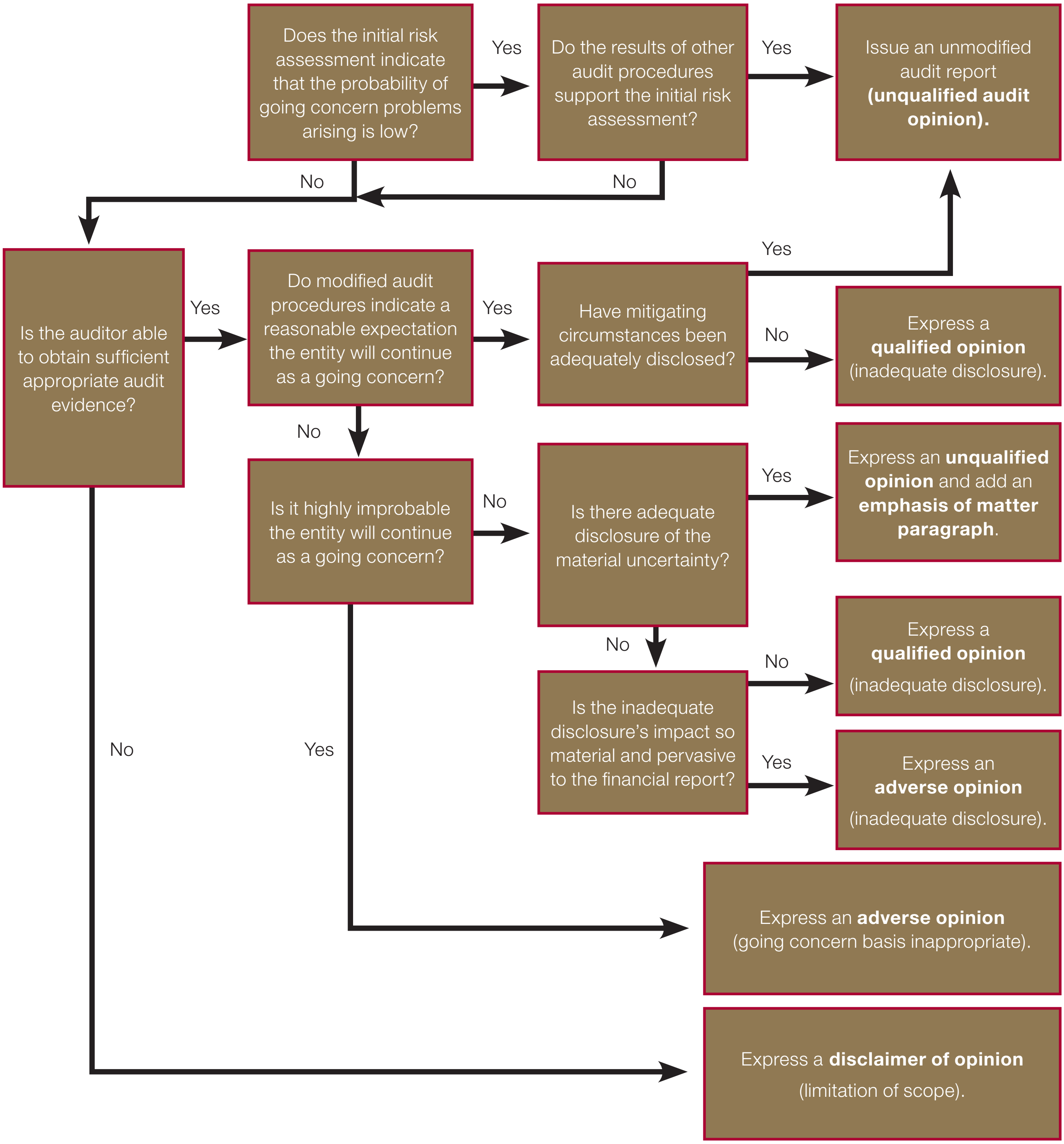
Summary

This Bulletin highlights some audit considerations that are relevant in a difficult or uncertain economic environment. It does not address all issues that could arise when auditing in such an environment.

Auditors are reminded that many financial reports to be audited in an uncertain economic environment are likely to be affected, to some degree by that environment. In many cases, the risks of material misstatement in these financial reports will be significantly higher than in prior years (when the economic conditions were more favourable). These circumstances increase pressure on auditors to perform new and increased procedures to address identified audit issues. Such procedures will need to include the effective assessment of, and responses to, the higher risks of material misstatement. Overriding matters to consider include an increased focus on making sure that the engagement team and any experts used have the training and experience appropriate for the audit. Moreover, that the level of direction, supervision and review by the engagement partner is timely and adequate. Further, timely consultation, quality control review procedures, documentation of significant matters, and the nature and frequency of communications among the engagement team as well as with management and those charged with governance of the entity, will need to be appropriate to the circumstances of each audit. The need to exercise professional scepticism and professional judgement will also be particularly important in times of economic difficulty or uncertainty.

APPENDIX I

Linking Going Concern Considerations With Types Of Audit Opinions[69]



69 See Compiled Auditing Standard ASA 570, paragraphs 35-49 (inclusive) and Compiled Auditing Standard ASA 701 for further information.

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